



**Auditor of State
Betty Montgomery**

SOUTHERN OHIO AGRICULTURAL AND COMMUNITY DEVELOPMENT FOUNDATION

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Auditor of State Betty Montgomery

INDEPENDENT ACCOUNTANTS' REPORT

Southern Ohio Agricultural and Community Development Foundation
100 South High Street
Hillsboro, Ohio 45133

We have audited the accompanying basic financial statements of the Southern Ohio Agricultural and Community Development Foundation (the Foundation), State of Ohio, as of and for the year ended June 30, 2004, as listed in the table of contents. These financial statements are the responsibility of the Foundation's management. Our responsibility is to express opinions 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 opinions.

As discussed in Note 1, the basic financial statements present only the Foundation's activity and are not intended to present fairly the financial position of the State of Ohio and the results of the State of Ohio's operations and cash flows of its proprietary fund types in conformity with accounting principles generally accepted in the United States of America.

In our opinion, the basic financial statements referred to above present fairly, in all material respects, the financial position of the governmental activities of the Southern Ohio Agricultural and Community Development Foundation as of June 30, 2004, and the results of its operations for the year then ended in conformity with accounting principles generally accepted in the United States of America.

As discussed in Note 11, during the year ended June 30, 2004, the Foundation adopted the Governmental Accounting Standards Board's Technical Bulletin No. 2004-1, *Tobacco Settlement Recognition and Financial reporting Entity Issues*.

In accordance with *Government Auditing Standards*, we have also issued our report dated October 8, 2004, on our consideration of the Southern Ohio Agricultural and Community Development Foundation'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.

The management's discussion and analysis is not a required part of the basic financial statements, but is supplementary information the Governmental Accounting Standards Board requires. We applied limited procedures, consisting principally of inquiries of management regarding the methods of measurement and presentation of the supplementary information. However, we did not audit the information and express no opinion thereon.

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

Betty Montgomery
Auditor of State

October 8, 2004

SOUTHERN OHIO AGRICULTURAL AND COMMUNITY DEVELOPMENT FOUNDATION

MANAGEMENT'S DISCUSSION & ANALYSIS

For the Year Ended June 30, 2004

Unaudited

As management of the Southern Ohio Agricultural & Community Development Foundation (the Foundation), we are providing this overview of the Foundation's financial activities for the fiscal year ended June 30, 2004. Please read the overview in conjunction with the Foundation's basic financial statements, which follow.

The Foundation is included within the State of Ohio's Comprehensive Annual Financial Report as part of the primary government. The foundation uses a special revenue fund to report its financial position and results of operations. We believe these financial statements present all activities for which the Foundation is financially responsible.

FINANCIAL HIGHLIGHTS

Key financial highlights for fiscal year 2004 are as follows:

- The assets of the Foundation exceeded its liabilities at the close of the most recent fiscal year by \$33.3 million (net assets). Of this amount, \$33 million may be used in the Foundation's programs to reduce tobacco use and production.
- The Foundation's total net assets increased by \$4.1 million during fiscal year 2004.
- The Foundation continued its grant programs and disbursed \$10.5 million in grants to Southern Ohio farmers. Grants were awarded for 1) Educational Assistance; 2) Lime Program; 3) Agricultural Easement; 4) Grain Handling/ Livestock Systems; 5) Economic Development; and 6) Agricultural Expansion/ Diversification.
- \$16.3 million was received under Amended Substitute Senate Bill No. 242 to be disbursed, less administrative expenses, to eligible tobacco farmers for indemnification payments.
- Interest earned totaled \$570,592 during fiscal year 2004.

OVERVIEW OF THE FINANCIAL STATEMENTS

This discussion and analysis is intended to serve as an introduction to the Foundation's basic financial statements. These basic financial statements are comprised of two components: 1) combined government-wide and fund financial statements, and 2) notes to the financial statements. For most governmental entities, the government-wide and fund financial statements are presented separately; however, since the Foundation is comprised of only one special revenue fund, we are presenting both types of financial statements on one combined set of financial statements, as described below:

- ***Governmental Fund Balance Sheet/Statement of Net Assets***

The column labeled "Special Revenue Fund" presents information on the Foundations assets, liabilities, and fund balance using the modified-accrual basis of accounting. The fund is an accounting device that the State of Ohio uses to keep track of specific sources of funding and spending for particular purposes. The fund balance may serve as a useful measure of the Foundation's net resources available for spending at the end of the fiscal year.

The column labeled "Statement of Net Assets" presents information on the Foundation's assets and liabilities, with the difference between the two reported as *net assets*. Such information is presented on the accrual basis of accounting, which is similar to the accounting used by most private-sector companies. Over time, increases or decreases in net assets may serve as a useful indicator of whether the financial position of the Foundation is improving or deteriorating.

- ***Statement of Governmental Fund Revenues, Expenditures, and Changes in Fund Balance/Statement of Activities***

The column labeled "Special Revenue Fund" presents information on near-term inflows, outflows, and balances of expendable resources. Such information is presented on the modified-accrual basis of accounting.

SOUTHERN OHIO AGRICULTURAL AND COMMUNITY DEVELOPMENT FOUNDATION

MANAGEMENT'S DISCUSSION & ANALYSIS

For the Year Ended June 30, 2004

Unaudited

OVERVIEW OF THE FINANCIAL STATEMENTS (Continued)

The column labeled "Statement of Activities" presents information showing how the Foundation's net assets changed during the most recent fiscal year. Such information is presented on the accrual basis of accounting. All changes in net assets are reported as soon as the underlying event giving rise to the change occurs, regardless of the timing of the related cash flows.

Because the focus of fund financial statements is narrower than that of government-wide financial statements, it is useful to compare the information presented on a fund basis with similar information presented on a government-wide basis. By doing so, readers may better understand the long-term impact of the government's near-term financing decisions. The combined government-wide and fund financial statements include a reconciliation to facilitate this comparison (see column labeled "Adjustments").

FINANCIAL ANALYSIS OF THE FOUNDATION

The following is a summary of the Foundation's net assets as of June 30, 2004 compared to June 30, 2003.

