



**Auditor of State
Betty Montgomery**

**PATHWAY SCHOOL OF DISCOVERY
MONTGOMERY COUNTY**

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Auditor of State Betty Montgomery

INDEPENDENT ACCOUNTANTS' REPORT

Pathway School of Discovery
Montgomery County
173 Avondale Drive
Dayton, Ohio 45404

To the Board of Directors:

We have audited the basic financial statements of Pathway School of Discovery, Montgomery County, (the Academy), 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 Academy's management. Our responsibility is to express opinion on these financial statements based on our audit. We did not audit the contracted service expense activity of the Academy. Other auditors audited those expenses, and have furnished their report thereon to us and we base our opinion, insofar as it relates to those amounts included for the Academy on the report of the other auditors.

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 reasonably assure whether the financial statements are free of material misstatement. The other auditors audited the contracted service expense activity of the Academy in accordance with auditing standards generally accepted in the United States of America and not in accordance with *Government Auditing Standards*. 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 and the report of the other auditors provide a reasonable basis for our opinion.

In our opinion, based on our audit and the report of the other auditors, the financial statements referred to above present fairly, in all material respects, the financial position of Pathway School of Discovery, Montgomery County, as of June 30, 2004, and the changes in financial position and cash flows, for the year then ended in conformity with accounting principles generally accepted in the United States of America.

In accordance with *Government Auditing Standards*, we have also issued our report date June 16, 2005, 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 grant agreements and other matters. While we did not opine on the internal control over financial reporting or on compliance, that report describes the scope of our testing of internal control over financial reporting and compliance and the results of that testing. That report is an integral part of an audit performed in accordance with *Government Auditing Standards*. You should read it in conjunction with this report in assessing the results of our audit.

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Management's Discussion and Analysis is not a required part of the basic financial statements but is supplementary information accounting principles generally accepted in the United States of America requires. We have applied certain limited procedures, consisting principally of inquiries of management regarding the methods of measuring and presenting the required supplementary information. However, we did not audit the information and express no opinion on it.

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

Betty Montgomery
Auditor of State

June 16, 2005

**PATHWAY SCHOOL OF DISCOVERY
MONTGOMERY COUNTY**

**MANAGEMENT DISCUSSION AND ANALYSIS
FOR THE YEAR ENDED JUNE 30 2004
UNAUDITED**

This section of the annual financial report for Pathway School of Discovery (the "Academy") provides an overview of the Academy's financial activities for the period from January 26, 2001 (date of incorporation) through June 30, 2004. It should be read in conjunction with the financial statements, which immediately follow this section. The Academy implemented Statement No. 34 of the Governmental Accounting Standards Board, *Basic Financial Statements – and Management's Discussion and Analysis – for State and Local Governments*, effective July 1, 2003.

Using this Annual Report

This annual report consists of a series of financial statements and notes to those statements. The Statement of Net Assets and the Statement of Revenues, Expenses and Changes in Net Assets on pages 5 and 6 provide information about the activities of the Academy as a whole.

Basic Financial Statements

The basic financial statements include all assets and liabilities and results of operations using the accrual basis of accounting, which is similar to the accounting used by most private sector companies.

The statement of net assets and statement of revenues, expenses, and change in net assets report the activities for the Academy, which encompass all the Academy's services, including instruction, support services and food services. State aid (based on student count) and state and federal grants finance most of these activities. The Academy has entered into a management agreement with National Heritage Academies, Inc. ("NHA") which requires NHA to provide administration, strategic planning and all labor, materials, equipment and supervision necessary for the provision of educational services to students. As part of the consideration received under the management agreement, NHA also provides the facility in which the Academy operates. Under the terms of the agreement, NHA receives as remuneration for its services an amount equal to the total revenue received by the Academy from all revenue sources.

The table below provides a summary of the Academy's net assets as of June 30:

	Net Assets 2004
Assets—current	\$ 468,619
Liabilities—current	<u>460,529</u>
Net assets—Unrestricted	<u><u>\$ 8,090</u></u>

The unrestricted net assets represent the accumulated results of life to date operations. These assets can be used to finance day to day operations without constraints, such as legislative or legal requirements. The results of the current year operations for the Academy as a whole are reported in the statement of activities, which shows the change in net assets.

