



**Auditor of State
Betty Montgomery**

**VIRTUAL SCHOOLHOUSE
CUYAHOGA COUNTY**

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**Auditor of State
Betty Montgomery**

INDEPENDENT ACCOUNTANTS' REPORT

Virtual Schoolhouse
Cuyahoga County
2490 Lee Boulevard, Suite 217
Cleveland, Ohio 44118

To the Board of Trustees:

We were engaged to audit the accompanying financial statements of the Virtual Schoolhouse, Cuyahoga County, Ohio, (the School) as of and for the year ended June 30, 2005, as listed in the table of contents. These financial statements are the responsibility of the School's management.

The School did not provide original supporting documentation, based on the records of the School, for non-payroll cash disbursements. Consequently, we were unable to verify the accuracy, completeness, and valuation of the amounts reported.

Since the School did not provide the evidence described in the paragraph above, the scope of our auditing procedures was not sufficient to enable us to express, and we do not express, an opinion on these financial statements.

In accordance with *Government Auditing Standards*, we have also issued our report dated August 30, 2006 on our consideration of the Academy's internal control over financial reporting and our tests of its compliance with certain provisions of laws, regulations, contracts and grant agreements, and other matters. While we did not opine on the internal control over financial reporting or on compliance, that report describes the scope of our testing of internal control over financial reporting and compliance and the results of that testing. That report is an integral part of an audit performed in accordance with *Government Auditing Standards*. You should read it in conjunction with this report in assessing the results of our attempt to audit.

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

Betty Montgomery
Auditor of State

August 30, 2006

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

Our discussion and analysis of Virtual Schoolhouse, Inc. (School's) financial performance provides and overall review of the School's financial activities for the fiscal year ended June 30, 2005. The intent of this discussion and analysis is to look at the School's financial performance as a whole; readers should also review the basic financial statements and notes to the basic financial statements to enhance their understanding of the School's financial performance.

The Management's Discussion and Analysis (MD&A) is an element of the new reporting model adopted by the Governmental Accounting Standards Board (GASB) in their Statement No. 34 Basic Financial Statements – and Management's Discussion and Analysis – for State and Local Government issued June 1999. Certain comparative information between the current year and the prior year is required to be presented in the MD&A.

Financial Highlights

In total, the School ended its first year with net assets of \$323,268.

The School's activities reflect an operating loss of (\$51,092).

Using this Financial Report

This report consists of three parts, the MD&A, the basic financial statements, and notes to those statements. The basic financial statements include a Statement of Net Assets, a Statement of Revenues, Expenses and Changes in Net Assets, and a Statement of Cash Flows.

One of the most important questions asked about the School's finances is, "Is the School better off or worse off as a result of the year's activities?" The Statement of Net Assets and the Statement of Revenues, Expenses and Changes in Net Assets report information about the School as a whole and about its activities in a manner that helps to answer this question. These statements include all assets and liabilities using the accrual basis of accounting similar to the accounting used by private sector corporations. All of the current year's revenues and expenses are taken into consideration regardless of when cash is received or paid.

These two statements report the School's net assets and changes in them. The change in net assets provides the reader a tool to assist in determining whether the School's financial health is improving or deteriorating. The reader will need to consider other nonfinancial factors such as state revenue, student enrollment growth, and facility conditions in arriving at their conclusion regarding the overall health of the School.

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

As this is the School's first year of operations, fiscal year 2005 figures follow:

	Net Assets
	<u>2005</u>
Current Assets	\$ 496,877
Capital Assets, Net	<u>41,806</u>
Total Assets	538,683
Current Liabilities	<u>215,415</u>
Total Liabilities	215,415
Net Assets:	
Invested in Capital	
Assets, net of debt	41,806
Unrestricted	<u>281,462</u>
Total Net Assets	<u>\$ 323,268</u>

A portion of the School's net assets (12.9%) reflects its investment in capital assets less any related debt used to acquire those assets that is still outstanding. The School uses capital assets to provide services; consequently, these assets are not available for future spending.

Net Assets of the School are \$323,268 and unrestricted net assets reflect a healthy positive balance of \$281,462.