Net Assets at June 30

	<u>2004</u>	<u>2003</u>	<u>% Change</u>
Assets			
Cash and Investments	18,098,879	29,139,145	-37.89%
Collateral on Lent Securities	1,244,051	6,276,332	-80.18%
Tobacco Settlement Receivables	15,144,938	-	100.00%
Capital Assets	89,199	111,642	-20.10%
Other Assets	<u>8,452</u>	<u>3,053</u>	176.84%
Total Assets	<u>34,585,519</u>	<u>35,530,172</u>	
Liabilities			
Accounts Payable	27,528	98,708	-72.11%
Wages Payable	18,271	14,321	27.58%
Obligations under Lent Securities	1,244,051	6,276,332	-80.18%
Compensated Absences Payable	<u>45,613</u>	<u>22,276</u>	104.76%
Total Liabilities	<u>1,335,463</u>	<u>6,411,637</u>	
Net Assets			
Invested in capital assets	89,199	111,642	-20.10%
Restricted for Indemnification Program	163,312	574,018	-71.55%
Restricted for Programs to Reduce Tobacco Use	<u>32,997,545</u>	<u>28,432,875</u>	16.05%
	<u>33,250,056</u>	<u>29,118,535</u>	

The fiscal year 2003 payment under the Tobacco Master Settlement Agreement was deferred until fiscal year 2014 and the fiscal year 2004 payment was not received until July 2005. These factors resulted in the significant decrease in cash and investments and the corresponding increase in Tobacco Settlement receivables.

Only the portion of the Foundation's cash and investment portfolio on deposit with the State of Ohio and invested in STAR Ohio is subject to security lending. During fiscal year 2004, the Foundation transferred funds from STAR Ohio to two investment managers resulting in the significant decreases in collateral on lent securities and the related obligations under lent securities.

SOUTHERN OHIO AGRICULTURAL AND COMMUNITY DEVELOPMENT FOUNDATION

MANAGEMENT'S DISCUSSION & ANALYSIS

For the Year Ended June 30, 2004

Unaudited

The following is a summary of the Foundation's Statement of Activities for the year ending June 30, 2004 compared to the year ending June 30, 2003

Statement of Activity for the year ending June 30

	<u>2004</u>	<u>2003</u>	<u>% Change</u>
Revenues			
Indemnification Program Revenues	16,275,517	15,835,000	2.78%
Tobacco Settlement Income received from the State of Ohio	15,144,938	6,057,089	150.04%
Interest Income	570,592	762,731	-25.19%
Other Income	515	-	100.00%
Total Revenues	<u>31,991,562</u>	<u>22,654,820</u>	
Expenses			
Salaries and Benefits	394,139	354,541	11.17%
Purchased Services	418,237	361,903	15.57%
Materials, Supplies and Other	75,197	101,243	-25.73%
Depreciation	29,368	28,771	2.08%
Grants	10,482,590	10,942,237	-4.20%
Indemnification Program Payments	16,460,510	14,971,807	9.94%
Total Expenses	<u>27,860,041</u>	<u>26,760,502</u>	
Change in Net Assets	4,131,521	(4,105,682)	-200.63%
Net Assets, Beginning of Year	<u>29,118,535</u>	<u>33,224,217</u>	
Net Assets, End of Year	<u>33,250,056</u>	<u>29,118,535</u>	

The Foundation's scheduled Tobacco Master Settlement Agreement payment for fiscal year 2003 was deferred to fiscal year 2014, resulting in the significant increase in Tobacco Settlement Income received from the State of Ohio in fiscal year 2004.

During fiscal year 2004, the Foundation's net assets increased by \$4.1 million. This increase is the result of Tobacco Settlement Income received from the State of Ohio exceeding grant awards and administrative costs. All of the Foundation's net assets are restricted for the use of grants and loans, and administrative expenditures.

BUDGET VARIANCES IN THE GENERAL FUND

The majority of the Foundation's assets are maintained in unappropriated accounts requiring no budgetary monitoring or reporting. The remaining assets of the Foundation are maintained in two special revenue funds within the Central Accounting System (CAS), CAS Funds 5M9 and K87. Although appropriated, CAS Funds 5M9 and K87 are not major special revenue funds, and therefore, budgetary reporting is not required.

SOUTHERN OHIO AGRICULTURAL AND COMMUNITY DEVELOPMENT FOUNDATION

MANAGEMENT’S DISCUSSION & ANALYSIS

For the Year Ended June 30, 2004

Unaudited

CAPITAL ASSETS

At the end of fiscal year 2004, the Foundation had \$89,199 invested in net capital assets, as detailed below:

Capital Assets at June 30

	<u>2004</u>	<u>2003</u>	<u>% Change</u>
Vehicles	\$34,701	\$ 47,895	-27.55%
Equipment	31,384	32,929	-4.69%
Computer Software	23,114	30,818	-25.00%
Total Capital Assets	<u>\$89,199</u>	<u>\$111,642</u>	

Total net capital assets for the Foundation decreased by \$22,443 during fiscal year 2004. The decrease is mostly due to current depreciation expense offset by the purchase of some equipment.

ECONOMIC FACTORS

The Southern Ohio Agricultural and Community Development Foundation continues to believe in its mission: “To help create and enhance economic opportunities for Ohio’s burley tobacco farm families and their rural communities. Monies not used for administrative expenses and programs will be available for new programs as they are developed and are approved by the Board, or for investment.”

For fiscal year 2005, the Foundation’s Board has approved the following grant programs to burley tobacco farmers and rural communities in the 22 southern counties of Ohio:

- Educational Assistance:** The SOACDF Educational Assistance Program assists tobacco farmers who have suffered the economic impact of reductions in quota in recent years. The funds are intended to help these individuals acquire skills to enter new or supplemental income-generating occupations, and to help put their dependents through college with financial support that can no longer be solely derived from the growing of tobacco. SOACDF for FY2004-05 again offers grant dollars for educational assistance for Ohio’s burley tobacco farm families. The educational assistance program is an investment in Appalachian Ohio that will pay dividends well into the future. Award recipients are to apply their assistance toward tuition and fees in-state or out-of-state accredited institutions of higher education, or to receive specialized training at non-accredited institutions approved by the Board of SOACDF. Students may participate in certificate programs or other training that will provide them with employment opportunities. For the 2004-05 academic year, the SOACDF Educational Assistance Program will provide up to \$3,000 in educational assistance per person for eligible tobacco growers, their spouses and immediate family dependents. Quota Owners, their spouses and immediate family dependents may each receive up to \$1,000. The actual amount awarded to an individual may not exceed the calculated need determined by the educational institution. The total assistance provided to any family may not exceed \$10,000 per academic year.
- Agricultural Diversification Program:** \$3 million is approved for FY2005 fiscal year. Ohio burley tobacco growers completing requirements set forth by the Board and certified by FSA county office including a Business plan, completed tobacco history, cash flow projections that qualify as Quota Owner/Growers or Grower Tenants can apply for 50% cost share up to a maximum of \$40,000 and qualified Quota Owners can apply for 50% cost share up to a maximum of \$15,000. These projects must be agriculturally based and go through a competitive review & score process by a review committee. Agriculture Diversification Projects are designed to help those who voluntarily decide to transition away from their dependence on tobacco or replace lost income from tobacco.