**PATHWAY SCHOOL OF DISCOVERY
MONTGOMERY COUNTY**

**MANAGEMENT DISCUSSION AND ANALYSIS
FOR THE YEAR ENDED JUNE 30, 2004
UNAUDITED
(Continued)**

The table below provides a summary of the Academy's change in net assets for the period ended June 30:

	Change in Net Assets 2004
Operating revenues:	
State aid	\$1,653,932
Other state sources	109,690
Local sources	<u>32,829</u>
Total operating revenue	1,796,451
Operating expenses—	
Contracted service fee	<u>3,316,164</u>
Operating loss	(1,519,713)
Non-operating revenues	
Private sources—National Heritage Academies, Inc.	1,281,231
Federal and state grants	<u>246,572</u>
Total non-operating revenue	<u>1,527,803</u>
Change in net assets	<u><u>\$8,090</u></u>

As reported in the statement of revenues, expenses and change in net assets, operating expenses were \$3,316,164. These activities were primarily funded by the Academy's state aid (based on student count) and governments that subsidized certain programs with grants. Revenues—Private sources—NHA represent a credit granted by NHA for the excess of Academy expenses over public revenues available.

The Academy experienced an increase in net assets of \$8,090 in 2004. Under the terms of the agreement with NHA, NHA provides a spending account to the board for discretionary expenditures. The primary reason for the change in net assets is the timing of these discretionary expenditures.

General Economic Factors

The Academy depends on legislative and governmental support to fund its operations. There is current litigation regarding the legality of Ohio's charter school program and its school funding. Based on information currently available, no significant changes are expected to occur in the nature of the funding or operations of the Academy in 2005.

Contacting the Academy's Financial Management

The financial report is designed to provide users of the report with a general overview of the Academy's finances and to demonstrate the Academy's accountability for the money it receives. If you have questions about this report, contact the Chief Financial Officer of National Heritage Academies, Inc., 3850 Broadmoor SE, Ste 201, Grand Rapids, Michigan 49512.

**PATHWAY SCHOOL OF DISCOVERY
MONTGOMERY COUNTY**

**STATEMENT OF NET ASSETS
JUNE 30, 2004**

ASSETS

Cash	\$37,282
Due from Other Governments	<u>431,337</u>
Total Assets	468,619

LIABILITIES

Due to National Heritage Academies, Inc.	<u>460,529</u>
Total Liabilities	<u>460,529</u>

NET ASSETS:

Unrestricted	<u>8,090</u>
Total Net Assets	<u><u>\$8,090</u></u>

See accompanying notes to basic financial statements.

**PATHWAY SCHOOL OF DISCOVERY
MONTGOMERY COUNTY**

**STATEMENT OF REVENUES, EXPENSES
AND CHANGES IN NET ASSETS
FOR THE YEAR ENDED JUNE 30, 2004**

OPERATING REVENUES:	
State aid	\$1,653,932
Other state sources	109,690
Local sources	<u>32,829</u>
Total operating revenues	1,796,451
OPERATING EXPENSES:	
Contracted service fee	<u>3,316,164</u>
Total operating expenses	<u>3,316,164</u>
OPERATING LOSS	(1,519,713)
NON-OPERATING REVENUE:	
Private Sources - National Heritage Academies, Inc.	1,281,231
Federal and state grants	<u>246,572</u>
Total Non-operating Revenue	1,527,803
NET INCOME	8,090
NET ASSETS - Beginning of Year	<u>-</u>
NET ASSETS - End of Year	<u><u>\$8,090</u></u>

See notes to the basic financial statements.