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

Changes in Net Assets

	2005
Operating Revenues:	
Sales	\$ 662
Foundation payments	2,785,022
Other Operating Revenues	<u>4,547</u>
Total Revenues	2,790,231
Operating Expenses:	
Salaries & Wages	165,590
Fringe Benefits	46,702
Purchased Services	2,511,400
Materials & Supplies	80,084
Depreciation	6,705
Miscellaneous	<u>30,842</u>
Total Expenses	2,841,323
Total Operating Loss	(51,092)
Non-Operating Revenues:	
Investment Earnings	225
State subsidies	5,000
Federal subsidies	<u>369,135</u>
Total Non-Operating Revenue	374,360
Change in Net Assets	\$323,268

The School's operating expenses exceeded operating revenues for the first year of operation. The resulting loss from operations is primarily due to startup expenses for the School. The School will be monitoring operating expenses in the ensuing year to ensure fiscal stability of the organization.

Capital Assets

The School has \$41,806 invested in capital assets net of depreciation. The most significant purchase of the School's capital assets for the 2005 fiscal year was the purchase of computers for student instruction. Detailed information regarding capital asset activity is included in the notes to the basic financial statements (Note 5).

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

Restrictions and Other Limitations

The future financial stability of the School is not without challenges.

The first challenge is the state economy. The School does not receive any funds from taxes. The primary source of funding is the state foundation program. An economic slowdown in the state could result in budgetary cuts to education, which would have a negative impact on the School.

The second challenge facing the School is the future of state funding. On September 6, 2001 the Ohio Supreme Court found the Ohio School Funding system to be unconstitutional pending some modifications by the legislature. The District is unable to determine what effect, if any, this decision will have on future funding from the State.

The final challenge is the existence of the school in the future. An ongoing lawsuit filed in Franklin County Common Pleas Court on May 14, 2001, alleging that Ohio's Community (i.e., Charter) Schools program violates the state constitution and state laws. On April 21, 2003 the court dismissed the counts containing constitutional claims and stayed the other counts pending appeal of the constitutional issues. The plaintiffs appealed to the Court of Appeals, the issues have been briefed, and the case was set for oral argument on November 18th, 2003. The case remains at the Court of Appeals at this time. The effect of this suit, if any, on the School is not presently determinable.

**Virtual Schoolhouse
Cuyahoga County
Statement of Net Assets
as of June 30, 2005**

Assets

Current Assets

Cash and Investments	\$ 162,702
Receivable - Federal	331,368
Prepaid retirement	2,807
Total Current Assets	<u>496,877</u>

Non-Current Assets

Fixed assets (Net of Accumulated Depreciation)	<u>41,806</u>
Total Assets	<u>\$ 538,683</u>

Liabilities

Current Liabilities

Accounts Payable	\$ 188,744
Accrued Wages & Benefits	26,671
Compensated Absences	0
Payable to State Pension Systems	0
Capital Leases Payable	0
Note Payable	0
Total Current Liabilities	<u>215,415</u>

Long-Term Liabilities

Capital Leases Payable	0
Note Payable	0
Total Long-Term Liabilities	<u>0</u>

Total Liabilities	<u>215,415</u>
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Net Assets

Invested in Capital Assets, Net of related Debt	41,806
Unrestricted	281,462
Total Net Assets	<u>323,268</u>

The accompanying Notes are an integral part of the Financial Statements

**Virtual Schoolhouse
Cuyahoga County
Statement of Revenues, Expenses,
and Changes in Fund Net Assets
for the Fiscal Year ended June 30, 2005**

Operating Revenues	
Sales	\$ 662
Foundation Payments	2,785,022
Other Operating Revenues	4,547
Total Operating Revenues	<u>2,790,231</u>
Operating Expenses	
Salaries & Wages	165,590
Fringe Benefits	46,702
Purchased Services	2,511,400
Materials & Supplies	80,084
Depreciation	6,705
Miscellaneous	30,842
Total Operating Expenses	<u>2,841,323</u>
Operating Income	(51,092)
Non-Operating Revenues and (Expenses)	
Interest Earnings	225
State subsidies	5,000
Federal subsidies	369,135
Interest Expense	0
Total Non-Operating Revenues and (Expenses)	<u>374,360</u>
Net Income	323,268
Net Assets Beginning of Year	-
Net Assets End of Year	<u>\$ 323,268</u>

The accompanying Notes are an integral part of the Financial Statements

Virtual Schoolhouse
Cuyahoga County
Statement of Cash Flows
for the Fiscal Year ended June 30, 2005