SOUTHERN OHIO AGRICULTURAL AND COMMUNITY DEVELOPMENT FOUNDATION

MANAGEMENT'S DISCUSSION & ANALYSIS

For the Year Ended June 30, 2004

Unaudited

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- **General Agricultural Projects:** The Foundation, formed three years ago with monies from the Tobacco Master Settlement Agreement, is charged with helping to create and enhance economic opportunities for tobacco farm families and rural communities. \$3 million is approved for FY2005 fiscal year for agricultural projects. Projects available this fiscal year for burley tobacco farmers include: Livestock Systems, Feeding Systems, (New) Forage Handling Equipment, Forage Improvement (Lime & Seeding), Production Livestock Genetic Improvement and Grain Handling. These grant awards are \$1,000 and \$2,000 and are meant to supplement lost income for a majority of the burley tobacco producers who do not opt to apply for the larger agricultural diversification grants. These grants will assist producers in making capital investments to achieve improved efficiencies for additional income over time.
 - **Economic Development:** \$3.5 million for approved Economic projects and \$500,000 for R&D projects is approved for FY2005 fiscal year for the Economic Development program. This program is designed to assist in strategic investments in communities that are affected by the reduction in the demand for tobacco. The emphasis of SOACDF's Economic Development program is to provide up to a maximum of 35% of a total project cost for projects that will create, retain, or expand job opportunities for residents in the traditional burley tobacco producing counties of southern Ohio. Both public and private sector businesses are eligible to apply in order to achieve those means. In the nine major burley tobacco producing counties, dollars are budgeted for use within those counties for projects that meet guideline criteria. An extensive review process which includes county, regional and final Board approval must be met before dollars are awarded.
 - **Investment:** The SOACDF Board adopted an investment policy in fiscal year 2003 and \$10 million dollars was budgeted for investment that began in fiscal year 2004. The investment managers which were chosen by the Treasurer of State were put in place and an additional \$2 million was added to the investment program. It is the Board's intention to continue to look for funds that can be placed into the investment program in order to extend the life line of the Foundation.
 - **Loan Program:** The SOACDF Board budgeted \$1 million for a loan program in fiscal year 2004, however, the Board is currently planning to proceed with a relatively larger loan, to be implemented in fiscal year 2005, upward to approximately \$5 million, with a pay back period of seven years.

In fiscal years 2003 and 2004, Amended Senate Bill No. 242 provided SOACDF funding to be used for an Indemnification Payment program to burley tobacco growers that were quota owners, quota owner/producers or grower/tenants in the 22 southern Ohio counties. The program was implemented, checks were disbursed to qualifying recipients and the program was completed during fiscal year 2004.

CONTACTING THE FOUNDATION'S FINANCIAL MANAGEMENT

This financial report is designed to provide an overview of the Foundation's finances and its accountability for the money it receives. If you have questions about this report or need additional financial information, contact Soundra Weaver, Fiscal Officer, Southern Ohio Agricultural & Community Development Foundation, 100 South High St., PO Box 47, Hillsboro, Ohio 45133.

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SOUTHERN OHIO AGRICULTURAL AND COMMUNITY DEVELOPMENT FOUNDATION

GOVERNMENTAL FUND BALANCE SHEET / STATEMENT OF NET ASSETS

As of June 30, 2004

	Special Revenue Fund	Adjustments (See Note 10)	Statement of Net Assets
Assets:			
Cash	\$ 355,822	\$ —	\$ 355,822
Investments.....	17,743,057	—	17,743,057
Collateral on Lent Securities.....	1,244,051	—	1,244,051
Tobacco Settlement Receivable.....	15,144,938	—	15,144,938
Prepaid Assets.....	4,408	—	4,408
Capital Assets, net of accumulated depreciation.....	—	89,199	89,199
Amount on Deposit for Compensated Absences.....	4,044	—	4,044
Total Assets.....	34,496,320	89,199	34,585,519
 Liabilities:			
Accounts Payable.....	26,163	1,365	27,528
Wages Payable.....	18,271	—	18,271
Obligations under Lent Securities.....	1,244,051	—	1,244,051
Compensated Absences:			
Due in one year.....	—	16,531	16,531
Due in more than one year.....	—	29,082	29,082
Total Liabilities.....	1,288,485	46,978	1,335,463
 Fund Balance/Net Assets:			
Reserved for Compensated Absences.....	4,044	(4,044)	—
Reserved for Prepaid Assets.....	4,408	(4,408)	—
Reserved for Indemnification Payments.....	163,312	(163,312)	—
Fund Balance Reserved.....	33,036,071	(33,036,071)	—
Total Fund Balance.....	33,207,835	(33,207,835)	—
Total Liabilities and Fund Balance.....	\$ 34,496,320		
 Net Assets:			
Invested in capital assets, net of related debt.....		89,199	89,199
Restricted for Indemnification Program.....		163,312	163,312
Restricted for Programs to Reduce Tobacco Use		32,997,545	32,997,545
Total Net Assets.....		\$ 33,250,056	\$ 33,250,056

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

SOUTHERN OHIO AGRICULTURAL AND COMMUNITY DEVELOPMENT FOUNDATION

**STATEMENT OF GOVERNMENTAL FUND REVENUES, EXPENDITURES
AND CHANGE IN FUND BALANCE / STATEMENT OF ACTIVITIES**

For the Year Ended June 30, 2004

	<u>Special Revenue Fund</u>	<u>Adjustments (See Note 10)</u>	<u>Statement of Activities</u>
Revenues:			
Indemnification Payment Program.....	\$16,275,517	—	\$16,275,517
Tobacco Settlement Income from the State of Ohio.....	15,144,938	—	15,144,938
Interest Income.....	570,592	—	570,592
Other.....	515	—	515
Total Revenues.....	<u>31,991,562</u>	<u>—</u>	<u>31,991,562</u>
Expenditures/Expenses:			
Current:			
Salaries and Benefits.....	370,802	23,337	394,139
Purchased Services.....	492,818	(74,581)	418,237
Materials, Supplies, and Other.....	75,197	—	75,197
Depreciation.....	—	29,368	29,368
Grants.....	10,482,590	—	10,482,590
Indemnification Project.....	16,460,510	—	16,460,510
Capital Outlay.....	6,925	(6,925)	—
Total Expenditures/Expenses.....	<u>27,888,842</u>	<u>(28,801)</u>	<u>27,860,041</u>
Excess of Revenues Over Expenditures..	4,102,720	(4,102,720)	—
Change in Net Assets.....	—	4,131,521	4,131,521
Fund Balance/Net Assets:			
Beginning of the year.....	29,105,115	13,420	29,118,535
End of the year.....	<u>\$ 33,207,835</u>	<u>\$ 42,221</u>	<u>\$ 33,250,056</u>

