



**KEYSTONE LOCAL SCHOOL DISTRICT
LORAIN COUNTY**

SINGLE AUDIT

FOR THE YEAR ENDED JUNE 30, 2005



**Auditor of State
Betty Montgomery**

**KEYSTONE LOCAL SCHOOL DISTRICT
LORAIN COUNTY**

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Auditor of State Betty Montgomery

INDEPENDENT ACCOUNTANTS' REPORT

Board of Education
Keystone Local School District
Lorain County
301 Liberty Street, P.O. Box 65
LaGrange, Ohio 44050

We have audited the accompanying financial statements of the governmental activities, each major fund, and the aggregate remaining fund information of Keystone Local School District, Lorain County, Ohio, (the District) as of and for the year ended June 30, 2005, which collectively comprise the District's basic financial statements as listed in the table of contents. These financial statements are the responsibility of the District'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 the Comptroller General of the United States' *Government Auditing Standards*. Those standards require that we plan and perform the audit to reasonably assure 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 our audit provides a reasonable basis for our opinions.

In our opinion, the financial statements referred to above present fairly, in all material respects, the respective financial position of the governmental activities, each major fund, and the aggregate remaining fund information of the Keystone Local School District, Lorain County, Ohio, as of June 30, 2005, and the respective changes in financial position and where applicable, cash flows, thereof and the respective budgetary comparison for the General Fund 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 dated March 10, 2006, on our consideration of the District'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.

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.

We conducted our audit to opine on the financial statements that collectively comprise the District's basic financial statements. The federal awards receipts and expenditures schedule is required by U.S. Office of Management and Budget Circular A-133, *Audits of States, Local Governments, and Non-Profit Organizations*, and is also not a required part of the basic financial statements. We subjected the federal awards receipts and expenditures schedule to the auditing procedures applied in the audit of the basic financial statements. In our opinion, this information is fairly stated in all material respects in relation to the basic financial statements taken as a whole.

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

Betty Montgomery
Auditor of State

March 10, 2006

Keystone Local School District
Lorain County

Management's Discussion and Analysis
For the Year Ended June 30, 2005

Unaudited

The discussion and analysis of Keystone Local School District's financial performance provides an overall review of the School District's financial activities for the fiscal year ended June 30, 2005. The intent of this discussion and analysis is to look at the School District's financial performance as a whole. Readers should also review the financial statements and notes to those respective statements to enhance their understanding of the School District's financial performance.

Financial Highlights

Key Financial Highlights for 2005 are as follows:

- In total, net assets increased by \$1,033,201
- Revenues for governmental activities totaled \$15,793,820 in 2005. Of this total, 90.55% consisted of General Revenues while Program Revenues accounted for the balance of 9.45%
- Program expenses totaled \$14,760,619. Instructional expenses made up 54.28% of this total while support services accounted for 35.22%. Other expenses rounded out the remaining 10.50 %

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Using this Annual Financial Report

This annual report consists of a series of financial statements and notes pertaining to those statements. These statements are organized so the reader can understand Keystone Local School District as a financial whole, or complete operating entity. The statements then proceed to provide an increasingly detailed look at specific financial activities.

The Statement of Net Assets and Statement of Activities provide information about the activities of the whole School District, presenting both an aggregate and longer-term view of those finances. Fund financial statements provide the next level of detail. For governmental funds, these statements explain how services were financed in the short-term as well as what remains for future spending. The fund financial statements also look at the School District's most significant funds with all other non-major funds presented in total in one column. In the case of Keystone Local School District, the General Fund by far is the most significant fund.

Reporting the School District as a Whole

Statement of Net Assets and the Statement of Activities

While this document contains all the funds used by the School District to provide programs and activities, the view of the School District as a whole considers all financial transactions and asks the question, "How did we do financially during 2005?" The *Statement of Net Assets* and the *Statement of Activities* answers this question. These statements include all assets and liabilities using the accrual basis of accounting, similar to the accounting used by most private-sector companies. Accrual accounting takes into account all of the current year's revenues and expenses regardless of when cash is received or paid.

Keystone Local School District
Lorain County

Management's Discussion and Analysis
For the Year Ended June 30, 2005

Unaudited

These two statements report the School District's net assets and changes in those assets. This change in net assets is important because it tells the reader that, for the District as a whole, the financial position of the School District has improved or diminished. The causes of this change may be the result of many factors, some financial, some not. Non-financial factors include the School District's performance, demographic and socioeconomic factors and willingness of the community to support the School District. On the other hand, financial factors may include the School District's financial position, liquidity and solvency, fiscal capacity and risk and exposure.

In the Statement of Net Assets and the Statement of Activities, the School District is classified into governmental activities. All of the School District's programs and services are reported here including instruction, support services, operation and maintenance of plant, pupil transportation, operation of food service and extracurricular activities.

Reporting the School District's Most Significant Funds

Fund Financial Statements

The analysis of the School District's major funds begins on page 15. Fund financial statements provide detailed information about the School District's major funds. The School District uses many funds to account for a multitude of financial transactions. However, these fund financial statements focus on the School District's most significant funds. The School District's major governmental funds are the General Fund, Debt Service Fund and Building Fund.

Governmental Funds

All of the School District's activities are reported as governmental funds, which focus on how money flows into and out of those funds and the balances left at year-end that are available for spending in future periods. These funds are reported using an accounting method called *modified accrual accounting*, which measures cash and all other financial assets that can readily be converted to cash. The governmental fund statements provide a detailed short-term view of the School District's general government operations and the basic services it provides. Governmental fund information helps you determine whether there are more or fewer financial resources that can be spent in the near future to finance educational programs. The relationship (or differences) between governmental activities (reported in the Statement of Net Assets and the Statement of Activities) and governmental funds is reconciled in the financial statements.

Keystone Local School District
Lorain County

Management's Discussion and Analysis
For the Year Ended June 30, 2005

Unaudited

The School District as a Whole

You may recall that the *Statement of Net Assets* provides the perspective of the School District as a whole. Table 1 provides a summary of the School District's net assets for 2005 compared to 2004.

Table 1
STATEMENT OF NET ASSETS

	6/30/2005	6/30/2004	Change
Assets			
Equity in pooled cash	\$ 16,285,847	\$ 39,293,545	\$(23,007,698)
Cash with fiscal agent	857,172	668,220	188,952
Accrued interest	62,296	52,613	9,683
Due from other governments	46,618	46,561	57
Inventories and supplies	3,974	6,977	(3,003)
Prepays	6,298	3,982	2,316
Taxes receivable	6,834,842	6,572,931	261,911
Capital assets			
Nondepreciable capital assets	8,193,834	1,403,293	6,790,541
Depreciable capital assets, net	4,194,277	4,285,217	(90,940)
Total assets	36,485,158	52,333,339	(15,848,181)
Liabilities			
Accounts and contracts payable	1,198,481	279,510	918,971
Retainage payable	388,402	-	388,402
Accrued salaries, wages and benefits	1,152,329	1,098,769	53,560
Accrued interest payable	63,777	245,128	(181,351)
Claims payable	327,744	280,602	47,142
Due to other governments	353,441	305,934	47,507
Unearned revenue	5,455,679	5,834,556	(378,877)
Matured bond and interest payable	5,000	5,000	-
Notes payable	-	17,500,000	(17,500,000)
Long term liabilities			
Due within one year	562,422	455,392	107,030
Due in more than one year	17,744,946	18,128,712	(383,766)
Total liabilities	27,252,221	44,133,603	(16,881,382)
Net assets			
Invested in capital assets, net of related debt	6,916,902	5,688,510	1,228,392
Restricted	1,915,127	2,054,608	(139,481)
Unrestricted	400,908	456,618	(55,710)
Total net assets	\$ 9,232,937	\$ 8,199,736	\$ 1,033,201

Keystone Local School District
Lorain County

Management's Discussion and Analysis
For the Year Ended June 30, 2005

Unaudited

Table 2 shows the statement of activities for fiscal year 2005 as compared to 2004.

Table 2
STATEMENT OF ACTIVITIES

	2005 Amount	% of Total	2004 Amount	% of Total
General revenues				
Property taxes levied for:				
General purpose	\$ 5,141,885	32.56%	\$ 4,306,050	31.41%
Debt service	1,241,464	7.86%	730,494	5.33%
Capital improvements	246,558	1.56%	214,036	1.56%
Grants and entitlements not restricted to specific purposes	7,479,210	47.36%	7,162,776	52.25%
Investment earnings	72,983	0.45%	69,031	0.50%
Miscellaneous	119,551	0.76%	68,816	0.50%
Total general revenues	<u>14,301,651</u>	<u>90.55%</u>	<u>12,551,203</u>	<u>91.55%</u>
Program revenues	1,492,169	9.45%	1,158,752	8.45%
Total revenues	<u>15,793,820</u>	<u>100.00%</u>	<u>13,709,955</u>	<u>100.00%</u>
Governmental activities				
Instruction				
Regular	6,672,376	45.20%	6,660,466	48.39%
Special	1,149,365	7.79%	984,184	7.15%
Vocational	191,049	1.29%	187,970	1.37%
Supporting services				
Pupil	1,003,630	6.80%	1,035,370	7.52%
Instructional staff	500,452	3.39%	404,004	2.94%
Board of education	38,728	0.26%	27,473	0.20%
Administration	1,210,985	8.20%	1,194,766	8.68%
Fiscal services	353,995	2.40%	357,675	2.60%
Operation and maintenance	1,117,247	7.57%	1,100,974	8.00%
Pupil transportation	813,566	5.51%	809,574	5.88%
Central services	160,288	1.09%	158,698	1.15%
Operation of non-instructional				
Food service operation	442,368	3.00%	436,982	3.17%
Community services	72,164	0.49%	-	0.00%
Latchkey operations	46,376	0.32%	41,780	0.30%
Extracurricular activities	379,314	2.57%	364,404	2.65%
Interest	608,716	4.12%	-	0.00%
Totals	<u>14,760,619</u>	<u>100.00%</u>	<u>13,764,320</u>	<u>100.00%</u>
Change in net assets	<u>\$ 1,033,201</u>		<u>\$ (54,365)</u>	

Keystone Local School District
Lorain County

Management's Discussion and Analysis
For the Year Ended June 30, 2005

Unaudited

Governmental Activities

The School District has carefully looked at its financial existence by forecasting its revenues and expenditures over the next five years. The School District has had a healthy cash carryover for the last couple of years. However, fiscal year 2005 was the third consecutive year with deficit spending. It is anticipated that fiscal year 2006 will have deficit spending. We have made over \$500,000 in cuts between fiscal year 2005 and fiscal year 2006 to decrease the amount of our deficit spending.

Although the District relies heavily upon local property taxes to support its operations, the District does actively solicit and receive additional grant and entitlement funds to help offset some operating costs.

As you can see in Table 2, 54.28% of the District's budget is used to fund instructional expenses. Additional supporting services for pupils, staff and business operations encompass an additional 35.22%. The remaining amount of program expenses, roughly 10.50%, is budgeted to facilitate other obligations of the District such as interest and fiscal charges, the food service program and numerous extracurricular activities.

The Statement of Activities shows the total net cost of program services. Table 3 shows the total cost of services for governmental activities and the net cost of those services. That is, it identifies the cost of these services supported by tax revenue and unrestricted state entitlements.

Keystone Local School District
Lorain County

Management's Discussion and Analysis
For the Year Ended June 30, 2005

Unaudited

	Total Cost of Services	Net Cost of Services
Governmental activities		
Instruction		
Regular	\$ 6,672,376	\$ (6,439,262)
Special	1,149,365	(943,985)
Vocational	191,049	(191,049)
Supporting services		
Pupil	1,003,630	(810,964)
Instructional staff	500,452	(342,229)
Board of education	38,728	(38,728)
Administration	1,210,985	(1,191,037)
Fiscal services	353,995	(352,947)
Operation and maintenance	1,117,247	(1,062,222)
Pupil transportation	813,566	(781,209)
Central services	160,288	(156,918)
Operation of non-instructional		
Food service operation	442,368	(18,291)
Community services	72,164	12,878
Latchkey operations	46,376	(46,376)
Extracurricular activities	379,314	(297,395)
Debt service		
Interest	608,716	(608,716)
Totals	\$ 14,760,619	\$(13,268,450)

As one can see, the reliance upon local tax revenues for governmental activities is important. Almost 44.92% of expenses are directly supported by local property taxes. Grants and entitlements not restricted to specific programs support approximately 50.67%, while investment and other miscellaneous type revenues support the remaining activity costs. Program revenues only account for approximately 10.11% of all governmental expenses.

School District's Funds

Information regarding the School District's major funds can be found on page 15. Governmental Funds are accounted for using the modified accrual basis of accounting. All governmental funds had total revenues of \$16,136,252 and expenditures of \$ 22,163,152.

Keystone Local School District
Lorain County

Management's Discussion and Analysis
For the Year Ended June 30, 2005

Unaudited

General Fund Budgeting Highlights

The School District's budget is prepared according to Ohio law and is based on accounting for certain transactions on a basis of cash receipts, disbursements and encumbrances. The most significant fund to be budgeted is the main operating fund of the School District, the General Fund.

During the course of fiscal 2005, the School District amended its General Fund budget numerous times. The School District uses a site-based style of budgeting and has in place systems that are designed to tightly control expenses yet provide flexibility for site-based decision and management.