**PATHWAY SCHOOL OF DISCOVERY
MONTGOMERY COUNTY**

**STATEMENT OF CASH FLOWS
FOR THE YEAR ENDED JUNE 30, 2004**

CASH FLOWS FROM OPERATING ACTIVITIES:

Cash received from state sources	\$1,488,038
Cash received from local sources	32,829
Cash paid on behalf of the Academy for goods and services	<u>(2,855,635)</u>
Net cash used in operating activities	(1,334,768)

CASH FLOWS FROM NONCAPITAL FINANCING ACTIVITIES -

Support from private sources - National Heritage Academies, Inc.	1,281,231
Federal and state grants received	<u>90,819</u>
Net Cash Provided by Noncapital Financing Activities	1,372,050

NET INCREASE IN CASH 37,282

CASH JULY 1, 2003 -

CASH JUNE 30, 2004 \$37,282

**RECONCILIATION OF OPERATING LOSS TO NET CASH
USED FOR OPERATING ACTIVITIES:**

Operating Loss	(\$1,519,713)
Adjustments to reconcile operating loss to net cash used for operating activities:	
Changes in assets and liabilities -	
Due from governmental revenue sources	(275,584)
Due to National Heritage Academies, Inc.	<u>460,529</u>

NET CASH USED IN OPERATING ACTIVITIES (\$1,334,768)

See notes to the basic financial statements

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**PATHWAY SCHOOL OF DISCOVERY
MONTGOMERY COUNTY**

**NOTES TO FINANCIAL STATEMENTS
FOR THE YEAR ENDED JUNE 30, 2004**

1. NATURE OF OPERATIONS

Pathway School of Discovery (the "Academy") was incorporated on January 26, 2001, and began operations during the fiscal year ended June 30, 2004. The Academy is an Ohio Public School Academy which provides education based on rigorous teaching methods, parental involvement, student responsibility and basic moral values.

The Academy operates under an approved charter received from the Ohio State Board of Education ("Sponsor"), which is responsible for oversight of the Academy's operations. The Academy provides education, at no cost to the parent, to students in kindergarten through the fifth grade. Enrollment is open to all appropriately aged children without regard to gender, ethnic background, disability, and/or religious affiliation.

The Academy is exempt from taxation as a governmental entity pursuant to Internal Revenue Code Section 115. The Academy qualifies for public charity status by meeting the requirements of Internal Revenue Code Sections 509(1) and 170(b)(A)(ii).

The Academy was approved for operation under contract with the Ohio Department of Education as Sponsor through April 2, 2004. As of that date, the Lucas County Educational Service Center became the Sponsor. The contract is renewable by the Sponsor. The Academy operates under a Board of Directors (the "Board"). The Board is responsible for carrying out the provisions of the contract with the Sponsor which includes, but is not limited to, state-mandated provisions regarding student population, curriculum, academic goals, performance standards, admission standards, and qualifications of teachers.

The Academy's primary sources of revenue are provided by the State of Ohio and consist of amounts per student multiplied by weighted average student counts. The state revenue is recognized ratably over the school year and was funded through payments from July 2003 through June 2004.

The Board of the Academy has entered into a management agreement (the "agreement") with National Heritage Academies, Inc. ("NHA") which requires NHA to provide administration, strategic planning and all labor, materials, equipment, and supervision necessary for the provision of educational services to students. As part of the consideration received under the agreement, NHA also provides the facility in which the Academy operates. The agreement will automatically renew on a year-to-year basis, unless at least 90 days written notice of intent to terminate or renegotiate is given by either the Academy or NHA.

Under the terms of the agreement, NHA receives as remuneration for its services an amount equal to the total revenue received by the Academy from all revenue sources. NHA provides a spending account to the Board for discretionary expenditures on an annual basis. Revenues—private sources—NHA represent a contribution granted by NHA for the excess of Academy expenditures over public revenues available.

The Board of Pathway School of Discovery serves in the same capacity for North Dayton School of Discovery in Dayton, Ohio.

**PATHWAY SCHOOL OF DISCOVERY
MONTGOMERY COUNTY**

**NOTES TO FINANCIAL STATEMENTS
FOR THE YEAR ENDED JUNE 30, 2004
(Continued)**

2. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

The accounting policies of the Academy conform to accounting principles generally accepted in the United States of America applicable to governmental nonprofit organizations. The Governmental Accounting Standards Board ("GASB") is the accepted standard-setting body for establishing governmental accounting and financial reporting principles.

As permitted by generally accepted accounting principles, the Academy has elected to apply only applicable Financial Accounting Standards Board statements and interpretations issued before November 30, 1989.