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

SOUTHERN OHIO AGRICULTURAL AND COMMUNITY DEVELOPMENT FOUNDATION

NOTES TO THE FINANCIAL STATEMENTS

For the Year Ended June 30, 2004

1. DESCRIPTION OF THE REPORTING ENTITY

Introduction

The Southern Ohio Agricultural and Community Development Foundation (the Foundation) was created by amended Senate Bill No. 192, effective June 2000, to "...endeavor to replace the production of tobacco in southern Ohio with the production of other agricultural products and to mitigate the adverse economic impact of reduced tobacco production in the region by preparing, implementing, and keeping current a plan to develop means for tobacco growers to grow other agricultural products voluntarily..." The Bill further describes a variety of means by which the Foundation is to develop its plan and carry out its charge.

Pursuant to its legislative mandate, the Foundation's Board is created in Ohio Rev. Code Section 183.12 and is enabled through Ohio Rev. Code Sections 183.11 to 183.17, inclusive. The Foundation's Board is composed of twelve voting members and four nonvoting members as set forth in Section 183.12 of the Ohio Rev. Code. Voting members include six active farmers and two persons with community development experience, all from Ohio's major tobacco growing counties, and four state officials sitting ex officio.

Method of Operation

The Foundation shall make grants or loans to individuals, public agencies, or privately owned companies to carry out the plan. The Foundation shall also adopt rules under Chapter 119 of the Ohio Rev. Code regarding conflicts of interest in the making of grants or loans.

To carry out the duties of the Foundation, a separate endowment fund was created in the custody of the Treasurer of State, but not part of the State Treasury. The Foundation is the trustee of the endowment fund. Disbursements from the fund shall be paid by the Treasurer of State only upon instruments duly authorized by the Board of Trustees of the Foundation or its designee. No disbursements shall be used for the direct production costs of growing tobacco.

The endowment fund is responsible for covering administrative expenditures such as staff salaries, equipment purchases, rental payments and program expenses. As a result of the legislation defining the Foundation's employees as state employees, the State established an appropriation to provide payroll for the Foundation, which is reimbursed by the Foundation's endowment fund.

At the request of the Foundation, the Treasurer of State shall select and contract with one or more investment managers to invest all money credited to the fund that is not currently needed for carrying out the functions of the Foundation. The eligible list of investments, as well as limitations and other requirements shall be the same as for the Public Employees Retirement System under Section 145.11 of the Revised Code.

Reporting Entity

Within the State of Ohio's Comprehensive Annual Financial Report, the Southern Ohio Agricultural and Community Development Foundation is included as part of the primary government. The Foundation's management believes these financial statements present all activities for which the Foundation is financially responsible.

SOUTHERN OHIO AGRICULTURAL AND COMMUNITY DEVELOPMENT FOUNDATION

NOTES TO THE FINANCIAL STATEMENTS

For the Year Ended June 30, 2004

2. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

The accompanying financial statements of the Southern Ohio Agricultural and Community Development Foundation present the financial position and results of operations of the Foundation. The financial statements, as of June 30, 2004, and for the year then ended, conform with accounting principles generally accepted in the United States of America as applied to governments. The Governmental Accounting Standards Board (GASB) is the standard-setting body for establishing governmental accounting and financial reporting principles. The GASB's Codification of Governmental Accounting and Financial Reporting Standards (GASB Codification) documents these principles.

The Foundation follows GASB Statement No. 34 "Basic Financial Statements - and Management's Discussion and Analysis - for State and Local Governments." Under GASB Statement No. 34 the financial statements include separate Statement of Net Assets and Statement of Activities columns reporting the financial activities using the accrual basis of accounting, in addition to the Special Revenue Fund column reporting the financial activities using the modified accrual basis of accounting. The Foundation's other significant accounting policies are as follows.

A. Fund Accounting

The foundation uses a special revenue fund to report its financial position and results of operations. The special revenue fund is an independent fiscal and accounting entity with a self-balancing set of accounts. The special revenue fund is established to account for the proceeds of specific revenue sources that are legally restricted to expenditure for specified purposes.

B. Measurement Focus and Basis of Presentation

The accounting and financial reporting treatment applied to a fund is determined by its measurement focus. All governmental funds are accounted for using a flow of current financial resources measurement focus. With this measurement focus, only current assets and current liabilities generally are included on the balance sheet. Operating statements of these funds present increases (e.g., revenues) and decreases (e.g., expenditures) in net current assets, and unreserved fund balance is a measure of available expendable resources. This measurement focus has been applied to the "Special Revenue Fund" columns on the accompanying financial statements.

The "Statement of Net Assets" and "Statement of Activities" columns on the accompanying financial statements have been prepared using the economic resources measurement focus. This is the same approach used in the preparation of proprietary fund financial statements but differs from the manner in which governmental fund financial statements are prepared. The financial statements therefore present an adjustment column to identify reconciling items to arrive at the "Statement of Net Assets" and the "Statement of Activities" columns.

C. Basis of Accounting

Basis of accounting refers to when revenues and expenditures or expenses are recognized in the accounts and reported in the financial statements. The "Special Revenue Fund" columns on the accompanying financial statements were prepared using the modified accrual basis of accounting. Under the modified accrual basis of accounting, the Foundation recognizes revenues when susceptible to accrual (i.e., when they are "measurable and available"). "Measurable" means the amount of the transaction is determinable, and "available" means the amount is collectible within the current period or soon enough thereafter to pay liabilities of the current period. The Foundation considers revenues as available when collected within 60 days after year-end.

SOUTHERN OHIO AGRICULTURAL AND COMMUNITY DEVELOPMENT FOUNDATION

NOTES TO THE FINANCIAL STATEMENTS

For the Year Ended June 30, 2004

2. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (Continued)

Under the modified accrual basis, expenditures are recorded when related fund liabilities are incurred, which are recognized as expenditures when due. Significant revenue sources susceptible to accrual under the modified accrual basis of accounting may include master settlement agreement revenues received from the State of Ohio and interest income.

The "Statement of Net Assets" and the "Statement of Activities" columns on the accompanying financial statements were prepared using the accrual basis of accounting. Under the accrual basis of accounting, expenses are recorded at the time they are incurred and revenues are recognized when measurable.