For the General Fund, the final budget basis revenue estimated totaled \$11,344,514. This was above the original budget estimate of \$11,329,514. The main difference between the original and final estimates was due to an increase in grants. Since the funds were not needed to appropriate, the budget basis expense estimate totaled \$13,347,152 compared to the original estimate of \$13,308,052. This difference was primarily due to changes in staffing costs throughout the year.

The School District's unencumbered ending cash balance totaled \$2,655,288, which was above the original budgeted amount.

Keystone Local School District
Lorain County

Management's Discussion and Analysis
For the Year Ended June 30, 2005

Unaudited

Capital Assets and Debt Administration

Capital Assets

At the end of fiscal 2005, the School District had \$12,388,111 invested in land, buildings, equipment, and vehicles. Table 4 shows fiscal 2005 values compared to 2004.

Table 4
Net Capital Assets at June 30
Governmental Activities

	2005	2004
Land	\$ 521,816	\$ 521,816
Construction in progress	7,672,018	881,477
Land improvements	241,420	244,908
Buildings and improvements	3,405,751	3,441,144
Furniture and equipment	186,627	183,305
Vehicles	360,479	415,860
	<u>\$ 12,388,111</u>	<u>\$ 5,688,510</u>

All capital assets, except land and construction in progress, are reported net of depreciation. As one can see, the increases in our capital assets during the fiscal year occurred in Construction in progress, due to the new high school construction project. For additional capital asset information, see Note 9 of the Notes to the Basic Financial Statements.

Debt

The School District passed a \$17.5 million bond issue on November 4, 2003. That bond issue will cover the construction of a new high school. The bonds were issued in May 2004 with the first interest and principal payment due December 1, 2004. Our general obligation outstanding debt at June 30, 2005 is \$17,215,000. For additional debt information, see Notes 14 and 15 of the Notes to the Basic Financial Statements.

School District Outlook

Keystone Local School District has a good financial outlook for fiscal year 2006 and a fair outlook for fiscal year 2007. The Board of Education and Administration closely monitor its revenues and expenditures in accordance with its financial forecast and the School District's Continuous Improvement Plan. The School District received an Effective Rating on the 2004-2005 Report Card.

The financial future of the School District beyond fiscal year 2006 is not without its challenges. These challenges are internal and external in nature. The internal challenges will continue to exist as the School District must rely on local property taxes to fund its operations. External challenges continue to evolve as the State of Ohio determines the amount of funding they will allocate to education through each of their biennium budgets.

Keystone Local School District
Lorain County

Management's Discussion and Analysis
For the Year Ended June 30, 2005

Unaudited

The School District receives approximately 42% of its revenue from local property taxes. The community support for the schools is good, but we have to be cautious since we usually have to go back several times before operating levies are passed. Since our 8-mill levy expired in 2002, we have dropped to the 20-mill floor for the Residential/Agricultural values. We also have two 1-mill continuing permanent improvement levies plus the 5.61 mill bond issue. The School District has communicated to the community that while we are grateful for their support of the \$17.5 million bond issue passed in November 2003, we will be needing additional operating funds and will be back on the ballot in 2005. We had a \$1.7 million 5-year emergency levy on the November 8, 2005 ballot which failed. We are now analyzing how to proceed.

Externally, the State of Ohio was found by the Ohio Supreme Court in March 1997 to be operating an unconstitutional educational funding system, one that was neither "adequate" nor "equitable". In May of 2000, the Ohio Supreme Court again, ruled that, while the State had made some progress, the current funding system for schools is far too dependent on property taxes, which are inherently not "equitable" nor "adequate". The court directed the Governor and the legislature to address the fundamental issue creating the inequities. In September 2001, the Ohio Supreme Court issued another opinion regarding the funding system. The decision identified aspects of the current plan that require modification. In December 2002, the Court ruled again that the funding system is unconstitutional, but removed itself from the picture. The current biennium budget began July 1, 2005. It has not been good to schools. It did address some of the issues brought about by the DeRolf Lawsuit so it will be very difficult to file suit against the State again on some issues by playing a "shell game" with their available funds. The budget created "Building Blocks" which is broken into Basic Aid (base classroom teachers, other personnel and non-personnel support), Basic Aid Supplements (student intervention, professional development for all students, data based decision making and professional development for data-based decision making) and Poverty-Based Assistance, which we don't qualify for.

The budget has also phased out the personal tangible property taxes faster than originally planned. The tax base decreases by $\frac{1}{4}$ beginning with the tax year 2006 until it is completely phased out in 2009. School districts have been told they will be "held harmless" via reimbursements through 2010. In 2011 and 2012, we would lose $\frac{3}{17}$ of the reimbursement. It would continue to decrease until the reimbursement is gone in 2018. There are other affecting factors such as the inventory assessment rate, which will make the losses start before 2010. On the upside of this, Keystone only received 2.6% of its revenue from personal property taxes in fiscal year 2005, or \$322,000.

As a result of the challenges mentioned above, it is imperative that the School District's management continue to carefully and prudently plan in order to provide the resources required to meet student needs over the next several years.

In summary, the Keystone Local School District has committed itself to financial and educational excellence for many years to come.

Keystone Local School District
Lorain County

Management's Discussion and Analysis
For the Year Ended June 30, 2005

Unaudited

Contacting the School District's Financial Management

This financial report is designed to provide our citizens, taxpayers and investors and creditors with a general overview of the School District's finances and to show the School District's accountability for the money it receives. If you have any questions about this report or need additional financial information, contact Bev Fry, Treasurer/CFO, at Keystone Local School District, 301 Liberty Street, P. O. Box 65, LaGrange, Ohio 44050, or e-mail at keystn_bf@leeca.org.

KEYSTONE LOCAL SCHOOL DISTRICT
LORAIN COUNTY

STATEMENT OF NET ASSETS

JUNE 30, 2005

Assets	
Equity in pooled cash	\$ 16,285,847
Cash with fiscal agent	857,172
Accrued interest	62,296
Due from other governments	46,618
Inventories and supplies	3,974
Prepays	6,298
Taxes receivable	6,834,842
Capital assets	
Nondepreciable capital assets	8,193,834
Depreciable capital assets, net	4,194,277
Total assets	36,485,158
Liabilities	
Accounts and contracts payable	1,198,481
Retainage payable	388,402
Accrued salaries, wages and benefits	1,152,329
Accrued interest payable	63,777
Claims payable	327,744
Due to other governments	353,441
Unearned revenue	5,455,679
Matured bond and interest payable	5,000
Long term liabilities	
Due within one year	562,422
Due in more than one year	17,744,946
Total liabilities	27,252,221
Net assets	
Invested in capital assets, net of related debt	6,916,902
Restricted for:	
Debt service	1,036,660
Capital projects	771,629
School supplies	37,169
Extracurricular	9,507
State grants	33,306
Federal grants	22,664
Other purposes	4,192
Unrestricted	400,908
Total net assets	\$ 9,232,937

See accompanying notes to the Basic Financial Statements.

KEYSTONE LOCAL SCHOOL DISTRICT
LORAIN COUNTY
STATEMENT OF ACTIVITIES
FOR THE YEAR ENDED JUNE 30, 2005

	Expenses	Program Revenues			Net (Expense) Revenue and Changes in Net Assets
		Charges for Services and Sales	Operating Grants Interest and Contributions	Capital Grants and Contributions	
Governmental activities					
Instruction					
Regular	\$ 6,672,376	\$ 68,955	\$ 148,934	\$ 15,225	\$ (6,439,262)
Special	1,149,365	-	205,380	-	(943,985)
Vocational	191,049	-	-	-	(191,049)
Supporting services					
Pupil	1,003,630	58,623	134,043	-	(810,964)
Instructional staff	500,452	-	158,223	-	(342,229)
Board of education	38,728	-	-	-	(38,728)
Administration	1,210,985	-	19,948	-	(1,191,037)
Fiscal services	353,995	-	1,048	-	(352,947)
Operation and maintenance	1,117,247	41,144	13,881	-	(1,062,222)
Pupil transportation	813,566	-	32,357	-	(781,209)
Central services	160,288	-	3,370	-	(156,918)
Operation of non-instructional					
Food service operation	442,368	322,058	102,019	-	(18,291)
Community services	72,164	-	85,042	-	12,878
Latchkey operations	46,376	-	-	-	(46,376)
Extracurricular activities	379,314	81,919	-	-	(297,395)
Interest	608,716	-	-	-	(608,716)
Totals	<u>\$ 14,760,619</u>	<u>\$ 572,699</u>	<u>\$ 904,245</u>	<u>\$ 15,225</u>	<u>\$ (13,268,450)</u>

General revenues	
Property taxes levied for:	
General purpose	5,141,885
Debt service	1,241,464
Capital improvements	246,558
Grants and entitlements not restricted to specific purposes	7,479,210
Investment earnings	72,983
Miscellaneous	119,551
Total general revenues	<u>14,301,651</u>

Change in net assets	1,033,201
Net assets at beginning of year	8,199,736
Net assets at end of year	<u>\$ 9,232,937</u>

See accompanying notes to the Basic Financial Statements.

KEYSTONE LOCAL SCHOOL DISTRICT
LORAIN COUNTY

BALANCE SHEET -
GOVERNMENTAL FUNDS

JUNE 30, 2005

	General	Debt Service	Building Fund	Other Governmental Funds	Total Governmental Funds
Assets					
Equity in pooled cash	\$ 2,759,696	\$ 861,104	\$ 11,743,791	\$ 921,256	\$ 16,285,847
Restricted cash	-	5,000	-	-	5,000
Receivables, net of allowance					
Taxes, current	5,165,018	1,306,777	-	247,172	6,718,967
Taxes, delinquent	88,875	22,749	-	4,251	115,875
Accrued interest	2,289	-	60,007	-	62,296
Due from other governments	-	-	-	46,618	46,618
Interfund receivable	7,355	-	-	-	7,355
Prepaid expenses	6,298	-	-	-	6,298
Inventories and supplies	-	-	-	3,974	3,974
Total assets	\$ 8,029,531	\$ 2,195,630	\$ 11,803,798	\$ 1,223,271	\$ 23,252,230
Liabilities and fund balances					
Liabilities					
Accounts and contracts payable	\$ 7,026	\$ -	\$ 1,161,177	\$ 30,278	\$ 1,198,481
Retainage payable	-	-	388,402	-	388,402
Accrued wages and benefits	1,083,745	-	-	68,584	1,152,329
Due to other governments	223,524	-	128	5,530	229,182
Interfund payable	-	-	-	7,355	7,355
Unearned revenue	4,253,274	1,112,942	-	205,338	5,571,554
Compensated absences	46,049	-	-	2,575	48,624
Matured bond and interest payable	-	5,000	-	-	5,000
Total liabilities	5,613,618	1,117,942	1,549,707	319,660	8,600,927
Fund balances					
Reserved for prepaids	6,298	-	-	-	6,298
Reserved for property taxes	1,000,619	216,584	-	47,408	1,264,611
Reserved for encumbrances	87,200	-	9,784,911	148,254	10,020,365
Unreserved, reported in					
General Fund	1,321,796	-	-	-	1,321,796
Special Revenue Funds	-	-	-	98,407	98,407
Debt Service Fund	-	861,104	-	-	861,104
Capital Projects Funds	-	-	469,180	609,542	1,078,722
Total fund balances	2,415,913	1,077,688	10,254,091	903,611	14,651,303
Total liabilities and fund balances	\$ 8,029,531	\$ 2,195,630	\$ 11,803,798	\$ 1,223,271	\$ 23,252,230

See accompanying notes to the Basic Financial Statements.

KEYSTONE LOCAL SCHOOL DISTRICT
LORAIN COUNTY
RECONCILIATION OF TOTAL GOVERNMENTAL FUND BALANCES TO
NET ASSETS OF GOVERNMENTAL ACTIVITIES
JUNE 30, 2005

Total governmental funds balances	\$ 14,651,303
Amount reported for governmental activities in the statement of net assets are different because:	
Capital assets used in governmental activities are not financial resources and therefore not reported in the funds.	12,388,111
Other long term assets are not available to pay for current period expenditures and therefore are deferred in the funds. These deferrals are attributed to delinquent property taxes.	115,875
An internal service fund is used by management to charge the costs of insurance to individual funds. The assets and liabilities of the internal service fund are included in governmental activities in the statement of net assets.	524,428
Due to other governments includes contractually required pension contributions not expected to be paid with expendable available financial resources and therefore not reported in the funds.	(124,259)
Long term liabilities are not due and payable in the current period and therefore are not reported in the funds:	
Compensated absences	(1,043,744)
Bonds	(17,215,000)
Accrued interest payable	(63,777)
	9,232,937
Net assets of governmental activities	\$ 9,232,937

See accompanying notes to the Basic Financial Statements.