Cash Flows from Operating Activities	
Cash received from sales	\$ 662
Cash received from Foundation Payments	2,785,022
Cash received from Other Operating Revenues	4,547
Cash payments for personal services	(188,428)
Cash payments for contract services	(2,324,302)
Cash payments for supplies and materials	(78,438)
Cash payments for Miscellaneous	(30,842)
Net Cash Provided By/(Used for) Operating Activities	<u>168,221</u>
Cash Flows from Noncapital Financing Activities	
Cash from Federal & State Subsidies	<u>42,767</u>
Net Cash from Noncapital Financing Activities	<u>42,767</u>
Cash Flows from Capital and Related Financing Activities	
Payments for Capital Acquisitions	(48,511)
Payments for Interest on Capital Acquisitions	0
Net Cash Used for Capital and Related Financing Activities	<u>(48,511)</u>
Cash Flows from Investing Activities	
Interest on cash and cash equivalents	<u>225</u>
Net cash from investing activities	<u>225</u>
Net increase in cash and cash equivalents :	162,702
Cash and cash equivalents at beginning of year	-
Cash and cash equivalents at end of year	<u>\$ 162,702</u>
Reconciliation of Operating Income to Net Cash Provided By (Used for) Operating Activities	
Operating Income	(51,092)
Adjustments to Reconcile Operating Income to Net Cash Provided by (Used for) Operating Activities	
Depreciation	6,705
Changes in Assets and Liabilities:	
Prepaid retirement	(2,807)
Accounts Payable	188,744
Accrued Wages and Benefits	26,671
Payable to State Pension Systems	0
Compensated Absences	0
Total Adjustments	<u>219,313</u>
Net cash provided (used) by operating activities	<u>\$ 168,221</u>

The accompanying Notes are an integral part of the Financial Statements

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Virtual Schoolhouse
Cuyahoga County

Notes to the Financial Statements
For the Fiscal Year Ended June 30, 2005

1. DESCRIPTION OF THE SCHOOL AND REPORTING ENTITY

Virtual Schoolhouse (the School) is a nonprofit corporation established pursuant to Ohio Revised Code Chapters 3314 and 1702 to address the needs of students in kindergarten through fifth grade. The School, which is part of the State's education program, is independent of any school district and is nonsectarian in its programs, admissions policies, employment practices, and all other operations. The School may sue and be sued, acquire facilities as needed, and contract for any necessary services necessary for the operation of the school.

The School was approved for operation under contract with Lucas County Educational Service Center (the Sponsor) for a period of five years commencing July 1, 2004. The Sponsor is responsible for evaluating the performance of the School and has the authority to deny renewal of the contract at its expiration or terminate the contract prior to its expiration.

The School operates under the direction of a six member Board of Trustees. The Board is responsible for carrying out the provisions of the contract which include, but are not limited to, state mandated provisions regarding student population, curriculum, academic goals, performance standards, admission standards, and qualifications of teachers. The Board of Trustees control the School's instructional/support facility staffed by 5 classified and 1 certificated teaching personnel who provide services to 281 students.

2. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

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

A. Basis of Presentation

The School uses enterprise accounting to maintain its financial records during the school year. Enterprise accounting focuses on the determination of operating income, changes in net assets, financial position and cash flows. Enterprise accounting may be used to account for any activity for which a fee is charged to external users for goods and services.

Virtual Schoolhouse
Cuyahoga County

Notes to the Financial Statements
For the Fiscal Year Ended June 30, 2005
(Continued)

2. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (CONTINUED)

B. Measurement Focus and Basis of Accounting

Enterprise accounting uses a flow of economic resources measurement focus. With this measurement focus, all assets and all liabilities are included on the statement of net assets. Operating statements present increases and decreases in net total assets.

Basis of accounting refers to when revenues and expenses are recognized in the accounts and reported in the financial statements. Basis of accounting relates to the timing of the measurements made. The accrual basis of accounting is used for reporting purposes. Revenues are recognized when earned and expenses are recognized when they are incurred.

C. Budgetary Process

Unlike other public schools located in the State of Ohio, community schools are not required to follow the budgetary provisions set forth in Ohio Revised Code Chapter 5705, unless specifically provided in the School's contract with its Sponsor. The contract between the School and its Sponsor does not prescribe a budgetary process for the School.

D. Cash and Investments

All monies received by the School are pooled and deposited in a central bank account. All monies of the School are maintained in this account or temporarily used to purchase short term investments.