D. Budgetary Data

The majority of the Foundation's assets are maintained in unappropriated accounts requiring no budgetary monitoring or reporting. The remaining assets of the Foundation are maintained in two special revenue funds within the Central Accounting System (CAS), CAS Funds 5M9 and K87. Although appropriated, CAS Funds 5M9 and K87 are not major special revenue funds, and therefore, budgetary reporting is not required.

E. Cash

Cash of the Foundation includes amounts held in a custodial account with the Treasurer of State, CAS Funds 5M9 and K87, indemnification amounts on deposit with JP Morgan, and petty cash.

F. Investments

Investments of the Foundation are reported at fair value, which includes accrued interest receivable. Fair value is the amount at which an investment could be exchanged in a current transaction between willing parties other than in a forced or liquidation sale. If quoted market price is available for an investment, the fair value to be used is the total number of trading units of the instrument times the market price per unit.

Ohio Revised Code Section 183.16 restricts the types of investments the Foundation may purchase to those types of investments permitted for the public employees retirement system under section 145.11 of the Ohio Revised Code. All investments shall be subject to the same limitations and requirements as the retirement system under that section and Sections 145.112 and 145.113 of the Ohio Revised Code.

The Foundation invests in the State Treasury Asset Reserve of Ohio (STAR Ohio), whereby the deposits are pooled with other deposits and reinvested daily. STAR Ohio investments are considered short-term and are reported at cost, which approximates market values. The pooled deposits at STAR Ohio have the general characteristics of a demand deposit account whereby additional cash can be deposited at any time and can also be effectively withdrawn at any time, without prior notice or penalty. The Treasurer of State is the investment advisor and administrator of STAR Ohio, a statewide external investment pool authorized under Section 135.45, Ohio Revised Code.

G. Securities Lending Transactions

GASB Statement No. 28, *Accounting and Financial Reporting for Securities Lending Transactions*, requires disclosure of assets and liabilities arising from securities lending transactions. The Foundation's investments with the State's cash and investment pool and STAR Ohio are both subject to lending transactions by the Treasurer of State. In accordance with paragraph 9 of GASB Statement No. 28, the Foundation's recording of assets and liabilities for securities lending transactions is based on their share of the cash and investment pool, as of the balance sheet date, as calculated by the Office of Budget and Management.

SOUTHERN OHIO AGRICULTURAL AND COMMUNITY DEVELOPMENT FOUNDATION

NOTES TO THE FINANCIAL STATEMENTS

For the Year Ended June 30, 2004

2. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (Continued)

H. Capital Assets and Depreciation

It is the Foundation's policy to capitalize all assets with an initial cost of \$1,000 or more. Capital assets are reported in the "Statement of Net Assets" column, but are not reported in the "Special Revenue Fund" column on the accompanying Governmental Fund Balance Sheet/Statement of Net Assets. All capital assets are capitalized at cost (or estimated historical cost) and updated for additions and retirements during the year.

All reported capital assets of the Foundation are depreciated. Depreciation is computed using the straight-line method of depreciation over the applicable useful life of the asset and commences the year after the asset is purchased. The useful life for each asset category noted in Note 4 is 5 years.

I. Revenues and Receivables

Master Settlement Agreement Income

Master settlement agreement income received from the State of Ohio comprises the Foundation's primary source of revenue. These revenues are derived from the 1998 Tobacco Master Settlement Agreement (the Agreement) that was entered into by the State of Ohio, along with numerous other states, against major tobacco product manufacturers. The Agreement stipulates the conditions and calculations to be applied in order for each state to receive its annual allotments. Ohio Rev. Code Section 183.02 requires all payments received by the State to be deposited into the Treasurer of State's Tobacco Master Settlement Agreement Fund (Fund 087) and the payments and related interest are to be distributed by the Office of Budget and Management in accordance with the distribution schedule.

Payments are credited to the Tobacco Master Settlement Agreement Fund in accordance with the following schedule stipulated by Ohio Rev. Code Section 183.02 (C), and subsequently transferred, though not necessarily in the same fiscal year, to the Southern Ohio Agricultural and Community Development Fund (Fund K87).

<u>Year</u>	<u>Percentage</u>
2000 (First Payment Credited)	5.00%
2000 (Net Amount Credited)	8.73%
2001	8.12%
2002	9.18%
2003	8.91%
2004	7.84%
2005	7.79%
2006	7.76%
2007	17.39%
2008 through 2011	17.25%

For fiscal year 2002 and 2003, the anticipated transfer to the Foundation, pursuant to the above schedule, was not received. Instead, in accordance with amended Senate Bill 242, other tobacco settlement monies, which were designated specifically for an Indemnification Payment Program, were transferred to the Foundation. Ohio Rev. Code Section 183.02 (C)(2), as amended, provides that amounts due under the above payment schedule for 2002 and 2003, shall be transferred to the Foundation in fiscal years 2013 and 2014, respectively. The fiscal year 2004 transfer, totaling \$15,144,938, was received in July of 2005 and has been reported as a Tobacco Settlement Receivable on the Statement of Net Assets.

SOUTHERN OHIO AGRICULTURAL AND COMMUNITY DEVELOPMENT FOUNDATION

NOTES TO THE FINANCIAL STATEMENTS

For the Year Ended June 30, 2004

2. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (Continued)

I. Revenues and Receivables (Continued)

Before fiscal year 2011 begins, the Foundation must report to the Governor and Legislature the progress the Foundation has made towards its goals and whether a need for additional funding still exists. At this point, the Governor and Legislature will decide whether funding to the Foundation will be continued. Funding estimates for receiving monies under the Master Tobacco Settlement Agreement were only projected through the year 2025; however, under the terms of the Agreement payments from the tobacco product manufacturers are to continue into perpetuity. Ohio Rev. Code Section 183.02 (K) further states that future year revenues from the Agreement are contingent upon sufficient proceeds being received to cover designated revenue set asides for the Education Facilities Trust and Endowment Funds.

Interest Income

The Foundation receives interest income from investments with STAR Ohio, Mellon Bank, MDL Capital Management Inc., deposits in CAS Funds 5M9 and K87, deposits with JP Morgan and custodial deposits with the Treasurer of State. In fiscal year 2004, the Foundation earned \$570,592 in interest income.

J. Expenditures and Accounts Payable

Administrative expenditures

Administrative expenditures include operating and overhead items such as salaries and benefits, equipment purchases, and other miscellaneous expenditures. Ohio Rev. Code Section 183.30 (B) requires no more than five percent of total expenditures within a fiscal year shall be for administrative purposes.