KEYSTONE LOCAL SCHOOL DISTRICT
LORAIN COUNTY

STATEMENT OF REVENUES, EXPENDITURES AND CHANGES IN
FUND BALANCES - GOVERNMENTAL FUNDS

FOR THE YEAR ENDED JUNE 30, 2005

	General	Debt Service	Building Fund	Other Governmental Funds	Total Governmental Funds
Revenues					
Taxes	\$ 5,137,007	\$ 1,238,510	\$ -	\$ 246,359	\$ 6,621,876
Tuition and fees	109,599	-	-	-	109,599
Interest	110,776	10,754	311,978	513	434,021
Intergovernmental	7,275,630	147,639	-	975,411	8,398,680
Charges for services	-	-	-	316,175	316,175
Extracurricular	4,595	-	-	100,654	105,249
Other	95,366	-	9,015	46,271	150,652
Total revenues	12,732,973	1,396,903	320,993	1,685,383	16,136,252
Expenditures					
Current					
Instruction					
Regular	6,519,132	-	-	160,662	6,679,794
Special	921,767	-	-	205,381	1,127,148
Vocational	189,986	-	-	-	189,986
Supporting services					
Pupil	810,844	-	-	184,977	995,821
Instructional staff	261,087	-	-	157,041	418,128
Board of education	38,728	-	-	-	38,728
Administration	1,201,757	-	-	19,867	1,221,624
Fiscal services	319,315	19,024	6,365	4,841	349,545
Operation and maintenance	1,036,028	-	-	68,642	1,104,670
Pupil transportation	732,194	-	-	32,358	764,552
Central services	156,474	-	-	3,639	160,113
Operation of non-instructional					
Food service operation	-	-	-	445,941	445,941
Community services	-	-	-	72,164	72,164
Latchkey operations	46,496	-	-	-	46,496
Extracurricular activities	283,457	-	-	92,254	375,711
Capital outlay	-	-	6,902,771	115,542	7,018,313
Debt service					
Principal	-	285,000	-	-	285,000
Interest	-	832,427	36,991	-	869,418
Total expenditures	12,517,265	1,136,451	6,946,127	1,563,309	22,163,152
Excess (deficiency) of revenues over expenditures	215,708	260,452	(6,625,134)	122,074	(6,026,900)
Other financing sources (uses)					
Transfers-in	-	-	17,685,741	-	17,685,741
Gain on sale of assets	1,679	-	-	-	1,679
Transfers-out	-	(17,685,741)	-	-	(17,685,741)
Total other financing sources (uses)	1,679	(17,685,741)	17,685,741	-	1,679
Net change in fund balances	217,387	(17,425,289)	11,060,607	122,074	(6,025,221)
Fund balances, beginning of year	2,198,526	18,502,977	(806,516)	781,537	20,676,524
Fund balances, end of year	\$ 2,415,913	\$ 1,077,688	\$ 10,254,091	\$ 903,611	\$ 14,651,303

See accompanying notes to the Basic Financial Statements.

KEYSTONE LOCAL SCHOOL DISTRICT
LORAIN COUNTY

RECONCILIATION OF STATEMENT OF REVENUES, EXPENDITURES AND CHANGES
IN FUND BALANCES OF GOVERNMENTAL FUNDS TO THE STATEMENT OF ACTIVITIES

FOR THE YEAR ENDED JUNE 30, 2005

Net change in fund balances - total governmental funds \$ (6,025,221)

Amounts reported for governmental activities in the statement of activities are different because:

Governmental funds report capital outlays as expenditures.

How ever, in the statement of activities, the cost of those assets is allocated over their usefull lives and reported as depreciation expense. This is the amount by w hich depreciation exceeded capital outlays in the current period.

Capital outlay	6,817,425	
Depreciation expense	(117,823)	
Total	6,699,602	6,699,602

Revenues in the statement of activities that do not provide current financial resources are not reported as revenues in the funds. 8,031

Repayment of bond principal is an expenditure in the governmental funds, but the repayment reduces long term liabilities in the statement of net assets. 285,000

In the statement of activities, interest is accrued on outstanding bonds, w hereas in governmental funds, an interest expenditure is reported w hen due. 11,184

Some expenses reported in the statement of activities, such as compensated absences and due to other governments payable w hich represents contractually required pension contributions, do not require the use of current financial resources and therefore are not reported as expenditures in governmental funds.

Compensated absences	(77,178)	
Pension obligations	(10,026)	
	(87,204)	(87,204)

The internal service fund used by management to charge the costs of insurance to individual funds is not reported in the district-w ide statement of activities. Governmental fund expenditures and the related internal service fund revenues are eliminated. The net revenue (expense) of the internal service fund is allocated among the governmental activities. 141,809

Change in net assets of governmental activities \$ 1,033,201

KEYSTONE LOCAL SCHOOL DISTRICT
LORAIN COUNTY

STATEMENT OF REVENUES, EXPENDITURES AND CHANGES IN FUND BALANCE
BUDGET BASIS (NON-GAAP) AND ACTUAL – GENERAL FUND

FOR THE YEAR ENDED JUNE 30, 2005

	Budgeted Amounts		Actual	Variance
	Original	Final		Favorable (Unfavorable)
Revenues				
Taxes	\$ 4,492,975	\$ 4,492,975	\$ 4,646,701	\$ 153,726
Tuition and fees	92,370	56,600	109,599	52,999
Interest	114,297	114,297	111,330	(2,967)
Intergovernmental	6,578,672	6,613,672	7,275,630	661,958
Extracurricular	45,200	8,000	4,595	(3,405)
Other	6,000	58,970	90,437	31,467
Total revenues	11,329,514	11,344,514	12,238,292	893,778
Expenditures				
Current				
Instruction				
Regular	6,575,954	6,653,747	6,513,652	140,095
Special	1,045,111	1,010,927	938,191	72,736
Vocational	205,754	205,754	196,175	9,579
Supporting services				
Pupil	882,943	880,838	833,946	46,892
Instructional staff	311,535	309,408	271,353	38,055
Board of education	43,360	47,860	38,722	9,138
Administration	1,297,128	1,276,678	1,195,773	80,905
Fiscal services	356,515	356,738	348,818	7,920
Operation and maintenance	1,205,103	1,217,903	1,055,440	162,463
Pupil transportation	810,884	810,884	732,717	78,167
Central services	201,400	201,400	176,797	24,603
Operation of non-instructional				
Food service operation	-	-	-	-
Latchkey operations	52,300	54,300	46,496	7,804
Extracurricular activities	312,565	316,715	281,478	35,237
Capital outlay	7,500	4,000	-	4,000
Total expenditures	13,308,052	13,347,152	12,629,558	717,594
Excess (deficiency) of revenues over expenditures	(1,978,538)	(2,002,638)	(391,266)	1,611,372
Other financing sources (uses)				
Advances-in	20,000	25,000	46,000	21,000
Advances-out	(20,000)	(25,500)	(43,355)	(17,855)
Transfers-out	(5,000)	-	-	-
Total other financing sources (uses)	(5,000)	(500)	2,645	3,145
Excess (deficiency) of revenues over expenditures and other sources (uses)	(1,983,538)	(2,003,138)	(388,621)	1,614,517
Fund balances, beginning of year	2,906,403	2,906,403	2,906,403	-
Prior year encumbrances	137,506	137,506	137,506	-
Fund balances, end of year	\$ 1,060,371	\$ 1,040,771	\$ 2,655,288	\$ 1,614,517

See accompanying notes to the Basic Financial Statements.

KEYSTONE LOCAL SCHOOL DISTRICT
LORAIN COUNTY
STATEMENT OF NET ASSETS -
PROPRIETARY FUND
JUNE 30, 2005

	Internal Service Fund - Self Insurance
Assets	
Equity in pooled cash	\$ 852,172
Total assets	852,172
Liabilities	
Claims payable	327,744
Total liabilities	327,744
Net assets	
Unrestricted	\$ 524,428

See accompanying notes to the Basic Financial Statements.

KEYSTONE LOCAL SCHOOL DISTRICT
LORAIN COUNTY
STATEMENT OF REVENUES, EXPENSES AND CHANGES IN NET ASSETS -
PROPRIETARY FUND
FOR THE YEAR ENDED JUNE 30, 2005

	Internal Service Fund - Self Insurance
Operating revenues	
Charges for services	\$ 1,565,461
Operating expenses	
Purchased services	87,602
Claims	1,347,514
Total operating expenses	1,435,116
Operating income	130,345
Non-operating revenue	
Interest	11,464
Increase in net assets	141,809
Net assets, beginning of year	382,619
Net assets, end of year	\$ 524,428

See accompanying notes to the Basic Financial Statements.

KEYSTONE LOCAL SCHOOL DISTRICT
LORAIN COUNTY
STATEMENT OF CASH FLOWS -
PROPRIETARY FUND
FOR THE YEAR ENDED JUNE 30, 2005

Cash flows from operating activities	
Cash received from interfund services	\$ 1,565,461
Cash payments for goods and services	(87,602)
Cash payments for claims	(1,300,371)
Net cash provided by operating activities	177,488
Cash flow from investing activities	
Interest	11,464
Net increase in cash and cash equivalents	188,952
Cash and cash equivalents, beginning of year	663,220
Cash and cash equivalents, end of year	\$ 852,172
Reconciliation of operating income to net cash used for operating activities	
Operating income	\$ 130,345
Adjustments	
Increase in claims payable	47,143
Net cash provided by operating activities	\$ 177,488

See accompanying notes to the Basic Financial Statements.

KEYSTONE LOCAL SCHOOL DISTRICT
LORAIN COUNTY
STATEMENT OF FIDUCIARY ASSETS AND LIABILITIES -
AGENCY FUND
JUNE 30, 2005

	Student Activities
Assets	
Equity in pooled cash	\$ 29,961
Total assets	29,961
 Liabilities	
Accounts payable	3,440
Due to students	26,521
Total liabilities	\$ 29,961

See accompanying notes to the Basic Financial Statements.

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KEYSTONE LOCAL SCHOOL DISTRICT
LORAIN COUNTY
NOTES TO THE BASIC FINANCIAL STATEMENTS
FOR THE YEAR ENDED JUNE 30, 2005

NOTE 1 - DESCRIPTION OF THE SCHOOL DISTRICT AND REPORTING ENTITY

The Keystone Local School District (the District) was established for the purpose of exercising the rights and privileges conveyed to it by the constitution and laws of the State of Ohio. The District is a local school district as defined by Section 3311.03 of the Ohio Revised Code. The District operates under an elected Board of Education consisting of five members and is responsible for providing public education to residents of the District. Average daily membership on, or as of, October 1, 2004 was 1,819. The District employs 123 certificated and 94 non-certificated employees.

The reporting entity is composed of the primary government, component units and other organizations that are included to ensure that the financial statements of the District are not misleading. The primary government consists of all funds, departments, boards and agencies that are not legally separate from the District. For the District, this includes general operations, food service, and student related activities of the District.

Component units are legally separate organizations for which the District is financially accountable. The District is financially accountable for an organization if the District appoints a voting majority of the organizations' governing board and, 1) the District is able to significantly influence the programs or services performed or provided by the organization; or 2) the District is legally entitled to or can otherwise access the organizations' resources; the District is legally obligated or has otherwise assumed the responsibility to finance the deficits of or provided financial support to the organization; or the District is obligated for the debt of the organization. Component units may also include organizations that are fiscally dependent on the District in that the District approves the budget, the issuance of debt, or the levying of taxes. The District has no component units.

The District is associated with the Lake Erie Educational Computer Association, the Lake Erie Regional Council (LERC), the Lorain County Joint Vocational School District, Ohio Schools Council Association, OASBO Worker's Compensation and Lake Erie Regional Employee Protection Plan (LEEP). These organizations and their relationships with the District are described in more detail in Notes 10 and 19 to these financial statements.

NOTE 2 - SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

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

A. BASIS OF PRESENTATION

The District's basic financial statements consist of government-wide statements, including a statement of net assets and a statement of activities, and fund financial statements which provide a more detailed level of financial information.

KEYSTONE LOCAL SCHOOL DISTRICT
LORAIN COUNTY
NOTES TO THE BASIC FINANCIAL STATEMENTS
FOR THE YEAR ENDED JUNE 30, 2005

NOTE 2 - SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (continued)

A. BASIS OF PRESENTATION (continued)

Government-wide Financial Statements

The statement of net assets and the statement of activities display information about the District as a whole. These statements include the financial activities of the primary government, except for fiduciary funds.

The statement of net assets presents the financial condition of the governmental activities of the District at year-end. The statement of activities presents a comparison between direct expenses and program revenues for each program or function of the District's governmental activities. Direct expenses are those that are specifically associated with a service, program, or department and therefore clearly identifiable to a particular function. Program revenues include charges paid by the recipient for the goods or services offered by the program, and grants and contributions that are restricted to meeting the operational or capital requirements of a particular program. Revenues which are not classified as program revenues are presented as general revenues of the District, with certain limited exceptions. The comparison of direct expenses with program revenues identifies the extent to which each governmental function is self-financing or draws from the general revenues of the District.

Fund Financial Statements

During the year, the District segregates transactions related to certain District functions or activities in separate funds in order to aid financial management and to demonstrate legal compliance. Fund financial statements are designed to present financial information of the District at this more detailed level. The focus of governmental financial statements is on major funds rather than reporting funds by type. Each major fund is presented in a separate column. Nonmajor funds are aggregated and presented in a single column. Fiduciary funds are reported by fund type.

B. FUND ACCOUNTING

The District uses funds to maintain its financial records during the fiscal year. Fund accounting is designed to demonstrate legal compliance and to aid management by segregating transactions related to certain District functions or activities. A fund is defined as a fiscal and accounting entity with a self-balancing set of accounts. The various funds of the District are grouped into the categories governmental, proprietary, and fiduciary.