Basis of Presentation—The Academy's basic financial statements consist of a statement of net assets, a statement of revenues, expenses and change in net assets and a statement of cash flows. The Academy uses enterprise accounting to maintain its financial records during the fiscal year.

Enterprise accounting focuses on the determination of operating income, changes in net assets, financial position, and cash flows. Enterprise accounting may be used to account for any activity for which a fee is charged to external users for goods or services.

Measurement Focus and Basis of Accounting—Enterprise accounting uses a flow of economic resources measurement focus. With this measurement focus, all assets and all liabilities are included on the statement of net assets. Operating statements present increases (i.e., revenues) and decreases (i.e., 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 measurement made.

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

Budget—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 Section 5705, unless specifically provided in the Academy's contract with its Sponsor. The contract between the Academy and its Sponsor requires a detailed school budget for each year of the contract; however, the budget does not have to follow the provisions of Ohio Revised Code Section 5705.

Estimates—The preparation of financial statements in conformity with accounting principles generally accepted in the United States of America requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities and disclosures of contingent assets and liabilities at the date of the financial statements and the reported amounts of revenues and expenses during the reporting period. Actual results could differ from those estimates.

Cash—Cash as of June 30, 2004 represents bank deposits, which are covered by federal depository insurance. Accordingly, there are no investments which are required to be categorized according to risk.

**PATHWAY SCHOOL OF DISCOVERY
MONTGOMERY COUNTY**

**NOTES TO FINANCIAL STATEMENTS
FOR THE YEAR ENDED JUNE 30, 2004
(Continued)**

2. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (Continued)

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

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

Eligibility requirements include timing requirements, which specify the year when resources are required to be used or the fiscal year when use is 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 various federal and state programs through the Ohio Department of Education. The programs the Academy participated in during the fiscal year 2004, of which there were still receivables at June 30, 2004; include Title I and Title II, and the Charter School Grant. Revenue to be received from these programs is recognized as non-operating revenue in the accompanying financial statements.

Net Assets – Net assets represent the difference between assets and liabilities. Net assets are reported as restricted when there are limitations imposed on their use either through constitutional provisions or enabling legislation adopted or through external restrictions imposed by creditors, grantors, or laws or regulations of other governments. At fiscal year end, the Academy had no restricted assets.

Due to National Heritage Academies, Inc.—This amount consists of revenues recognized at year-end by the Academy and expenses incurred by National Heritage Academies, Inc. for management services rendered during fiscal year 2004.

3. RECEIVABLES

Receivables (Due from Other Governments) at June 30, 2004 consisted of intergovernmental receivables arising from grants and entitlements. All receivables are considered collectable within one year.

4. DEFINED BENEFIT PENSION PLANS

School Employees Retirement System—NHA, on behalf of employees at the Academy, contributes to the School Employees Retirement System (“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 plan members and beneficiaries. Authority to establish and amend benefits is provided by Chapter 3309 of the Ohio Revised Code. SERS issues a publicly available, stand-alone financial report that includes financial statements and required supplementary information. That report may be obtained by writing to the School Employees Retirement System, 300 East Broad Street, Suite 100, Columbus, Ohio 43215-3476.

**PATHWAY SCHOOL OF DISCOVERY
MONTGOMERY COUNTY**

**NOTES TO FINANCIAL STATEMENTS
FOR THE YEAR ENDED JUNE 30, 2004
(Continued)**

4. DEFINED BENEFIT PENSION PLANS (Continued)

Plan members are required to contribute 10 percent of their annual covered salary and NHA is required to contribute at an actuarially determined rate of 14 percent for 2004, 9.09 percent was the portion 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. NHA's required contribution for pension obligations to SERS for the fiscal year ended June 30, 2004, was \$21,010, of which 100 percent was contributed for fiscal 2004.

State Teachers Retirement System—NHA, on behalf of employees at 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 and death and survivor benefits to beneficiaries. Authority to establish and amend benefits is provided by Chapter 3307 of the Ohio Revised Code.