Administrative expenditures for fiscal year 2004 were \$916,941. Of this amount, \$289,711 is attributed to carrying out the Indemnification Payment Program. The remaining \$627,230 is attributed to administering the Foundation's other programs.

K. Compensated Absences

The State of Ohio, which governs employee leave benefits and policies, pays compensation to separated employees for sick, vacation, and personal leave balances accumulated during the employee's term of service. The Foundation's compensated absences liability is calculated and reported in accordance with the guidance set forth in the Governmental Accounting Standards Board (GASB) Statement No. 16, "Accounting for Compensated Absences."

L. Fund Balance/Net Assets

In accordance with the reporting requirements associated with GASB Statement No. 33's purpose restrictions, fund balance/net assets will be reported as reserved/restricted for making grants or loans to qualifying individuals, public agencies, or privately owned companies and covering administrative expenditures of the Foundation.

M. Self-Insurance

The State of Ohio serves as the Foundation's primary government and is self-insured for claims covered under its traditional healthcare, vehicle liability, public fidelity blanket bonds, property losses, and tort liability insurance plans. Additionally, the State of Ohio participates in a public entity risk pool that covers liabilities associated with claims submitted to the Bureau of Workers' Compensation.

SOUTHERN OHIO AGRICULTURAL AND COMMUNITY DEVELOPMENT FOUNDATION

NOTES TO THE FINANCIAL STATEMENTS

For the Year Ended June 30, 2004

3. DEPOSITS AND INVESTMENTS

The following information classifies deposits and investments by categories of risk as defined in GASB Statement No. 3, *Deposits with Financial Institutions, Investments (including Repurchase Agreements), and Reverse Repurchase Agreements*:

Deposits

At fiscal year end, the carrying amount of the Foundation's deposits was \$355,822 and the bank balance was \$359,817. Of the bank balance, \$57,561 was held on deposit by the State of Ohio, \$242,299 was maintained in a custodial account held by the Treasurer of State, and \$59,457 was on deposit with Bank One. The remaining \$500 represents petty cash maintained by the Foundation. The State of Ohio's deposits span all three categories of investment risk, all of which meet applicable collateralization requirements. Custodial balances are collateralized with securities held by the pledging financial institution's trust department or an agent in the State's name.

Investments

GASB Statement No. 3 requires that governments disclose the carrying amounts and market value of investments, classified by risk. Investments are to be categorized as either (1) insured or registered, or securities held by the Foundation or its agent in the Foundation's name, (2) uninsured and unregistered, with securities held by the counterparty's trust department or agent in the Foundation's name or (3) uninsured and unregistered, with securities held by the counterparty, or by its trust department or agent but not in the Foundation's name.

As of June 30, 2004, the carrying amount and fair value of the investment balances and related risk categories required by GASB Statement 3 are shown below. STAR Ohio is an investment pool operated by the Treasurer of State and is unclassified since it is not evidenced by securities that exist in physical or book entry form.

<u>Investment Type</u>	<u>Category 1</u>	<u>Category 2</u>	<u>Category 3</u>	<u>Fair Value</u>
U.S. Treasury Notes and Bonds	3,023,771			3,020,086
Mortgage Backed Securities	1,622,335			1,631,346
Corporate Bonds	1,183,492			1,178,346
Equities	5,974,479			6,272,846
Mutual Funds				211,602
STAR Ohio				<u>5,428,831</u>
Total Investments				<u><u>17,743,057</u></u>

SOUTHERN OHIO AGRICULTURAL AND COMMUNITY DEVELOPMENT FOUNDATION

NOTES TO THE FINANCIAL STATEMENTS

For the Year Ended June 30, 2004

4. CAPITAL ASSETS

A summary of capital asset activity during the fiscal year follows:

<u>Asset Category</u>	<u>Beginning Balance</u>	<u>Additions</u>	<u>Deletions</u>	<u>Ending Balance</u>
Equipment	\$ 42,350	\$ 6,925	\$ -	\$ 49,275
Vehicles	65,966	-	-	65,966
Computer Software	38,523	-	-	38,523
Subtotal	146,839	6,925	-	153,764
Accumulated Depreciation	(35,197)	(29,368)	-	(64,565)
Net Capital Assets	<u>\$ 111,642</u>	<u>\$ (22,443)</u>	<u>\$ -</u>	<u>\$ 89,199</u>

5. COMPENSATED ABSENCES

For the purpose of calculating the compensated absences liability, vacation, personal, sick, and compensatory leaves only are considered. The current portion of the liability consists of the amount of compensated absences that is due to be paid within one year of the balance sheet date, as estimated by the State of Ohio's Office of Budget and Management by analyzing trend data from the previous three fiscal years.

Changes in compensated absences for the year ended June 30, 2004, are as follows:

<u>Beginning Balance</u>	<u>Increase</u>	<u>Decrease</u>	<u>Ending Balance</u>	<u>Amount Due in One Year</u>
\$ 22,276	\$ 40,853	\$ (17,516)	\$ 45,613	\$ 16,531

6. DEFINED BENEFIT PENSION PLANS

All full-time employees participate in the Ohio Public Employees Retirement System (OPERS). OPERS administers three separate pension plans as described below:

1. The Traditional Plan (TP) – a cost-sharing multiple-employer defined benefit pension plan.
2. The Member-Directed Plan (MD) – a defined contribution plan in which the member invests both member and employer contributions (employer contributions vest over five years at 20% per year). Under the Member-Directed Plan members accumulate retirement assets equal to the value of member and (vested) employer contributions plus any investment earnings thereon.
3. The Combined Plan (CO) – a cost-sharing multiple-employer defined benefit pension plan. Under the Combined Plan employer contributions are invested by the retirement system to provide a formula retirement benefit similar in nature to the Traditional Plan benefit. Member contributions, the investment of which is self-directed by the members, accumulate retirement assets in a manner similar to the Member-Directed Plan.

OPERS provides retirement, disability, survivor and death benefits and annual cost of living adjustments to members of the Traditional Plan and Combined Plans. Members of the Member-Directed Plan do not qualify for ancillary benefits.

SOUTHERN OHIO AGRICULTURAL AND COMMUNITY DEVELOPMENT FOUNDATION

NOTES TO THE FINANCIAL STATEMENTS

For the Year Ended June 30, 2004

6. DEFINED BENEFIT PENSION PLANS (Continued)

Authority to establish and amend benefits is provided by state statute per Chapter 145 of the Ohio Revised Code. OPERS issues a stand-alone financial report. Interested parties may obtain a copy by making a written request to 277 East Town Street, Columbus, Ohio 43215-4642 or by calling (614) 222-6705 or 1-800-222-PERS (7377).