Governmental Funds

Governmental funds are those through which most governmental functions typically are financed. Governmental funds focus on the sources, uses, and balances of current financial resources. Expendable assets are assigned to the various governmental funds according to the purposes for which they may or must be used. Current liabilities are assigned to the fund from which they will be paid. The difference between governmental fund assets and liabilities is reported as fund balance. The following is the District's major governmental funds:

KEYSTONE LOCAL SCHOOL DISTRICT
LORAIN COUNTY
NOTES TO THE BASIC FINANCIAL STATEMENTS
FOR THE YEAR ENDED JUNE 30, 2005

NOTE 2 - SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (continued)

B. FUND ACCOUNTING (continued)

Governmental Funds (continued)

General Fund - the General Fund is the operating fund of the District and is used to account for all financial resources, except those required to be accounted for in another fund.

Debt Service Fund- the Debt Service Fund is used to account for the accumulation of resources for, and the payment of, general long term debt principal, interest and related cost.

Building Fund – the Building Fund is used to account for the acquisition, construction or improvement of capital facilities.

The other governmental funds of the District account for grants and other resources whose use is restricted to a particular purpose.

Proprietary Fund

The proprietary fund focuses on the determination of the changes in net assets, financial position, and cash flows. Proprietary funds are classified as enterprise or internal service. The District's self insurance fund is classified as an internal service fund. The District has no enterprise funds.

Fiduciary Funds

Fiduciary fund reporting focuses on net assets and changes in net assets. The fiduciary fund category is split into four classifications: pension trust funds, investment trust funds, private-purpose trust funds, and agency funds. Trust funds are used to account for assets held by the District under a trust agreement for individuals, private organizations, or other governments and are therefore not available to support the District's own programs. Agency funds are custodial in nature (assets equal liabilities) and do not involve measurement of results of operations. The District's agency fund accounts for student activities.

C. MEASUREMENT FOCUS

Government-wide Financial Statements - The government-wide financial statements are prepared using the economic resources measurement focus. All assets and all liabilities associated with the operation of the District are included on the Statement of Net Assets. The Statement of Activities presents increases (revenues) and decreases (expenses) in the total net assets.

Fund Financial Statements - 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. The statement of revenues, expenditures and changes in fund balances reports on the sources (i.e., revenues and other financing sources) and uses (i.e., expenditures and other financing uses) of current financial resources. This approach differs from the manner in which the governmental activities of the government-wide financial statements are prepared. Governmental fund financial statements therefore include a reconciliation with brief explanations to better identify the relationship between the government-wide statements and the statements for governmental funds.

Like the government-wide statements, the internal service fund is accounted for on a flow of economic resources measurement focus. All assets and all liabilities associated with the operation of this fund are included on the statement of net assets. The statement of revenue, expenses and changes in fund net assets presents increases (i.e., revenues) and decreases (i.e., expenses) in net total assets. The statement of cash flows provides information about how the District finances and meets the cash flow needs of its proprietary activity.

KEYSTONE LOCAL SCHOOL DISTRICT
LORAIN COUNTY
NOTES TO THE BASIC FINANCIAL STATEMENTS
FOR THE YEAR ENDED JUNE 30, 2005

NOTE 2 - SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (continued)

D. BASIS OF ACCOUNTING

Basis of accounting determines when transactions are recorded in the financial records and reported on the financial statements. Government-wide financial statements are prepared using the accrual basis of accounting. Governmental funds use the modified accrual basis of accounting. Proprietary and fiduciary funds also use the accrual basis of accounting. Differences in the accrual and modified accrual basis of accounting arise in the recognition of revenue, the recording of deferred revenue and in the presentation of expenses versus expenditures.

Revenues - Exchange and Non-exchange Transactions

Revenue resulting from exchange transactions, in which each party gives and receives essentially equal value, is recorded on the accrual basis when the exchange takes place. On a modified accrual basis, revenue is recorded in the fiscal year in which the resources are measurable and become available. "Measurable" means the amount of the transaction can be determined and "available" means collectible within the current fiscal year or soon enough thereafter to be used to pay liabilities of the current fiscal year. For the District, available means expected to be received within sixty days of fiscal year end.

Nonexchange transactions, in which the District receives value without directly giving equal value in return, include property taxes, grants, entitlements, and donations. On an accrual basis, revenue from property taxes is recognized in the fiscal year for which the taxes are levied (See Note 7). Revenue from grants, entitlements, and donations is recognized in the fiscal year in which all eligibility requirements have been satisfied. Eligibility requirements include timing requirements, which specify the year when the resources are required to be used or the year when use is first permitted; matching requirements, in which the District must provide local resources to be used for a specified purpose; and expenditure requirements, in which the resources are provided to the District on a reimbursement basis. On a modified accrual basis, revenue from nonexchange transactions must also be available before it can be recognized.

Under the modified accrual basis, the following revenue sources are considered to be both measurable and available at fiscal year end: property taxes available as an advance, grants, investment earnings, tuition, and student fees.

Unearned Revenue

Unearned revenue arises when assets are recognized before revenue recognition criteria have been satisfied.

Property taxes for which there is an enforceable legal claim as of June 30, 2005, but which were levied to finance fiscal year 2005 operations, have been recorded as unearned revenue. Grants and entitlements received before the eligibility requirements are met are also recorded as unearned revenue.

On governmental fund financial statements, receivables that will not be collected within the available period have also been reported as unearned revenue.

KEYSTONE LOCAL SCHOOL DISTRICT
LORAIN COUNTY
NOTES TO THE BASIC FINANCIAL STATEMENTS
FOR THE YEAR ENDED JUNE 30, 2005

NOTE 2 - SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (continued)

D. BASIS OF ACCOUNTING (continued)

Expenditures/Expenses

On the accrual basis of accounting, expenses are recognized at the time they are incurred. The measurement focus of governmental fund accounting is on decreases in net financial resources (expenditures) rather than expenses. Expenditures are generally recognized in the accounting period in which the related fund liability is incurred, if measurable. Allocations of cost, such as depreciation and amortization, are not recognized in governmental funds.

E. BUDGETARY PROCESS

All funds, other than agency funds, are legally required to be budgeted and appropriated. The major documents prepared are the tax budget, the appropriation resolution and the certificate of estimated resources, which are prepared on the budgetary basis of accounting. The tax budget demonstrates a need for existing or increased tax rates. The certificate of estimated resources establishes a limit on the amounts that the Board of Education may appropriate. The appropriation resolution is the Board's authorization to spend resources and set annual limits on expenditures plus encumbrances at a level of control selected by the Board. The legal level of control has been established by the Board of Education at the fund, object level for the General Fund and Debt Service Fund and at the fund level for all other funds.

The certificate of estimated resources may be amended during the year if projected increases or decreases in revenue are identified by the District Treasurer. The amounts reported as the original budgeted amounts in the budgetary statements reflect the amounts in the certificate when the original appropriations were adopted. The amounts reported as the final budgeted amounts in the budgetary statements reflect the amounts in the final amended certificate that were in effect at the time the final appropriations were passed by the Board of Education.

The appropriation resolution is subject to amendment by the Board throughout the year with the restriction that appropriations may not exceed estimated resources. The amounts reported as the original budgeted amounts reflect the first appropriation for that fund that covered the entire fiscal year, including amounts automatically carried over from prior years. The amounts reported as the final budgeted amounts represent the final appropriation amounts passed by the Board during the year.

F. CASH AND INVESTMENTS

Cash received by the District is deposited in one central bank account with individual fund balance integrity maintained through District records. Monies for all funds are maintained in this account or temporarily transferred to the State Treasurer's investment pool (STAROhio) or other short term investments. Under existing Ohio statutes, interest earnings are allocated to funds based on average monthly cash balances. Interest income earned for the year ended June 30, 2005, totaled \$ 72,983.

Except for investment contracts and money market investments that had a remaining maturity of one year or less at the time of purchase, investments are reported at fair value, which is based on quoted market prices. Investment contracts and money market investments that had a remaining maturity of one year or less at the time of purchase are reported at cost or amortized cost.

KEYSTONE LOCAL SCHOOL DISTRICT
LORAIN COUNTY
NOTES TO THE BASIC FINANCIAL STATEMENTS
FOR THE YEAR ENDED JUNE 30, 2005

NOTE 2 - SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (continued)

F. CASH AND INVESTMENTS (continued)

The District has invested in the State Treasurer's investment pool (STAROhio) during the year. STAROhio is an investment pool managed by the State Treasurer's Office, which allows governments within the State to pool their funds for investment purposes. STAROhio is not registered with the SEC as an investment company, but does operate in a manner consistent with Rule 2a7 of the Investment Company Act of 1940. Investments in STAROhio are valued at STAROhio's share price, which is the price the investment could be sold for on June 30, 2005.

Investments with an original maturity of three months or less at the time of purchase are considered to be cash equivalents.

G. INVENTORY

On government-wide financial statements, inventories are presented at the lower of cost or market on a first-in, first-out basis and are expensed when used.

On fund financial statements, inventories of governmental funds are stated at cost. Cost is determined on a first-in, first-out basis. Inventory in governmental funds consists of expendable supplies held for consumption. The cost of inventory items is recorded as an expenditure in the governmental fund types when used.

H. RESTRICTED ASSETS

Assets are reported as restricted assets when limitations on their use change the normal understanding of the availability of the asset. Such constraints are either imposed by creditors, contributors, grantors, or laws of other governments or imposed by enabling legislation.

I. CAPITAL ASSETS

General capital assets generally result from expenditures in the governmental funds. These assets are reported in the governmental activities column of the government-wide statement of net assets but are not reported on the fund financial statements.

All capital assets are capitalized at cost (or estimated historical cost) and updated for additions and reductions during the year. Donated capital assets are recorded at their fair market values as of the date received. The District maintains a capitalization threshold of five thousand dollars. The District does not possess any infrastructure. Improvements are capitalized; the costs of normal maintenance and repairs that do not add to the value of the asset or materially extend an asset's life are not capitalized. Interest costs for capital asset construction within the government-wide statement of net assets are capitalized. Interest costs incurred during 2005 were \$249,518, of which all has been capitalized.

All reported capital assets, other than land and construction in progress, are depreciated. Improvements are depreciated over the remaining useful lives of the related capital assets. Depreciation is computed using the straight-line method over the following useful lives:

Description	Estimated Lives
Land improvements	5-30 years
Buildings	30-50 years
Building improvements	30-50 years
Furniture and equipment	7-20 years
Vehicles	10 years

KEYSTONE LOCAL SCHOOL DISTRICT
LORAIN COUNTY
NOTES TO THE BASIC FINANCIAL STATEMENTS
FOR THE YEAR ENDED JUNE 30, 2005

NOTE 2 - SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (continued)

J. INTERFUND BALANCES

On fund financial statements, receivables and payables resulting from short-term interfund loans are classified as "interfund receivable/ payable". These amounts are eliminated in the governmental column of the statement of net assets.

K. COMPENSATED ABSENCES

Vacation benefits are accrued as a liability as the benefits are earned if the employees' rights to receive compensation are attributable to services already rendered and it is probable that the District will compensate the employees for the benefits through paid time off or some other means.

Sick leave benefits are accrued as a liability using the vesting method. The liability is based on an estimate of the amount of accumulated sick leave that will be paid as a termination benefit. The liability includes employees who are currently eligible to receive termination benefits and those the District has identified as probable of receiving payment in the future. The amount is based on accumulated sick leave and employees' wage rates at fiscal year end, taking into consideration any limits specified in the District's termination policy.

For governmental fund financial statements, the current portion of unpaid compensated absences is the amount that is normally expected to be paid using expendable available financial resources. These amounts are recorded in the account "compensated absences payable" in the fund from which the employees who have accumulated leave are paid. The noncurrent portion of the liability is not reported.

L. ACCRUED LIABILITIES AND LONG-TERM OBLIGATIONS

All payables, accrued liabilities and long-term obligations are reported in the government-wide financial statements.

In general, governmental fund payables and accrued liabilities that, once incurred, are paid in a timely manner and in full from current financial resources, are reported as obligations of the funds. However, claims and judgments, compensated absences, and contractually required pension contributions that will be paid from governmental funds are reported as a liability in the fund financial statements only to the extent that they are due for payment during the current year. Long-term notes and capital leases are recognized as a liability on the governmental fund financial statements when due.

M. NET ASSETS

Net assets represent the difference between assets and liabilities. Net assets invested in capital assets, net of related debt, consists of capital assets, net of accumulated depreciation, reduced by the outstanding balances of any borrowings used for the acquisition, construction, or improvement of those assets. Net assets are reported as restricted when there are limitations imposed on their use either through the enabling legislation adopted by the District or through external restrictions imposed by creditors, grantors or laws, or regulations of other governments.

The District applies restricted resources when an expense is incurred for purposes for which both restricted and unrestricted net assets are available.

KEYSTONE LOCAL SCHOOL DISTRICT
LORAIN COUNTY
NOTES TO THE BASIC FINANCIAL STATEMENTS
FOR THE YEAR ENDED JUNE 30, 2005

NOTE 2 - SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (continued)

N. FUND BALANCE RESERVES AND DESIGNATIONS

The District reserves those portions of fund balance which are legally segregated for a specific future use or which do not represent available expendable resources and therefore are not available for appropriation or expenditure. Unreserved fund balance indicates that portion of fund balance which is available for appropriation in future periods. Fund balance reserves have been established for property taxes, prepaids, and encumbrances.