STRS Ohio issues a stand-alone financial report that may be obtained by writing to STRS Ohio, 275 East Broad St., Columbus, Ohio 43215-3371 or by calling (614) 227-4090.

New members have a choice of three retirement plans, a Defined Benefit ("DB") Plan, a Defined Contribution ("DC") Plan and a Combined Plan. The DB Plan offers an annual retirement allowance based on final average salary times a percentage that varies based on years of service, or an allowance based on member 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, 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 DB 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 balance from the existing DBP into the DCP or CP. This option expired on December 31, 2001.

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

Plan members are required to contribute 10 percent of their annual covered salaries. NHA was required to contribute 14 percent; 13 percent was the portion used to fund pension obligations. Contribution rates are established by the State Teachers Retirement Board, upon recommendations 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 statutory authority for member and employer contributions. NHA's required contribution for pension obligations for the fiscal year ended June 30, 2004, was \$78,275, of which 100 percent was contributed for fiscal 2004.

**PATHWAY SCHOOL OF DISCOVERY
MONTGOMERY COUNTY**

**NOTES TO FINANCIAL STATEMENTS
FOR THE YEAR ENDED JUNE 30, 2004
(Continued)**

5. POST-EMPLOYMENT BENEFITS

NHA, on behalf of employees at the Academy, provides comprehensive health care benefits to retired teachers and their dependents through the State Teachers Retirement System (STRS), and to retired classified 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 obligation 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.

The State Teachers Retirement Board has statutory authority over how much, if any, of the health care costs will be absorbed by STRS. Most benefit recipients pay a portion of the health care cost in the form of a monthly premium. By law, the cost of coverage paid from STRS funds shall be included in the employer contribution rate, currently 14 percent of covered payroll. For fiscal year 2004, the Board allocated employer contributions equal to 1 percent of covered payroll to the Health Care Reserve Fund. For the Academy, this amount was \$6,022.

STRS pays health care benefits from the Health Care Reserve Fund. The balance in the Fund was \$3.1 billion at June 30, 2004. For the fiscal year ended June 30, 2004, net health care costs paid by STRS were \$268,739,000, and STRS had 111,853 eligible benefit recipients.

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

For the fiscal year ended June 30, 2004, employer contributions to fund health care benefits were 4.91 percent of covered payroll. In addition, SERS levies a surcharge to fund health care benefits equal to 14 percent of the difference between a minimum pay and the member's pay, pro-rated for partial service credit. For fiscal year 2004, the minimum pay was established at \$24,500. For the NHA, the amount to fund health care benefits, including the surcharge, was \$14,715 for fiscal year 2004.

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, 2004, were \$223,443,805, and the target level was \$335.2 million. At June 30, 2004, SERS had net assets available for payment of health care benefits of \$300.8 million. SERS has approximately 62,000 participants currently receiving health care benefits.

6. RISK MANAGEMENT

The Academy is exposed to various risks of loss related to general liability. Commercial insurance policies to cover certain risks of loss have been obtained through Indiana Insurance Company. General liability coverage provides \$1,000,000 per occurrence and \$2,000,000 in the aggregate with no deductible. The Indiana Insurance Company also provides umbrella liability coverage of \$1,000,000 per occurrence, as well as, in the aggregate.

**PATHWAY SCHOOL OF DISCOVERY
MONTGOMERY COUNTY**

**NOTES TO FINANCIAL STATEMENTS
FOR THE YEAR ENDED JUNE 30, 2004
(Continued)**

7. CONTRACTED SERVICE FEE

NHA has informed the Academy that the contracted service fee includes payment for the following:

Instruction:	
Basic instruction	\$1,100,691
Added needs	48,877
Special education	109,845
Support services:	
Pupil services	26,636
Instructional staff	107,423
Board of education	21,678
Executive administration	264,430
Office of the Principal	200,984
Business support services	41,776
Operations and maintenance	1,087,225
Central services	124,326
Food services	99,775
Unexpended Resources	82,498
Total contracted service fee	<u>\$3,316,164</u>

8. RELATED PARTIES

The Board of Pathway School of Discovery services in the same capacity for North Dayton School of Discovery in Dayton, Ohio. National Heritage Academies, Inc. is also North Dayton School of Discovery's management company.