The Ohio Revised Code provides statutory authority for employee and employer contributions. For 2003, member and employer contribution rates were consistent across all three plans (TP, MD and CO).

The 2003 member contribution rate for Foundation employees was 8.5% of covered payroll. The 2003 employer contribution rate for the Foundation was 13.31% of covered payroll. The Foundation's required contributions to OPERS for the years ended June 30, 2004, 2003, and 2002 were \$37,846, \$36,060, and \$24,318, respectively. The full amount has been contributed for each year.

7. OTHER POST-EMPLOYMENT BENEFITS

The Ohio Public Employees Retirement System (OPERS) administers three separate pension plans: The Traditional Plan (TP) – a cost-sharing multiple-employer defined benefit plan; the Member-Directed Plan (MD) – a defined contribution plan; and the Combined Plan (CO) – a cost-sharing multiple-employer defined benefit pension plan that has elements of both a defined benefit and defined contribution plan.

OPERS provides retirement, disability, survivor and post-retirement health care benefits to qualifying members of both the Traditional and the Combined Plans; however, health care benefits are not statutorily guaranteed. Members of the Member-Directed Plan do not qualify for ancillary benefits, including post-employment health care coverage.

In order to qualify for post-retirement health care coverage, age and service retirees must have 10 or more years of qualifying Ohio service credit. Health care coverage for disability recipients and primary survivor recipients is available. The health care coverage provided by the Retirement System is considered an Other Post-employment Benefit (OPEB) as described in GASB Statement No. 12.

A portion of each employer's contribution to OPERS is set aside for the funding of post-retirement health care. The Ohio Revised Code provides statutory authority for employer contributions. The 2003 employer contribution rate was 13.31% of covered payroll, and 5% was used to fund health care.

The assumptions and calculations below were based on the Retirement System's latest Actuarial Review performed as of December 31, 2002.

An entry age normal actuarial cost method of valuation is used in determining the present value of OPEB. The difference between assumed and actual experience (actuarial gains and losses) becomes part of unfunded actuarial accrued liability. All investments are carried at market. For actuarial valuation purposes, a smoothed market approach is used. Under this approach assets are adjusted to reflect 25% of unrealized market appreciation or depreciation on investment assets annually.

The investment assumption rate for 2002 was 8%. An annual increase of 4%, compounded annually, is the base portion of the individual pay increase assumption. This assumes no change in the number of active employees. Additionally, annual pay increases, over and above the 4% base increase, were assumed to range from .5% to 6.3%. Health care costs were assumed to increase 4.00% annually.

OPEB's are advance-funded on an actuarially determined basis. At year-end 2003, the number of active contributing participants in the Traditional and Combined Plans totaled 364,881. The contribution rates stated above are the actuarially determined contribution requirements for OPERS. The portion of the Foundation's 2003 contributions that were used to fund post-employment benefits were \$14,215.

SOUTHERN OHIO AGRICULTURAL AND COMMUNITY DEVELOPMENT FOUNDATION

NOTES TO THE FINANCIAL STATEMENTS

For the Year Ended June 30, 2004

7. OTHER POST-EMPLOYMENT BENEFITS (Continued)

\$10 billion represents the actuarial value of the Retirement System's net assets available for OPEB at December 31, 2002. The actuarially accrued liability and the unfunded actuarial accrued liability, based on the actuarial cost method used, were \$18.7 billion and \$8.7 billion, respectively.

In December 2001, the Board adopted the Health Care "Choices" Plan in its continuing effort to respond to the rise in the cost of health care. The Choices Plan will be offered to all persons newly hired in an OPERS-covered position after January 1, 2003, with no prior service credit accumulated toward health care coverage. Choices, as the name suggests, will incorporate a cafeteria approach, offering a more broad range of health care options. The Plan uses a graded scale from ten to thirty years to calculate a monthly health care benefit. This is in contrast to the ten-year "cliff" eligibility standard for the present plan.

The benefit recipient will be free to select the option that best meets their needs. Recipients will fund health care costs in excess of their monthly health care benefit. The Plan will also offer a spending account feature, enabling the benefit recipient to apply their allowance toward specific medical expenses, much like a Medical Spending Account.

In response to the adverse investment returns experienced by OPERS from 2000 through 2002 and the continued staggering rate of health care inflation, the OPERS Board, during 2003, considered extending "Choices" type cost cutting measures to all active members and benefit recipients. As of this date, the Board has not determined the exact changes that will be made to the health care plan.

8. LEASES

On July 1, 2003, the Foundation amended their lease agreement for office space. In addition, the Foundation entered into an operating lease agreement for a Pitney Bowes posting machine. Leased properties not having elements of ownership are classified as operating leases and likewise are recorded as expenditures when payable. For fiscal year 2004, total operating lease expenses for the office space and the posting machine were \$24,624 and \$822, respectively. The following schedule details future lease payments of the Foundation.

Term	Office Space	Postage Machine
Fiscal year 2005	24,624	3,288
Fiscal year 2006	24,624	3,288
Fiscal year 2007	24,624	3,288
Fiscal year 2008	25,353	3,288
Fiscal year 2009	25,353	2,466
Fiscal year 2010	26,136	-
Fiscal year 2011	26,136	-

According to the Foundation's amended lease agreement for office space, provided the Foundation is in compliance with the existing terms of the contract, the Foundation has the option to renew the lease for up to four successive and continuous terms of two years each upon the same terms and conditions except that the base rent during said renewal terms be as noted above.

9. CONTINGENCIES

As of June 30, 2004, the Foundation's management, in consultation with the Ohio Attorney General's Office, was unaware of any pending litigation which could result in a material unfavorable outcome requiring amounts to be reported or disclosed in the Foundation's financial statements.

SOUTHERN OHIO AGRICULTURAL AND COMMUNITY DEVELOPMENT FOUNDATION

NOTES TO THE FINANCIAL STATEMENTS

For the Year Ended June 30, 2004

10. EXPLANATION OF ADJUSTMENTS

The following is a detailed description of the amounts included in the "Adjustments" column of the accompanying financial statements:

Governmental Fund Balance Sheet/Statement of Net Assets

Capital assets used in governmental activities are not financial resources and, therefore, are not reported in the special revenue fund; however, capital assets are reported in the Statement of Net Assets column

\$89,199

Long-term liabilities, such as accounts payable and compensated absences, are not due and payable in the current period and, therefore, are not reported in the special revenue fund. However, long-term liabilities are reported in the Statement of Net Assets column.