During fiscal year 2005, investments were limited to STAR Ohio and money market funds. STAR Ohio is an investment pool managed by the State Treasurer's Office which allows governments within the State to pool their funds for investment purposes. STAR Ohio 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 STAR Ohio are valued at STAR Ohio's share price which is the price the investment could be sold for on June 30, 2005. Money market funds are valued at cost.

For purposes of the statement of cash flows and for presentation on the statement of net assets, investments with a maturity of three months or less at the time they are purchased are considered to be cash equivalents.

E. Fixed Assets and Depreciation

Fixed assets are capitalized at cost and updated for additions and retirements during the year. Donated fixed assets are recorded at their fair values as of the dates received. The School maintains a capitalization threshold of five hundred dollars. The School does not possess any infrastructure. Improvements are capitalized, the cost 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.

Virtual Schoolhouse
Cuyahoga County

Notes to the Financial Statements
For the Fiscal Year Ended June 30, 2005
(Continued)

2. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (CONTINUED)

E. Fixed Assets and Depreciation (Continued)

Property, plant and equipment is depreciated using the straight line method over the following estimated useful lives. Improvements to fixed assets are depreciated over the remaining useful life of the related fixed assets.

<u>Assets</u>	<u>Years</u>
Buildings	50
Building Improvements	20
Vehicles	10
Furniture and Equipment	10
Computer equipment	5

F. Intergovernmental Revenues

The School currently participates in the State Foundation Program. Revenues received from this program are recognized as operating revenues in the accounting period in which all eligibility requirements are met.

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

Eligibility requirements include timing requirements, which specify the year when the resources are required to be used or the fiscal year use is first permitted, matching requirements, in which the School must provide local resources to be used for a specified purpose, and expenditure requirements, in which the resources are provided to the School on a reimbursement basis.

Amounts awarded under the above named programs for 2005 school year totaled \$2,785,022.

Virtual Schoolhouse
Cuyahoga County

Notes to the Financial Statements
For the Fiscal Year Ended June 30, 2005
(Continued)

3. DEPOSITS AND INVESTMENTS

Deposits: The carrying value of the School's deposits totaled \$79,477, and the bank balance totaled \$79,826, all of which was covered by federal depository insurance.

Investments of the School as of June 30, 2005 were as follows:

<u>Investments</u>	<u>Fair Value</u>	<u>Weighted Average Maturity(Years)</u>
Money Market	\$ 79,447	0.00
Star Ohio	<u>83,225</u>	0.00
Total Investments	<u>\$ 83,225</u>	

Interest Rate Risk – The School's investment policy does not limit investment maturities as a means of managing its exposure to fair value losses arising from increasing interest rates.

Credit Risk – The money market fund is covered by federal depository insurance. The School places no limit on the amount that may be invested in any one issuer.

4. RECEIVABLES

Receivables at June 30, 2005, consisted of intergovernmental receivables of \$331,368.

5. FIXED ASSETS

A summary of the School's fixed assets at June 30, 2005, follows:

	Balance 6/30/05
Capital Assets being depreciated	
Furniture and Equipment	1,247
Computer Equipment	<u>47,237</u>
Subtotal	48,511
Less: Accumulated Depreciation	<u>(6,705)</u>
Net Fixed Assets	<u>\$ 41,806</u>

Virtual Schoolhouse
Cuyahoga County

Notes to the Financial Statements
For the Fiscal Year Ended June 30, 2005
(Continued)

6. RISK MANAGEMENT

A. Property and Liability

The School is exposed to various risks of loss related to torts; theft of, damage to, and destruction of assets; errors and omissions; injuries to employees; and natural disasters. For fiscal year 2005, the School contracted with Western Heritage Insurance Company for property and general liability insurance with a \$1,000,000 single occurrence limit and \$1,000,000 aggregate with a \$500 deductible.

B. Worker's Compensation

The School pays the State Worker's Compensation System a premium for employee injury coverage. The premium is calculated by multiplying the annual total gross payroll by a factor determined by the State.

7. DEFINED BENEFIT PENSION PLANS

State Teachers Retirement System

The School contributes to the State Teachers Retirement System of Ohio (STRS), a cost sharing multiple employer public employee retirement system administered by the State Teachers Retirement Board. STRS provides basic retirement benefits, disability, survivor, and health care benefits based on eligible service credit to members and beneficiaries. Benefits are established by Chapter 3307 of the Ohio Revised Code. STRS issues a publicly available financial report that includes financial statements and required supplementary information for STRS. The report may be obtained by writing to State Teachers Retirement System, 275 East Broad Street, Columbus, Ohio 43215-3771.