9. CONTINGENCIES

Grants—Amounts received from grantor agencies are subject to audit and adjustment by the grantor. Any disallowed costs may require refunding to the grantor. Amounts, which may be disallowed, if any, are not presently determinable. However, in the opinion of the Academy, any such disallowed claims will not have a material adverse effect on the financial position of the Academy.

State Funding—The Ohio Department of Education conducts reviews of enrollment data and FTE calculations made by the schools. These reviews are conducted to ensure the schools are reporting accurate student enrollment data to the State, upon which state foundation funding is calculated. The results of this review could result in the State funding being adjusted. The Academy does not anticipate any material adjustments to State funding for fiscal year 2004, as a result of such a review.

Litigation—A suit was filed in Franklin County Common Pleas Court on May 14, 2001 alleging 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 the case was set for oral argument on November 18, 2003. On August 24, 2004, the Court of Appeals rendered a decision that Community Schools are part of the state public educational system and this matter was sent to the Ohio Supreme Court. The effect of this suit, if any on the Academy is not presently determinable.

**PATHWAY SCHOOL OF DISCOVERY
MONTGOMERY COUNTY**

**NOTES TO FINANCIAL STATEMENTS
FOR THE YEAR ENDED JUNE 30, 2004
(Continued)**

10. STATE SCHOOL FUNDING DECISION

In 2002, the Ohio State Supreme Court (the "Court") reaffirmed earlier decisions that Ohio's current school funding plan is unconstitutional. The Court has also directed the State to develop a new system of school funding. In 2003, the Ohio State Supreme Court and the U.S. Court of Appeals have declined to further consider the case. The Academy is currently unable to determine what effect, if any, this decision will have on its future State funding and its financial operations.

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Auditor of State Betty Montgomery

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

Pathway School of Discovery
Montgomery County
173 Avondale Drive
Dayton, Ohio 45404

To the Board of Directors:

We have audited the financial statements of Pathway School of Discovery, Montgomery County, (the Academy), as of and for the year ended June 30, 2004, and have issued our report thereon dated June 16, 2005. 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 the Comptroller General of the United States' *Government Auditing Standards*. Other auditors audited the contracted service expense activity of the Academy, in accordance with auditing standards generally accepted in the United States of America and not in accordance with *Government Auditing Standards*, and accordingly, this report does not extend to those expenses.

Internal Control Over Financial Reporting

In planning and performing our audit, we considered the Academy's internal control over financial reporting to determine our auditing procedures in order to express our opinion on the financial statements and not to opine on the internal control over financial reporting. Our consideration of the internal control would not necessarily disclose all matters in the internal control over financial reporting that might be material weaknesses. 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 material to the financial statements we audited may occur and not be timely detected by employees when performing their assigned functions. We noted no matters involving the internal control over financial reporting and its operation that we consider material weaknesses. In a separate letter to the Academy's management dated June 16, 2005, we reported matters involving internal control over financial reporting we did not deem reportable conditions.

Compliance and Other Matters

As part of reasonably assuring whether the Academy's financial statements are free of material misstatement, we tested its compliance with certain provisions of laws, regulations, contracts, and grant agreements, noncompliance with which could directly and materially affect the determination of financial statement amounts. However, providing an opinion on compliance with those provisions was not an objective of our audit and, accordingly, we do not express an opinion. The results of our tests disclosed no instances of noncompliance or other matters we must report under *Government Auditing Standards*. In a separate letter to the Academy's management dated June 16, 2005, we reported other matters related to noncompliance we deemed immaterial.

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www.auditor.state.oh.us

We intend this report solely for the information and use of the management and Board of Directors. It is not intended for anyone other than these specified parties.

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

Betty Montgomery
Auditor of State

June 16, 2005



**Auditor of State
Betty Montgomery**

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800-282-0370
Facsimile 614-466-4490

**PATHWAY SCHOOL OF DISCOVERY
MONTGOMERY COUNTY**

CLERK'S CERTIFICATION

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

Susan Babbitt

CLERK OF THE BUREAU

**CERTIFIED
AUGUST 4, 2005**