The reserve for property taxes represents taxes recognized as revenue under generally accepted accounting principles, but not available for appropriation under State statute.

O. OPERATING REVENUES AND EXPENSES

Operating revenues are those revenues that are generated directly from the primary activity of the proprietary fund. For the District, these revenues are charges for services for the self-insurance program. Operating expenses are necessary costs incurred to provide the good or service that is the primary activity of this fund. Revenues and expenses not meeting those definitions are reported as non-operating.

P. INTERFUND TRANSACTIONS

Exchange transactions between funds are reported as revenues in the seller funds and as expenditures/expenses in the purchaser funds. Flows of cash or goods from one fund to another without a requirement for repayment are reported as interfund transfers. Interfund transfers are reported as other financing sources/uses in governmental funds. Repayments from funds responsible for particular expenditures/expenses to the funds that initially paid for them are not presented on the financial statements.

Q. ESTIMATES

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

NOTE 3- COMPLIANCE AND ACCOUNTABILITY

Not apparent in the basic financial statements are deficit fund balances in the Title VI R fund and the Title I fund of \$ 557 and \$ 615, respectively. The General Fund is liable for deficits in the funds and provides transfers when cash is required, not when accruals occur. The deficit fund balances, resulted from adjustments for accrued liabilities.

NOTE 4- CHANGE IN ACCOUNTING PRINCIPLES

For fiscal year 2005, the District has implemented GASB Statement No. 40, "Deposit and Investment Risk Disclosures," GASB Statement No. 46, "Net Assets Restricted by Enabling Legislation: and GASB Technical Bulletin No. 2004-2, "Recognition of Pension and Other Post-employment Benefit Expenditures/Expense and Liabilities by Cost-Sharing Employers."

GASB Statement No. 40 established disclosure requirements for investment credit risk, interest rate risk, deposit custodial risk and foreign currency risk.

GASB Statement No.46 clarifies when net assets should be considered restricted based upon enabling legislation.

KEYSTONE LOCAL SCHOOL DISTRICT
LORAIN COUNTY
NOTES TO THE BASIC FINANCIAL STATEMENTS
FOR THE YEAR ENDED JUNE 30, 2005

NOTE 4– CHANGE IN ACCOUNTING PRINCIPLES (continued)

GASB Technical Bulletin No. 2004-02 addresses the amount that should be recognized as expenditure/expense and as a liability each period by employers participating in a cost-sharing multiple-employer pension and other post-employment benefit (OPEB) plans.

The implementation of GASB Statement No. 46 and GASB Technical Bulletin No. 2004-02 did not affect the presentation of the financial statements of the District.

NOTE 5 - BUDGETARY BASIS OF ACCOUNTING

While the District is reporting financial position, results of operations, and changes in fund balances on the basis of generally accepted accounting principles (GAAP), the budgetary basis as provided by law is based upon accounting for certain transactions on a basis of cash receipts, disbursements, and encumbrances. The Statement of Revenues, Expenditures and Changes in Fund Balance – Budget Basis (Non-GAAP) and Actual presented for the General Fund is presented on the budgetary basis to provide a meaningful comparison of actual results with the budget. The major differences between the budget basis and GAAP basis statements are the following:

1. Revenues are recorded when received in cash (budget basis) as opposed to when susceptible to accrual (GAAP basis).
2. Expenditures are recorded when paid in cash (budget basis) as opposed to when the liability is incurred (GAAP basis).
3. Encumbrances are treated as expenditures (budget basis) rather than as a reservation of fund balance (GAAP basis).

The following table summarizes the adjustments necessary to reconcile the GAAP basis statements to the budgetary basis statements for the General Fund.

Net Change in Fund Balance	
General Fund	
	General
Budget basis	\$ (388,621)
Adjustments, increase (decrease)	
Revenue accruals	450,360
Expenditure accruals	155,648
GAAP basis, as reported	\$ 217,387

KEYSTONE LOCAL SCHOOL DISTRICT
LORAIN COUNTY
NOTES TO THE BASIC FINANCIAL STATEMENTS
FOR THE YEAR ENDED JUNE 30, 2005

NOTE 6 - DEPOSITS AND INVESTMENTS

A. LEGAL REQUIREMENTS

State statutes classify monies held by the District into three categories.

Active deposits are public deposits necessary to meet current demands on the treasury. Such monies must be maintained either as cash in the District Treasury, in commercial accounts payable or withdrawable on demand, including negotiable order of withdrawal (NOW) accounts, or in money market deposit accounts.

Inactive deposits are public deposits the Board of Education has identified as not required for use within the current five year period of designation of depositories. Inactive deposits must either be evidenced by certificates of deposit maturing not later than the end of the current period of designation of depositories, or by savings or deposit accounts including, but not limited to, passbook accounts.

Interim monies are those monies which are not needed for immediate use but which will be needed before the end of the current period of designation of depositories. Interim deposits must be evidenced by time certificates of deposit maturing not more than one year from the date of deposit, or by savings or deposit accounts, including passbook accounts.

Interim monies may be invested in the following securities:

1. United States Treasury bills, bonds, notes, or any other obligation or security issued by the United States Treasury, or any other obligation guaranteed as to principal and interest by the United States;
2. Bonds, notes, debentures, or any other obligation or security issued by any federal government agency or instrumentality including, but not limited to, the Federal National Mortgage Association, Federal Home Loan Bank, Federal Farm Credit Bank, Federal Home Loan Mortgage Corporation, Government National Mortgage Association, and Student Loan Marketing Association. All federal agency securities shall be direct issuances of federal government agencies or instrumentalities;
3. Written repurchase agreements in the securities listed above provided that the market value of the securities subject to the repurchase agreement must exceed the principal value of the agreement by at least 2 percent and be marked to market daily, and the term of the agreement must not exceed thirty days;
4. Bonds and other obligations of the State of Ohio;
5. No-load money market mutual funds consisting exclusively of obligations described in division (1) or (2) and repurchase agreements secured by such obligations, provided that investments in securities described in this division are made only through eligible institutions;
6. The State Treasurer's investment pool (STAR Ohio);
7. Commercial paper and bankers' acceptances (if authorized by the Board of Education), and
8. Under limited circumstances, corporate debt interests rated in either of the two highest rating classifications by at least two nationally recognized rating agencies.

KEYSTONE LOCAL SCHOOL DISTRICT
LORAIN COUNTY
NOTES TO THE BASIC FINANCIAL STATEMENTS
FOR THE YEAR ENDED JUNE 30, 2005

NOTE 6 - DEPOSITS AND INVESTMENTS (continued)

A. LEGAL REQUIREMENTS (continued)

Investments in stripped principal or interest obligations, reverse repurchase agreements, and derivatives are prohibited. The issuance of taxable notes for the purpose of arbitrage, the use of leverage, and short selling are also prohibited. An investment must mature within five years from the date of purchase, unless matched to a specific obligation or debt of the District, and must be purchased with the expectation that it will be held to maturity.

Protection of the District's deposits is provided by the Federal Deposit Insurance Corporation (FDIC), by eligible securities pledged by the financial institution as security for repayment, by surety company bonds deposited with the Treasurer by the financial institution, or by a single collateral pool established by the financial institution to secure the repayment of all public monies deposited with the institution.

Investments may only be made through specified dealers and institutions. Payment for investments may be made only upon delivery of the securities representing the investments to the Treasurer or qualified trustee or, if the securities are not represented by a certificate, upon receipt of confirmation of transfer from the custodian.

At fiscal year end, the District had \$ 100 in cash on hand which is included on the balance sheet of the District as part of "Equity in Pooled Cash".

B. DEPOSITS

Custodial credit risk is the risk that, in the event of a bank failure, the District's deposits may not be returned. The District does not have a deposit policy for custodial credit risk. At fiscal year end, the carrying amount of the District's deposits was \$ 3,643,960 and the bank balance was \$ 3,865,755. Of the bank balance, \$ 1,878,000 was covered by federal depository insurance and \$ 1,987,755 was uninsured. Of the remaining balance, \$ 1,987,755 was collateralized with securities held by the pledging institution's trust department not in the District's name.

C. INVESTMENTS

For an investment, custodial credit risk is the risk that, in the event of the failure of the counterparty, the District will not be able to recover the value of its investments or collateral securities that are in the possession of an outside party. As of June 30, 2005, the District had the following investments:

KEYSTONE LOCAL SCHOOL DISTRICT
LORAIN COUNTY
NOTES TO THE BASIC FINANCIAL STATEMENTS
FOR THE YEAR ENDED JUNE 30, 2005

NOTE 6 - DEPOSITS AND INVESTMENTS (continued)

C. INVESTMENTS (continued)

	Weighted Average Maturities Years	Fair Value
FHLB	* .579	\$ 3,083,189
FHLMC	* .432	6,103,010
FNMA	* .383	3,092,664
US Treasury Notes	* .751	99,133
Money Market Fund	n/a	13,185
Investment in State Treasurer's investment Pool	n/a	1,137,739
		\$ 13,528,920
Portfolio weighted average maturity	.536	

* The securities have various call dates. The District believes no securities will be called.

D. INTEREST RATE RISK

The Ohio Revised Code generally limits security purchases to those that mature within five years of the settlement date.

E. CREDIT RISK

The District follows the Ohio Revised Code that limits its investment choices. As of June 30, 2005, the District's investments in FHLB, FHLMC, FNMA, US Treasury Notes and StarOhio were rated AAA by Standard & Poor's.

F. CONCENTRATION OF CREDIT RISK

The District places no limit on the amount that may be invested in any one issuer.

NOTE 7 - PROPERTY TAXES

Property taxes are levied and assessed on a calendar year basis, while the District's fiscal year runs from July through June. First-half tax distributions are received by the District in the second half of the fiscal year. Second-half tax distributions are received in the first half of the following fiscal year.

Property taxes include amounts levied against all real, public utility, and tangible personal (used in business) property located in the District. Real and public utility property tax revenues received in calendar year 2005 represent the collection of calendar year 2004 taxes. Real property taxes for 2005 were levied after April 1, 2004, on the assessed values as of January 1, 2004, the lien date. Assessed values for real property taxes are established by State statute at 35 percent of appraised market value. Real property taxes are payable annually or semiannually. The first payment is due January 20, with the remainder payable by June 20.

KEYSTONE LOCAL SCHOOL DISTRICT
LORAIN COUNTY
NOTES TO THE BASIC FINANCIAL STATEMENTS
FOR THE YEAR ENDED JUNE 30, 2005

NOTE 7 - PROPERTY TAXES (continued)

Public utility real and tangible personal property taxes received in 2005 were levied after April 1, 2005, on the assessed values as of December 31, 2004, the lien date. Public utility real property is assessed at 88 percent of true value; tangible personal property is currently assessed at varying percentages of true value. Public utility property taxes are payable on the same dates as real property taxes described previously.

Taxes collected from tangible personal property, other than public utility, in one calendar year are levied in the prior calendar year on assessed values during and at the close of the most recent fiscal year of the taxpayer that ended on or before March 31 of that calendar year, and at the tax rates determined in the preceding year. Tangible personal property used in business, except for public utilities, is currently assessed for ad valorem taxation purposes at 25% of its true value. Amounts paid by multi-county taxpayers are due September 20. Single-county taxpayers may pay annually or semi-annually. If paid annually, payment is due April 30; if paid semi-annually, the first payment is due April 30 with the remainder payable by September 20.

The District receives property taxes from Lorain County. The County Auditor periodically advances to the District its portion of the taxes collected. Second-half real property tax payments collected by the County by June 30, 2005, are available to finance fiscal year 2005/2006 operations. The amount available to be advanced can vary based on the date the tax bills are sent.

Accrued property taxes receivable represents delinquent taxes outstanding and real property, public utility property, and tangible personal property taxes which were measurable as of June 30, 2005 and for which there is an enforceable legal claim. Although total property tax collections for the next fiscal year are measurable, amounts to be received during the available period are not subject to reasonable estimation at June 30, nor were they levied to finance fiscal year 2005 operations. The receivable is therefore offset by a credit to deferred revenue for that portion not intended to finance current year operations. The amount available as an advance was recognized as revenue.

The amount available as an advance at June 30, 2005, was \$ 1,000,619 in the General Fund, \$ 216,584 in the Debt Service Fund and \$ 47,408 in the Capital Projects Fund.