Accounts Payable	(\$1,365)
Compensated Absences	(\$45,613)

Statement of Revenues, Expenditures, and Change in Fund Balance/Statement of Activities

Governmental funds report capital outlays as expenditures. However, in the statement of activities, the cost of those assets is allocated over their estimated useful lives as depreciation expense. No depreciation expense is recorded in the Governmental funds.

Capital Outlay	\$6,925
Depreciation	(\$29,368)
	<hr/> (\$22,443)

Some expenses reported in the Statement of Activities do not require the use of current financial resources and, therefore, are not reported as expenditures in the special revenue fund.

Accounts Payable	74,581
Compensated Absences Payable	(\$23,337)
	<hr/> 51,244

11. CHANGES IN ACCOUNTING PRINCIPLES

Starting in fiscal year 2004, the Foundation implemented the provisions of *Governmental Accounting Standards Board (GASB) Technical Bulletin 2004-1, Tobacco Settlement Recognition and Financial Reporting Entity Issues*, which became effective for financial statements for periods ending after June 15, 2004. This GASB Technical Bulletin clarifies recognition guidance for tobacco settlement revenue transactions and for payments made to settling governments pursuant to the Master Settlement Agreement with the major tobacco companies. The Foundation now recognizes revenue coming from the State that is actually collected by the State as of year-end; however, the Foundation does not recognize any future settlement revenues that are owed to, but have not been collected by, the State as of year-end. Ohio Revised Code section 183.02 addresses the distribution to the Foundation of revenues already received by the State, not future tobacco settlement revenues. Implementation of the GASB Technical Bulletin resulted in the recognition of exchange transactions associated with tobacco settlement revenues received from the Tobacco Master Settlement Agreement in the amount of \$15,144,938 during fiscal year 2004. Previously, the Foundation viewed these revenues to be voluntary non-exchange transactions. Implementation of the GASB Technical Bulletin did not require the Foundation to restate any prior year balances.



Auditor of State Betty Montgomery

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

Southern Ohio Agricultural and Community Development Foundation
100 South High Street
Hillsboro, Ohio 45133

We have audited the accompanying basic financial statements of the Southern Ohio Agricultural and Community Development Foundation (the Foundation), State of Ohio, as of and for the year ended June 30, 2004, and have issued our report thereon dated October 8, 2004, wherein we noted the Foundation adopted GASB Technical Bulletin 2004-1. 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 Foundation's basic financial statements are free of material misstatement, we performed tests of the Foundation's compliance with certain provisions of laws, regulations, and contracts, 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 we must report under *Government Auditing Standards*. However, we noted certain matters that we reported to management of the Foundation, in a separate letter dated October 8, 2004.

Internal Control Over Financial Reporting

In planning and performing our audit, we considered the Foundation's internal control over financial reporting in order to determine our auditing procedures for the purpose of expressing our opinions on the basic financial statements and not to provide assurance on the internal control over financial reporting. However, we noted a certain matter involving the internal control over financial reporting and its operation that we consider to be a reportable condition. 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 Foundation's ability to record, process, summarize and report financial data consistent with management's assertions in the financial statements. A reportable condition is described in the accompanying schedule of findings as item 2004-001.

A material weakness is a reportable 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 caused by error or fraud 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. We noted no matters involving the internal control over financial reporting and its operation that we consider material weaknesses. However, we noted other matters involving internal control over financial reporting that we have reported to management of the Foundation, in a separate letter dated October 8, 2004.

This report is intended for the information and use of management and the Board of the Southern Ohio Agricultural and Community Development Foundation, management of the State of Ohio, and the Ohio Legislature, 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

October 8, 2004

SOUTHERN OHIO AGRICULTURAL AND COMMUNITY DEVELOPMENT FOUNDATION

SCHEDULE OF FINDINGS JULY 1, 2003 THROUGH JUNE 30, 2004

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

FINDING NUMBER 2004-001

MONITORING SERVICE ORGANIZATIONS

An entity's internal control structure consists of policies and procedures to reasonably ensure laws and regulations and the entity's goals and objectives are being met. When operating activity is not directly administered by the entity, such as when utilizing a service organization, it is critical that appropriate monitoring controls are designed and implemented to reasonably ensure the service organization is complying with applicable laws and regulations, as well as management's goals and objectives.

During state fiscal year 2004, approximately \$16.5 million was transferred from the Foundation's Key Bank account to a Bank One account to process indemnification payments as required by Am. Sub. S.B. No. 242, 124th General Assembly, Section 11.01. This was the second and final year of the indemnification payment project. The Foundation contracted with the Ohio Department of Agriculture to assist in making the indemnification payments as required by law for this two-year project. The Ohio Department of Agriculture determined the indemnification payment rate per basic quota and effective pound. In turn, the Ohio Department of Agriculture, with approval from the Foundation, contracted with Wachovia, N.A. to determine farmers eligible for the indemnification payment and calculate the amount of the payment. The Treasurer of State modified a contract with Bank One to allow Bank One, currently JP Morgan, to write the indemnification checks and mail the payments to farmers. Therefore, Wachovia, N.A., sent files detailing eligible indemnification recipients and payment amounts to Bank One for processing. Foundation management indicated they reviewed the payment file in hardcopy form as disbursements were made; however, no evidence of this review was maintained. The Foundation did not have any other documented monitoring controls in place during the audit period to reasonably ensure the indemnification payments calculated and processed by these service organizations complied with applicable laws and regulations. In addition, a SAS 70 report was not obtained related to the activities of the service organization.

Without performing and documenting adequate monitoring procedures related to the indemnification payments process, management may not be reasonably assured indemnification payments made were in accordance with Foundation Board requirements or Am. Sub. S.B. No. 242, 124th General Assembly, Section 11.01. In addition, the risk of lost, stolen, or misappropriated payments is increased, although no such issues were noted in our recalculations of the indemnification payments made in fiscal year 2004.

We recommend the Foundation establish a standardized process to identify and implement appropriate monitoring procedures to reasonably ensure any future special projects where service organizations have control over significant portions of the process are in accordance with applicable laws and regulations and management's requirements. These procedures should include, but not be limited to:

- Identifying the risks associated with the service being provided;
- Developing appropriate monitoring procedures to mitigate the risks identified and to ensure compliance with applicable rules and regulations;
- Obtaining, reviewing, and evaluating a Type Two (Tier II) SAS 70 report related to the service organization which is conducted in accordance with American Institute of Certified Public Accountant Standards by a firm registered and considered in good standing with the Accountancy Board of the respective state; and
- Documenting all monitoring procedures performed.



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**SOUTHERN OHIO AGRICULTURAL AND
COMMUNITY DEVELOPMENT FOUNDATION**

FRANKLIN 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
DECEMBER 7, 2004**