Plan members and the School are required to contribute 10 percent and 14 percent respectively, of their annual covered salary. Contribution rates are established by STRS, upon recommendation of its consulting actuary, not to exceed statutory maximum rates of 10 percent for members and 14 percent for employers. The School's required contribution for pension obligations to STRS for the year ending June 30, 2005 \$21,525. The School has contributed \$25,990 for fiscal year 2005, and the overpayment to STRS has been recorded as a prepaid item.

Virtual Schoolhouse
Cuyahoga County

Notes to the Financial Statements
For the Fiscal Year Ended June 30, 2005
(Continued)

8. POSTEMPLOYMENT BENEFITS

The School provides comprehensive health care benefits to retired teachers and their dependents through the State Teachers Retirement System (STRS). Benefits include hospitalization, physicians' fees, prescription drugs, and partial reimbursement of monthly Medicare premiums. Benefit provisions and the obligations to contribute are established by the Systems based on authority granted by State statute. Both systems are funded on a pay-as-you-go basis.

The State Teachers Retirement Board has statutory authority over how much, if any, of the health care costs will be absorbed by STRS. Most benefit recipients pay a portion of the health care cost in the form of a monthly premium. By Ohio law, the cost of coverage paid from STRS funds shall be included in the employer contribution rate. The board currently allocates employer contributions equal to 1.0% of covered payroll to the Health Care Reserve Fund from which payments for health care benefits are paid. For the School, this amount equaled \$1,658 during fiscal year 2005. For the year ended June 30, 2004, net health care costs paid by STRS were \$268,739,000 and eligible benefit recipients totaled 111,853.

9. OTHER EMPLOYEE BENEFITS

Insurance Benefits

The School has contracted with Aetna to provide employee health, dental and life insurance. The School paid a portion of the monthly premium for fiscal year 2005 for single coverage and joint coverage depending on the employee's contract.

10. STATE SCHOOL FUNDING DECISION

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

The Supreme Court relinquished jurisdiction over the case and directed "...the Ohio General Assembly to enact a school funding scheme that is thorough and efficient...".

As of the date of these financial statements, the School is unable to determine what effect, if any, this decision will have on its future State funding and on its financial operations.

Virtual Schoolhouse
Cuyahoga County

Notes to the Financial Statements
For the Fiscal Year Ended June 30, 2005
(Continued)

11. CONTINGENCIES

A. Grants

The School received financial assistance from federal and state agencies in the form of grants. The disbursement of funds received under these programs generally requires compliance with terms and conditions specified in the grant agreements and is subject to audit by the grantor agencies. Any disallowed claims resulting from such audits could become a liability of the 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 position of the School at June 30, 2005.

B. Litigation

A suit was filed in Franklin County Common Pleas Court on May 14, 2001, alleging that Ohio's Community (i.e., Charter) Schools program violates the state constitution and state laws. On April 21, 2003 the court dismissed the counts containing constitutional claims and stayed the other counts pending appeal of the constitutional issues. The plaintiffs appealed to the Court of Appeals, the issues have been briefed, and the case was set for oral argument on November 18th, 2003. On August 24, 2004 the Court of Appeals rendered a decision that Community Schools are part of the state education system and this matter was sent to the Ohio Supreme Court. The effect of this suit, if any on the school is not presently determinable.

12. PURCHASED SERVICES EXPENSES

For the year ended June 30, 2005, purchased service expenses were payments for services rendered by various vendors as follows:

Professional and Technical Services	\$ 2,389,655
Property Services	56,199
Travel Mileage/Meeting Expense	1,370
Communications	63,736
Other Purchased Services	440
Total Purchased Services	2,511,400

13. OTHER LEASES

During fiscal year 2005, the School entered into a lease agreement with the Maylee Building LLC for approximately 6,000 square feet for the School. The term of the lease commenced January 1, 2004 through December 31, 2004. Thereafter, the lease is renewed on an annual basis. The monthly rent for the space in 2004 was \$3,000 payable on or before the first day of each month increasing to \$3,500 during 2005.