The assessed values upon which the fiscal year 2005 taxes were collected are:

	2004 Second Half Collections		2005 First Half Collections	
	Amount	%	Amount	%
Agricultural/Residential	\$ 189,988,240	84.83	\$ 199,842,970	85.01
Commercial / Industrial	13,761,260	6.14	14,292,790	6.08
Public Utilities	47,750	0.02	48,550	0.02
Mineral	9,680	0.00	9,160	0.00
Tangible Personal Property	20,172,460	9.01	20,901,898	8.89
Total Assessed Value	<u>\$ 223,979,390</u>	<u>100.00</u>	<u>\$ 235,095,368</u>	<u>100.00</u>
Tax rate per \$1,000 of assessed valuation	<u>52.66</u>		<u>52.66</u>	

KEYSTONE LOCAL SCHOOL DISTRICT
LORAIN COUNTY
NOTES TO THE BASIC FINANCIAL STATEMENTS
FOR THE YEAR ENDED JUNE 30, 2005

NOTE 8 - RECEIVABLES

Receivables at June 30, 2005, consisted of property taxes, amounts due from other governments, and accrued interest. All receivables are considered substantially collectible in full due to the ability to foreclose for the nonpayment of taxes, the stable condition of State programs, and the current year guarantee of federal funds. All receivables are expected to be collected within one year

A summary of the principal items due from other governments follows:

	<u>Amount</u>
Governmental Activities	
Non-major funds	
Student intervention	\$ 933
IDEA Part B	32,603
Management Information Systems	1,124
Food service	<u>11,958</u>
	<u>\$ 46,618</u>
Total due from other governments	

KEYSTONE LOCAL SCHOOL DISTRICT
LORAIN COUNTY
NOTES TO THE BASIC FINANCIAL STATEMENTS
FOR THE YEAR ENDED JUNE 30, 2005

NOTE 9 - CAPITAL ASSETS

Capital asset activity for the fiscal year ended June 30, 2005, was as follows:

	Balance June 30, 2004	Additions	Disposals	Balance June 30, 2005
Governmental Activities				
Nondepreciable capital assets				
Land	\$ 521,816	\$ -	\$ -	\$ 521,816
Construction in progress	881,477	6,790,541	-	7,672,018
Total nondepreciable capital assets	<u>1,403,293</u>	<u>6,790,541</u>	<u>-</u>	<u>8,193,834</u>
Depreciable capital assets				
Land improvements	425,978	-	-	425,978
Buildings and improvements	5,545,929	-	-	5,545,929
Furniture and equipment	382,480	28,741	17,032	394,189
Vehicles	871,119	-	-	871,119
Total capital assets being depreciated	<u>7,225,506</u>	<u>28,741</u>	<u>17,032</u>	<u>7,237,215</u>
Less accumulated depreciation				
Land improvements	181,070	3,488	-	184,558
Buildings and improvements	2,104,785	35,393	-	2,140,178
Furniture and equipment	199,175	23,561	15,174	207,562
Vehicles	455,259	55,381	-	510,640
Total accumulated depreciation	<u>2,940,289</u>	<u>117,823</u>	<u>15,174</u>	<u>3,042,938</u>
Depreciable capital assets, net of accumulated depreciation	<u>4,285,217</u>	<u>(89,082)</u>	<u>1,858</u>	<u>4,194,277</u>
Governmental activities capital assets, net	<u>\$ 5,688,510</u>	<u>\$ 6,701,459</u>	<u>\$ 1,858</u>	<u>\$ 12,388,111</u>

KEYSTONE LOCAL SCHOOL DISTRICT
LORAIN COUNTY
NOTES TO THE BASIC FINANCIAL STATEMENTS
FOR THE YEAR ENDED JUNE 30, 2005

NOTE 9 - CAPITAL ASSETS (continued)

Depreciation expense was charged to governmental functions as follows:

Instruction		
Regular	\$	30,067
Special		1,503
Vocational		232
Supporting services		
Pupil		3,260
Instructional staff		951
Adminstration		1,441
Fiscal		387
Operation and maintenance of plant		20,057
Pupil transportation		52,751
Central services		1,111
Operation of noninstruction services		
Food service operation		4,892
Extracurricular activities		1,171
Total depreciation expense	\$	117,823

NOTE 10 - RISK MANAGEMENT

A. PROPERTY AND LIABILITY

The District is exposed to various risks of loss related to torts, theft of, damage to and destruction of assets, errors and omissions, injuries to employees and natural disasters. During fiscal year 2005, the District contracted with Indiana Insurance Company for property insurance. Professional liability is covered by the Nationwide Mutual Insurance Company with a \$ 5,000,000 aggregate limit. Automobile liability has a \$ 2,000,000 combined single limit of liability. Settled claims have not exceeded this commercial coverage in any of the past several years. Nationwide Mutual Insurance Company maintains performance bonds of \$ 20,000 for the Superintendent and the Board President, and a \$ 25,000 performance bond for the Treasurer.

B. WORKERS' COMPENSATION

The District participated in the Ohio Association of School Business Officials Workers' Compensation Group Rating Program (GRP), an insurance purchasing pool. The intent of the GRP is to achieve the benefit of a reduced premium for the District by virtue of its grouping and representation with other participants in the GRP. The workers' compensation experience of the participating school districts is calculated as one experience and a common premium rate is applied to all school districts in the GRP. Each participant pays its workers' compensation premium to the State based on the rate for the GRP rather than its individual rate. Total savings are then calculated and each participant's individual performance is compared to the overall savings percentage of the GRP.

A participant will then either receive money from or be required to contribute to the "equity pooling fund." This "equity pooling" arrangement insures that each participant shares equally in the overall performance of the GRP. Participation in the GRP is limited to school districts that can meet the GRP's selected criteria. The firm of Sheakley UniService, Inc., provides administrative, cost control and actuarial services to the GRP.

KEYSTONE LOCAL SCHOOL DISTRICT
LORAIN COUNTY
NOTES TO THE BASIC FINANCIAL STATEMENTS
FOR THE YEAR ENDED JUNE 30, 2005

NOTE 10 - RISK MANAGEMENT (continued)

C. EMPLOYEE MEDICAL BENEFITS

The District has contracted with the Lake Erie Regional Employee Protection Plan (LEEP) to provide medical/surgical and dental benefits for its employees and their covered dependents. LEEP is a program administered by LERC (Lake Erie Regional Council of Governments). LEEP is a claims-servicing pool comprised of fourteen school districts that provide public education within Lorain County. The Districts pay monthly contributions that are placed in a common fund from which eligible claims and expenses are paid for employees of participating school districts and their covered dependents. Claims are paid for all participants regardless of claims flow. This plan contains a stop-loss provision of \$ 165,000 per participant.

Premium contributions are determined annually based on the claims experience of the individual district. Premiums can increase or decrease by up to 20% of the prior year's contribution. Member districts may be liable for additional contributions to fund the liability pool. In the event of termination, all participating district's claims would be paid without regard to their individual account balances.

The LEEP Board of Directors has authority to return monies to an existing district subsequent to the settlement of all claims and expenses. This plan provides a medical/surgical and dental plan with a \$ 200 deductible for family coverage and a \$ 100 deductible for single coverage.

The claims liability of \$ 327,744 reported at June 30, 2005, was estimated by LERC and is based on the requirements of Governmental Standards Board Statement No. 10, which requires that a liability for unpaid claims costs, including estimates of costs related to incurred but not reported claims, be reported. The estimate was not affected by incremental claim adjustment expenses and does not include other allocated or unallocated claim adjustment expenses. Changes in balances of claims liability during the year ended June 30, 2005 and June 30, 2004 are summarized below.

	June 30, 2005	June 30, 2004
Unpaid claims, beginning of year	\$ 280,602	\$ 299,000
Incurred claims	1,347,512	1,274,008
Claims payments	(1,300,370)	(1,292,406)
Unpaid claims, end of year	\$ 327,744	\$ 280,602

NOTE 11 - DEFINED BENEFIT PENSION PLANS

A. SCHOOL EMPLOYEES RETIREMENT SYSTEM (SERS)

The District contributes to the School Employees Retirement System of Ohio (SERS), a cost-sharing multiple employer defined benefit pension plan. SERS provides retirement and disability benefits, annual cost of living adjustments, and death benefits to plan members and beneficiaries. Authority to establish and amend benefits is provided by state statute per 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 SERS, 300 East Broad St., Suite 100, Columbus, Ohio 43215-3746 or by calling (614) 222-5853.

KEYSTONE LOCAL SCHOOL DISTRICT
LORAIN COUNTY
NOTES TO THE BASIC FINANCIAL STATEMENTS
FOR THE YEAR ENDED JUNE 30, 2005

NOTE 11 - DEFINED BENEFIT PENSION PLANS (continued)

A. SCHOOL EMPLOYEES RETIREMENT SYSTEM (SERS) (continued)

Plan members are required to contribute 10 percent of their annual covered salary and the District is required to contribute at an actuarially determined rate. The current rate is 14 percent of annual covered payroll. A portion of the District's contribution is used to fund pension obligations with the remainder being used to fund health care benefits. For fiscal year 2005, 10.57 percent of annual covered salary was the portion used to fund pension obligations; for fiscal year 2004, 9.09 percent of annual covered salary was the portion used to fund pension obligations. The contribution requirements of plan members and employers are established and may be amended, up to statutory maximum amounts, by the SERS' Retirement Board. The District's contributions to SERS for the years ended June 30, 2005, 2004, and 2003 were \$ 245,300, \$ 243,000, and \$ 221,100, respectively. The full amount has been contributed for 2004 and 2003. For 2005, \$ 196,344 (80%) has been contributed with the remainder being reflected as an intergovernmental payable.

B. STATE TEACHERS RETIREMENT SYSTEM OF OHIO (STRS OHIO)

The District contributes to the State Teachers Retirement System of Ohio (STRS OHIO), a cost-sharing multiple employer public employee retirement system administered by the State Teachers Retirement Board. STRS OHIO is a statewide retirement plan for licensed teachers and other faculty members employed in the public schools of Ohio or any school, college, university, institution or other agency controlled, managed and supported, in whole or in part, by the state or any political subdivision thereof.

Plan options – New members have a choice of three retirement plan options. In addition to the Defined Benefit (DB) Plan, new members are offered a Defined Contribution (DC) Plan and a Combined Plan. The DC Plan allows members to invest all their member contributions and employer contributions equal to 10.5% of earned compensation. The Combined Plan offers features of 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. Contributions into the DC Plan and the Combined Plan are credited to member accounts as employers submit their payroll information to STRS Ohio, generally on a bi-weekly basis. 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.

DB Plan Benefits – Plan benefits are established under Chapter 3307 of the Revised Code. Any member may retire who has (i) five years of service credit and attained age 60; (ii) 25 years of service credit and attained age 55; or (iii) 30 years of service credit regardless of age. The annual retirement allowance, payable for life, is the greater of the "formula benefit" or the "money-purchase benefit" calculation. Under the "formula benefit", the retirement allowance is based on years of credited service and final average salary, which is the average of the member's three highest salary years. The annual allowance is calculated by using a base percentage of 2.2% multiplied by the total number of years service credit (including Ohio-valued purchased credit) times the final average salary. The 31st year of earned Ohio service credit is calculated at 2.5%. An additional one-tenth of a percent is added to the calculation for every year of earned Ohio service over 31 years (2.6% for 32 years, 2.7% for 33 years and so on) until 100% of final average salary is reached. For members with 35 or more years of Ohio contributing service, the first 30 years will be calculated at 2.5% instead of 2.2%. Under the "money-purchase benefit" calculation, a member's lifetime contributions plus interest at specified rates are matched by an equal amount from other STRS Ohio funds. This total is then divided by an actuarially determined annuity factor to determine the maximum annual retirement allowance.

KEYSTONE LOCAL SCHOOL DISTRICT
LORAIN COUNTY
NOTES TO THE BASIC FINANCIAL STATEMENTS
FOR THE YEAR ENDED JUNE 30, 2005

NOTE 11 - DEFINED BENEFIT PENSION PLANS (continued)

B. STATE TEACHERS RETIREMENT SYSTEM OF OHIO (STRS OHIO) (continued)

DC Plan Benefits – Benefits are established under sections 3307.80 to 3307.89 of the Revised Code. For members who select the DC Plan, all member contributions and employer contributions at a rate of 10.5% are placed in an investment account. The member determines how to allocate the member and employer money among various investment choices. A member is eligible to receive a retirement benefit at age 50 and termination of employment. The member may elect to receive a lifetime monthly annuity or a lump-sum withdrawal. Employer contributions into members' accounts are vested after the first anniversary of the first day of paid service. Members in the DC Plan who become disabled are entitled only to their account balance. If a member dies before retirement benefits begin, the members designated beneficiary is entitled to receive the members account balance.

Combined Plan Benefits – Member contributions are allocated by the member, and employer contributions are used to fund a defined benefit payment. A member's defined benefit is determined by multiplying 1% of the member's final average salary by the member's years of service credit. The defined benefit portion of the Combined Plan payment is payable to a member on or after age 60. The defined contribution portion of the account may be taken as a lump sum or converted to a lifetime monthly annuity at age 50.

Eligible faculty of Ohio's public colleges and universities may choose to enroll in either STRS Ohio or an alternative retirement plan (ARP) offered by their employer. Employees have 120 days from their employment date to select a retirement plan.

A retiree of STRS Ohio or another Ohio public retirement system is eligible for reemployment as a teacher following the elapse of two months from the date of retirement. Contributions are made by the reemployed member and employer during the reemployment. Upon termination of reemployment or age 65, whichever comes later, the retiree is eligible for a money-purchase benefit or a lump-sum payment in addition to the original retirement allowance.

Prior to February 1, 2003, benefits were increased annually by the greater of the amount of the change in the Consumer Price Index (CPI) or the cumulative CPI increase since retirement, less previous cost-of-living increases, up to a maximum of 3% of the original base benefit. Effective February 1, 2004, benefits are increased annually by 3% of the original base amount, regardless of the change in the CPI, for defined benefit plan participants.

The Defined Benefit and Combined Plans offer access to health care coverage to retirees who participated in the plans and their dependents. Coverage under the current program includes hospitalization, physician fees, prescription drugs and partial reimbursement of monthly Medicare Part B premiums. By Ohio Law, healthcare benefits are not guaranteed.

A defined Benefit or Combined Plan member with five or more years' credited service who becomes disabled may qualify for a disability benefit. Eligible spouse and dependents of these active members who die before retirement may qualify for survivor benefits. A death benefit of \$ 1,000 is payable to the beneficiary of each deceased retired member who participated in the Defined Benefit Plan. Death benefit coverage up to \$ 2,000 can be purchased by participants in the DB, DC or Combined Plans. Various other benefits are available to member's beneficiaries.

For the fiscal year ended June 30, 2005, plan members were required to contribute 10 percent of their annual covered salaries. The District 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 employees. Chapter 3307 of the Ohio Revised Code provides statutory authority for member and employer contributions.

KEYSTONE LOCAL SCHOOL DISTRICT
LORAIN COUNTY
NOTES TO THE BASIC FINANCIAL STATEMENTS
FOR THE YEAR ENDED JUNE 30, 2005

NOTE 11 - DEFINED BENEFIT PENSION PLANS (continued)

B. STATE TEACHERS RETIREMENT SYSTEM OF OHIO (STRS OHIO) (continued)

The District's contribution to STRS OHIO for the years ended June 30, 2005, 2004, and 2003 were \$ 883,600, \$ 854,000, and \$ 795,700, respectively. The full amount has been contributed for 2004 and 2003. For 2005, \$ 733,125 (83%) has been contributed with the remainder being reported as a liability within the respective funds.

STRS Ohio issues a stand-alone financial report. Copies of STRS Ohio's 2005 Comprehensive Annual Financial Report can be requested by writing STRS Ohio , 275 E. Broad St., Columbus, Ohio 43215-3371, or by calling 614-227-4090.

NOTE 12 - POSTEMPLOYMENT BENEFITS

A. SCHOOL EMPLOYEES RETIREMENT SYSTEM

The Ohio Revised Code gives the School Employees Retirement System (SERS) the discretionary authority to provide postretirement health care to retirees and their dependents. Coverage is made available to service retirees with ten or more years of qualifying service credit, disability and survivor benefit recipients. Effective January 1, 2004, all retirees and beneficiaries are required to pay a portion of their health care premium. The portion is based on years of service, medicare eligibility and retirement status. A safety net is in place for retirees whose household income falls below federal poverty levels. Premiums are reduced by 50% for those who apply.

After the allocation for basic benefits, the remainder of the employer's contribution is allocated to providing health care benefits. For the fiscal year ended June 30, 2005, employer contributions to fund health care benefits were 3.43 percent of covered payroll, a decrease of 1.48 percent from fiscal year 2004. In addition, SERS levies a surcharge to fund health care benefits equal to 14% of the difference between a minimum pay and the member's pay, pro-rated for partial service credit. For fiscal 2005, the minimum pay has been established as \$ 27,400. The surcharge rate added to the unallocated portion of the 14% employer contribution rate provides for maintenance of the asset target level for the health care fund.

Health care benefits are financed on a pay-as-you-go basis. The target level for the health care reserve is 150% of annual health care expenses, before premium deduction. Net expenses for health care at June 30, 2005 were \$ 178,221,113 and the target level was \$ 335.2 million. At June 30, 2005 the Retirement System's net assets available for payment of health care benefits was \$ 267.5 million.

The number of benefit recipients receiving health care benefits is approximately 58,123. The portion of the District's contributions that were used to fund postemployment benefits amounted to \$ 86,509.

B. STATE TEACHERS RETIREMENT SYSTEM OF OHIO

State Teachers Retirement System of Ohio (STRS Ohio) provides access to health care benefits to retirees who participated in the Defined Benefit or Combined Plans and their dependents. Coverage under the current program includes hospitalization, physicians' fees, prescription drugs and partial reimbursement of monthly Medicare Part B premiums. Pursuant to Revised Code (R.C.), the State Teachers Retirement Board has discretionary authority over how much, if any, of the associated health care costs will be absorbed by STRS Ohio. All benefit recipients pay a portion of the health care cost in the form of a monthly premium.

The Revised Code grants authority to STRS Ohio to provide health care coverage to eligible benefit recipients, spouses, and dependents. By Ohio law, health care benefits are not guaranteed and the cost of the coverage paid from STRS Ohio funds shall be included in the employer contribution rate, currently 14% of covered payroll.

KEYSTONE LOCAL SCHOOL DISTRICT
LORAIN COUNTY
NOTES TO THE BASIC FINANCIAL STATEMENTS
FOR THE YEAR ENDED JUNE 30, 2005

NOTE 12 - POSTEMPLOYMENT BENEFITS (continued)

B. STATE TEACHERS RETIREMENT SYSTEM OF OHIO (continued)

The Retirement Board allocates employer contributions to the Health Care Stabilization Fund from which health care benefits are paid. For the fiscal year ended June 30, 2005, the board allocated employer contributions equal to 1% of covered payroll to the Health Care Stabilization Fund. For the District, this amount equaled \$ 63,112 for fiscal year 2005. At June 30, 2005, the balance in the Health Care Stabilization Fund was \$ 3.3 billion.

For the year ended June 30, 2004 net health care costs paid by STRS Ohio were \$ 254,780,000. There were 115,395 eligible benefit recipients.

NOTE 13 – NOTES PAYABLE

Notes payable at June 30, 2005 consisted of the following:

	Outstanding June 30, 2004	Additions	Deductions	Outstanding June 30, 2005
Bond anticipation note (2004) 1.75% through 2005	\$ 14,500,000	\$ -	\$ 14,500,000	\$ -
Bond anticipation note (2004) 1.75% through 2005	3,000,000	-	3,000,000	-
	<u>\$ 17,500,000</u>	<u>\$ -</u>	<u>\$ 17,500,000</u>	<u>\$ -</u>

NOTE 14 – BONDS PAYABLE

Bonds payable at June 30, 2005 consisted of the following:

	Outstanding June 30, 2004	Additions	Deductions	Outstanding June 30, 2005
General obligation bonds School Improvement, (2004) 4.84%, through 2030	\$ 17,500,000	\$ -	\$ 285,000	\$ 17,215,000

NOTE 15 - LONG-TERM OBLIGATIONS

Changes in the District's long-term obligations during fiscal year 2005 were as follows:

	Outstanding June 30, 2004	Additions	Retired	Outstanding June 30, 2005	Amounts Due In One Year
Bonds payable	\$ 17,500,000	\$ -	\$ 285,000	\$ 17,215,000	\$ 475,000
Compensated absences	1,084,104	56,193	47,929	1,092,368	87,422
	<u>\$ 18,584,104</u>	<u>\$ 56,193</u>	<u>\$ 332,929</u>	<u>\$ 18,307,368</u>	<u>\$ 562,422</u>

The bonds payable will be repaid from the Debt Service Fund. The compensated absences will be repaid from the funds from which employee's salaries are paid.

KEYSTONE LOCAL SCHOOL DISTRICT
LORAIN COUNTY
NOTES TO THE BASIC FINANCIAL STATEMENTS
FOR THE YEAR ENDED JUNE 30, 2005

NOTE 16 – DEBT SERVICE REQUIREMENTS

The following is a description of the District's future annual debt service requirements to maturity for bonds payable:

Year ending June 30,	Principal	Interest	Total
2006	\$ 475,000	\$ 760,575	\$ 1,235,575
2007	510,000	749,450	1,259,450
2008	605,000	735,512	1,340,512
2009	645,000	718,275	1,363,275
2010	690,000	697,387	1,387,387
2011-2015	1,395,000	3,456,213	4,851,213
2016-2020	1,915,000	3,011,550	4,926,550
2021-2025	3,530,000	2,341,500	5,871,500
2026-2030	5,930,000	1,176,750	7,106,750
2031	1,520,000	38,000	1,558,000
	<u>\$ 17,215,000</u>	<u>\$ 13,685,212</u>	<u>\$30,900,212</u>

NOTE 17 – OPERATING LEASES

The District is obligated under certain leases accounted for as operating leases. Operating leases do not give rise to property rights or lease obligations, and therefore, the results of the lease agreements are not reflected in the District's statement of net assets. During 2005, expenditures for operating leases totaled \$ 90,432.

The following is a schedule of future minimum rental payments required under operating leases that have initial or remaining noncancelable lease terms in excess of one year as of June 30, 2005.

Year ending June 30,	Amount
2006	\$ 90,432
2007	90,432
2008	82,332
Total minimum lease payments	<u>\$ 263,196</u>

KEYSTONE LOCAL SCHOOL DISTRICT
LORAIN COUNTY
NOTES TO THE BASIC FINANCIAL STATEMENTS
FOR THE YEAR ENDED JUNE 30, 2005

NOTE 18 - SET-ASIDES

The District is required by State statute to annually set aside, in the General Fund, an amount based on a statutory formula for the purchase of textbooks and other instructional materials, and an equal amount for the acquisition and construction of capital improvements. Amounts not spent by the end of the fiscal year or offset by similarly restricted resources received during the year must be held in cash at year end. These amounts must be carried forward and used for the same purposes in future years.

The following cash basis information identifies the changes in the fund balance reserves for textbooks and capital improvements during fiscal year 2005.

	Textbook	Capital Maintenance	Total
Balance, July 1, 2004	\$ (866,797)	\$ -	\$ (866,797)
Required set aside	260,158	260,158	520,316
Offset credits	-	(255,639)	(255,639)
Qualifying expenditures	(303,418)	(130,602)	(434,020)
Totals	<u>\$ (910,057)</u>	<u>\$ (126,083)</u>	<u>\$ (1,036,140)</u>
Carry forward at June 30, 2005	<u>\$ (910,057)</u>	<u>\$ -</u>	<u>\$ (910,057)</u>

Expenditures and offset credits for textbooks and capital maintenance during the year were \$ 303,418 and \$ 386,241, respectively, which exceeded the required set-aside and the reserve balance. Textbook expenditures have exceeded statutory requirements by \$ 910,057 which may be used to offset future years' set aside requirements.

NOTE 19 - JOINTLY GOVERNED ORGANIZATIONS

A. LAKE ERIE EDUCATIONAL COMPUTER ASSOCIATION

The Lake Erie Educational Computer Association (LEECA) is a jointly governed organization comprised of thirty school districts. The jointly governed organization was formed to provide data processing services for accounting, administrative and instructional functions of member districts. Each of the governments of these districts supports LEECA based upon a per pupil charge dependent upon the software packages utilized. The LEECA assembly consists of a superintendent or designated representative from each participating district and a representative from the fiscal agent.

LEECA is governed by a board of directors chosen from the general membership of the LEECA assembly. The board of directors consists of a representative from the fiscal agent, the chairman of each operating committee, and at least one assembly member from each county from which participating districts are located. Financial information can be obtained by contacting the Treasurer at the Educational Service Center of Lorain County, which serves as fiscal agent, located at 1885 Lake Avenue, Elyria, Ohio 44035. During the year ended June 30, 2005, the District paid approximately \$ 3,300 to LEECA.

KEYSTONE LOCAL SCHOOL DISTRICT
LORAIN COUNTY
NOTES TO THE BASIC FINANCIAL STATEMENTS
FOR THE YEAR ENDED JUNE 30, 2005

NOTE 19 - JOINTLY GOVERNED ORGANIZATIONS (continued)

B. LAKE ERIE REGIONAL COUNCIL OF GOVERNMENTS (LERC)

The Lake Erie Regional Council of Governments (LERC) is a jointly governed organization among seventeen districts. The jointly governed organization was formed for the purpose of promoting cooperative agreements and activities among its members in dealing with problems of mutual concern such as a media center, gas consumption, and insurance. Each member provided operating resources to LERC on a per-pupil or actual usage charge, except for insurance.

The LERC assembly consists of a superintendent or designated representative from each participating district and the fiscal agent. A board of directors chosen from the general membership governs LERC. The degree of control exercised by any participating district is limited to its representation on the board. Financial information can be obtained by contacting the Treasurer at the Educational Service Center of Lorain County located at 1885 Lake Avenue, Elyria, Ohio 44035. During the year ended June 30, 2005, the District paid approximately \$ 1,530,112 to LERC.

C. COUNTY JOINT VOCATIONAL SCHOOL DISTRICT

The Lorain County Joint Vocational School District is a jointly governed organization. The jointly governed organization was formed for the purpose of providing vocational and special education needs of the students. The Lorain County Joint Vocational School Board is comprised of representatives from each participating school district and is responsible for approving its own budgets, appointing personnel, and accounting and financing related activities.

The degree of control exercised by any participating district is limited to its representation on the board. Financial information can be obtained by contacting the Treasurer at the Lorain County Joint Vocational School District located at 15181 State Route 58, Oberlin, Ohio 44074.

D. OHIO SCHOOL COUNCIL ASSOCIATION

The Ohio Schools Council Association (Council) is a jointly governed organization among ninety-one school districts. The organization was formed to purchase quality products and services at the lowest possible cost to the member districts. Each district supports the Council by paying an annual participation fee. The Council's Board consists of seven superintendents of the participating districts whose term rotates every year. The degree of control exercised by any district is limited to its representation on the Board. In fiscal year 2005, the District paid \$ 14,628 to the Council. Financial information can be obtained by contacting David A. Cottrell, the Executive Secretary/Treasurer of the Ohio Schools Council at 6133 Rockside Road, Suite 10, Independence, Ohio, 44131.

The District participates in the Council's electric purchase program which was implemented during fiscal year 1998. This program allows school districts to purchase electricity at reduced rates, if the districts will commit to participating for an eight year period. The participants make monthly payments based on estimated usage. Each June these estimated payments are compared to their actual usage for the year and any necessary adjustments are made.

Energy Acquisition Corp., a non-profit corporation with a self-appointing board, issued \$ 119,140,000 in debt to purchase eight years of electricity from Cleveland Electric Illuminating (CEI) for the participants. The participating districts are not obligated in any manner for the debt. If a participating district terminates its agreement, the district is required to repay the savings to CEI and CEI will refund the remaining prepayment related to that participant to Energy Acquisition Corp.

KEYSTONE LOCAL SCHOOL DISTRICT
LORAIN COUNTY
NOTES TO THE BASIC FINANCIAL STATEMENTS
FOR THE YEAR ENDED JUNE 30, 2005

NOTE 20 - SCHOOL FOUNDATION PROGRAM

On December 11, 2002, the Ohio Supreme Court issued its latest opinion regarding the State's school funding plan. The decision reaffirmed earlier decisions that Ohio's current school funding plan is unconstitutional. The Supreme Court relinquished jurisdiction over the case and directed "...the Ohio General Assembly to enact a school funding scheme that is thorough and efficient...". The District is currently unable to determine what effect, if any, this decision will have on its future State funding and its financial operations.

NOTE 21 - CONTINGENCIES

The District received financial assistance from federal and state agencies in the form of grants. The expenditure of funds received under these programs generally requires compliance with terms and conditions specified in the grant agreements and is subject to audit by the grantor agencies.

Any disallowed claims resulting from such audits could become a liability of the General Fund or other applicable funds. However, in the opinion of management, any such disallowed claims will not have a material adverse effect on the overall financial position of the District at June 30, 2005.

NOTE 22 - CONTRACTUAL COMMITMENTS

The District approved the contract for the new high school building. Outstanding commitments as a result of this project are \$ 6,752,093.

NOTE 23 - NEWLY ENACTED LEGISLATION

In June 2005, the State of Ohio enacted legislation, portions of which take effect at various times, that phases out the taxation of tangible personal property used in business (other than certain public utility tangible personal property) over four years from tax year 2006 to tax year 2009. New manufacturing machinery and equipment first reportable after 2005 is not subject to tangible personal property taxation. To compensate local government units for the foregone revenue, the recently enacted legislation provides for State distributions from revenue generated by a newly enacted commercial activities tax. The reimbursement is to be based on the aggregate value of tangible personal property reported for the local government for tax year 2004 (based on voted levies approved by the electors by September 1, 2005). Generally these distributions will fully reimburse the local government units at that base level through 2010 and then in declining amounts from 2011 through 2017.

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**KEYSTONE LOCAL SCHOOL DISTRICT
LORAIN COUNTY**

**FEDERAL AWARDS RECEIPTS AND EXPENDITURES SCHEDULE
FOR THE YEAR ENDED JUNE 30, 2005**

Federal Grantor/ Pass-Through Grantor/ Program Title	Pass-Through Entity Number	CFDA Number	Receipts	Non-Cash Receipts	Expenditures	Non-Cash Expenditures
U. S. Department of Agriculture						
<i>Passed Through the Ohio Department of Education</i>						
Child Nutrition Cluster:						
Food Distribution	N/A	10.550	\$0	\$22,087	\$0	\$22,087
National School Lunch Program	LL-P402 - 05	10.555	72,886	0	72,886	
Total Child Nutrition Cluster			72,886	22,087	72,886	22,087
Total U.S. Department of Agriculture			72,886	22,087	72,886	22,087
U. S. Department of Education						
<i>Passed Through the Ohio Department of Education</i>						
Special Education Grants to States, IDEA Part B	6BSF-2004-P	84.027	28,463	0	30,885	0
Special Education Grants to States, IDEA Part B	6BSF-2005-P	84.027	345,915	0	325,022	0
Total Education Grants to States			374,378	0	355,907	0
Title I, Part A, ESEA	C1S1-2004	84.010	3,455	0	14,430	0
Title I, Part A, ESEA	C1S1-2005	84.010	137,888	0	126,381	0
Total Title I, Grants to States			141,343	0	140,811	0
Innovative Educational Program Strategies, Title V	C2S1-2005	84.298	8,148	0	8,148	0
Safe and Drug Free Schools and Community State Grants	DRS1-2005	84.186	7,180	0	7,159	0
Education Technology State Grants, Title II-D	TJS1-2005	84.318	3,666	0	3,741	0
Improving Teacher Quality, Title II-A	TRS1-2004	84.367	764	0	7,209	0
Improving Teacher Quality, Title II-A	TRS1-2005	84.367	52,607	0	46,375	0
Total Improving Teacher Quality, Title II-A			53,371	0	53,584	0
Total U.S. Department of Education			588,086	0	569,350	0
U. S. Department of Health and Human Services						
<i>Passed Through the Ohio Department of Mental Retardation and Developmental Disabilities</i>						
State Children's Health Insurance Program	N/A	93.767	281	0	281	0
Medical Assistance Program - Community Alternative Fund System (Medicaid)	N/A	93.778	15,361	0	15,361	0
Total U.S. Department of Health and Human Services			15,642	0	15,642	0
Total Federal Assistance			\$676,614	\$22,087	\$657,878	\$22,087

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

**KEYSTONE LOCAL SCHOOL DISTRICT
LORAIN COUNTY**

**NOTES TO THE FEDERAL AWARDS RECEIPTS AND EXPENDITURES SCHEDULE
FOR THE YEAR ENDED JUNE 30, 2005**

NOTE A - SIGNIFICANT ACCOUNTING POLICIES

The accompanying Federal Awards Receipts and Expenditures Schedule (the Schedule) summarizes activity of the District's federal award programs. The Schedule has been prepared on the cash basis of accounting.

NOTE B - CHILD NUTRITION CLUSTER

Program regulations do not require the District to maintain separate inventory records for purchased food and food received from the U.S. Department of Agriculture. This nonmonetary assistance (expenditures) is reported in the Schedule at the fair market value of the commodities received.

Cash receipts from the U.S. Department of Agriculture are commingled with State grants. It is assumed federal monies are expended first.

N/A – Not Applicable

CFDA – Catalog of Federal Domestic Assistance



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*

Board of Education
Keystone Local School District
Lorain County
301 Liberty Street, P.O. Box 65
LaGrange, Ohio 44050

We have audited the financial statements of the governmental activities, each major fund, and the aggregate remaining fund information of Keystone Local School District, Lorain County, Ohio, (the District) as of and for the year ended June 30, 2005, which collectively comprise the District's basic financial statements and have issued our report thereon dated March 10, 2006. 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*.

Internal Control Over Financial Reporting

In planning and performing our audit, we considered the District's internal control over financial reporting to determine our auditing procedures in order to express our opinions on the financial statements and not to opine 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 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 District'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 2005-001.

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 material to the financial statements we audited may occur and not be timely detected by employees when performing their assigned functions. Our consideration of the internal control over financial reporting would not necessarily disclose all matters in the internal control that might be reportable conditions and, accordingly, would not necessarily disclose all reportable conditions that are also considered material weaknesses. However, we do not believe the reportable condition described above is a material weakness. In a separate letter to the District's management dated March 10, 2006, we reported other matters involving internal control over financial reporting which we did not deem reportable conditions.

Compliance and Other Matters

As part of reasonably assuring whether the District'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*.

We intend this report solely for the information and use of management, the Board of Education, federal awarding agencies, and pass-through entities. 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

March 10, 2006



Auditor of State Betty Montgomery

INDEPENDENT ACCOUNTANTS' REPORT ON COMPLIANCE WITH REQUIREMENTS APPLICABLE TO ITS MAJOR FEDERAL PROGRAM AND ON INTERNAL CONTROL OVER COMPLIANCE IN ACCORDANCE WITH OMB CIRCULAR A-133

Board of Education
Keystone Local School District
Lorain County
301 Liberty Street, P.O. Box 65
LaGrange, Ohio 44050

Compliance

We have audited the compliance of Keystone Local School District, Lorain County, Ohio, (the District) with the types of compliance requirements described in the U.S. Office of Management and Budget (OMB) Circular A-133, Compliance Supplement that apply to its major federal program for the year ended June 30, 2005. The summary of auditor's results section of the accompanying schedule of findings identifies the District's major federal program. The District's management is responsible for complying with the requirements of laws, regulations, contracts, and grants applicable to each major federal program. Our responsibility is to express an opinion on the District's compliance based on our audit.

We conducted our audit of compliance in accordance with auditing standards generally accepted in the United States of America; the standards applicable to financial audits contained in *Government Auditing Standards* issued by the Comptroller General of the United States; and OMB Circular A-133, *Audits of States, Local Governments, and Non-Profit Organizations*. Those standards and OMB Circular A-133 require that we plan and perform the audit to reasonably assure whether noncompliance occurred with the types of compliance requirements referred to above that could directly and materially affect a major federal program. An audit includes examining, on a test basis, evidence about the District's compliance with those requirements and performing other procedures we considered necessary in the circumstances. We believe our audit provides a reasonable basis for our opinion. Our audit does not provide a legal determination on the District's compliance with those requirements.

In our opinion, the Keystone Local School District complied, in all material respects, with the requirements referred to above that apply to its major federal program for the year ended June 30, 2005.

Internal Control Over Compliance

The District's management is responsible for establishing and maintaining effective internal control over compliance with requirements of laws, regulations, contracts, and grants applicable to federal programs. In planning and performing our audit, we considered the District's internal control over compliance with requirements that could directly and materially affect a major federal program to determine our auditing procedures for the purpose of expressing our opinion on compliance and to test and report on internal control over compliance in accordance with OMB Circular A-133.

Internal Control Over Compliance (Continued)

Our consideration of the internal control over compliance would not necessarily disclose all matters in the internal control 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 noncompliance with applicable requirements of laws, regulations, contracts and grants caused by error or fraud that would be material in relation to a major federal program being audited may occur and not be timely detected by employees when performing their assigned functions. We noted no matters involving the internal control over compliance and its operation that we consider to be material weaknesses

We intend this report solely for the information and use of management, the Board of Education, and federal awarding agencies, and pass-through entities. 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

March 10, 2006

**KEYSTONE LOCAL SCHOOL DISTRICT
LORAIN COUNTY**

**SCHEDULE OF FINDINGS
OMB CIRCULAR A -133 § .505
JUNE 30, 2005**

1. SUMMARY OF AUDITOR'S RESULTS

(d)(1)(i)	Type of Financial Statement Opinion	Unqualified
(d)(1)(ii)	Were there any material control weakness conditions reported at the financial statement level (GAGAS)?	No
(d)(1)(ii)	Were there any other reportable control weakness conditions reported at the financial statement level (GAGAS)?	Yes
(d)(1)(iii)	Was there any reported material noncompliance at the financial statement level (GAGAS)?	No
(d)(1)(iv)	Were there any material internal control weakness conditions reported for major federal programs?	No
(d)(1)(iv)	Were there any other reportable internal control weakness conditions reported for major federal programs?	No
(d)(1)(v)	Type of Major Programs' Compliance Opinion	Unqualified
(d)(1)(vi)	Are there any reportable findings under § .510?	No
(d)(1)(vii)	Major Programs (list):	Special Education Grants to States CFDA #84.027
(d)(1)(viii)	Dollar Threshold: Type A/B Programs	Type A: > \$ 300,000 Type B: all others
(d)(1)(ix)	Low Risk Auditee?	Yes

**KEYSTONE LOCAL SCHOOL DISTRICT
LORAIN COUNTY**

**SCHEDULE OF FINDINGS
OMB CIRCULAR A -133 § .505
JUNE 30, 2005
(Continued)**

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

FINDING NUMBER 2005-001

Requirements of SAS 70

The District has delegated employees' health care claims processing, which is a significant accounting function, to a third-party administrator. The District has not established procedures to determine whether this service organization has sufficient controls in place and operating effectively to reduce the risk that the health insurance claims have not been completely and accurately processed in accordance with the health insurance contract. Failure to obtain assurance over the claims processing may lead to qualification of opinion.

Statement on Auditing Standards (SAS) No. 70, as amended, prescribes standards for reporting on service organizations. An unqualified Type II Report on Policies and Procedures Placed in Operation and Tests of Operating Effectiveness in accordance with SAS No. 70 should provide the District with reasonable assurance that health insurance claim transactions conform to the contract.

We recommend the District require a Type II SAS 70 report in its contract with the third-party administrator. The District should review the SAS 70 report timely. The report should follow American Institute of Certified Public Accountants standards and be performed by a firm registered and considered in good standings with the Accountancy Board of the respective state.

If the third-party administrator refuses to furnish the District with a Type II SAS 70 report, we recommend the District contract with a third-party administrator that will provide such a report.

3. FINDINGS AND QUESTIONED COSTS FOR FEDERAL AWARDS

None



**Auditor of State
Betty Montgomery**

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**KEYSTONE LOCAL SCHOOL DISTRICT
LORAIN COUNTY**

CLERK'S CERTIFICATION

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

Susan Babbitt

CLERK OF THE BUREAU

**CERTIFIED
MAY 4, 2006**