14. TAX EXEMPT STATUS

The School has applied, under § 501(c)(3) of the Internal Revenue Code, for tax exempt organization status. Management is not aware of any course of action or series of events that might adversely affect the School's tax exempt status.

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**Auditor of State
Betty Montgomery**

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

Virtual Schoolhouse
Cuyahoga County
2490 Lee Boulevard
Cleveland, Ohio 44118

We were engaged to audit the financial statements of the Virtual Schoolhouse, Cuyahoga County, Ohio, (the School) as of and for the year ended June 30, 2005 and have issued our report thereon dated August 30, 2006. Our report indicated that due to the lack of original supporting documentation, based on the records of the School, we did not express an opinion on the financial statements. Except as discussed in the preceding sentence, we conducted our engagement 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 engagement, we considered the School'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 certain matters involving the internal control over financial reporting and its operation that we consider reportable conditions. Reportable conditions involve matters coming to our attention relating to significant deficiencies in the design or operation of the internal control over financial reporting that, in our judgment, could adversely affect the School's ability to record, process, summarize, and report financial data consistent with management's assertions in the financial statements. Reportable conditions are described in the accompanying schedule of findings as items 2005-004 through 2005-007.

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 which we were engaged to audit, 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. We consider reportable conditions 2005-004 through 2005-007 listed above to be material weaknesses.

Compliance and Other Matters

As part of reasonably assuring whether the School'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 instances of noncompliance or other matters we must report under *Government Auditing Standards* which are described in the accompanying schedule of findings as items 2005-001 through 2005-003.

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



Betty Montgomery
Auditor of State

August 30, 2006

**VIRTUAL SCHOOLHOUSE
CUYAHOGA COUNTY
FOR THE YEAR ENDED JUNE 30, 2005**

FINDINGS RELATED TO THE FINANCIAL STATEMENTS REQUIRED TO BE REPORTED IN ACCORDANCE WITH GAGAS
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FINDING NUMBER	2005-001
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Financial Report Filing

Ohio Revised Code Section 117.38 provides that each public office shall file a financial report for each fiscal year, within one hundred and fifty days for entities reporting on a GAAP basis. The Auditor of State may prescribe forms by rule or may issue guidelines, or both, for such reports. If the Auditor of State has not prescribed a rule regarding the form for the report, the public office shall submit its report on the form utilized by the public office. In part this report shall contain the following:

- Amount of collections and receipts, and accounts due from each source; and,
- Amount of expenditures for each purpose.

Ohio Administrative Code Section 117-2-03 (B) further clarifies the filing requirements of Ohio Revised Code Section 117.38. This section provides that all school districts, including educational service centers and community schools, shall file their annual financial reports pursuant to generally accepted accounting principles. Generally accepted accounting principles (GAAP) require the following:

- Balance sheet as prescribed by GAAP standards;
- Income and expense statement as prescribed by GAAP;
- Cash flow statement as prescribed by GAAP; and,
- Notes to the financial statements as prescribed by GAAP;

The School has not filed its financial statements for the year ended June 30, 2005, which was their first year of operation.

We recommend the School organize its financial recordkeeping, develop tickler files as a reminder of filing dates and take all other steps necessary to file its financial statements within the prescribed time period. If these financial statements are not filed within the prescribed timetable the School may be assessed a late filing penalty.

Client Response:

Virtual Schoolhouse appreciated the assistance of the Auditor's office in reviewing our first year financial statements and procedures. Upon review of the auditor's findings we were concerned to learn that the company we had expressly contracted to assist us in managing and overseeing our financial documents had failed to properly do so. Specifically, GAAP statements were not prepared on a timely basis and internal controls were lacking. As a direct response to the concerns brought to the Board's attention by the auditors, Virtual Schoolhouse is now utilizing State software and has engaged Charter School Specialists for financial and state reporting services, and to offer any other financial support as needed.

**VIRTUAL SCHOOLHOUSE
CUYAHOGA COUNTY
FOR THE YEAR ENDED JUNE 30, 2005
(CONTINUED)**

FINDINGS RELATED TO THE FINANCIAL STATEMENTS REQUIRED TO BE REPORTED IN ACCORDANCE WITH GAGAS
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FINDING NUMBER	2005-002
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Meeting of the Board

Ohio Revised Code Section 121.22 requires all meetings of public body to be open to the public at all times. The minutes of a regular or special meeting of any such public bodies shall be promptly recorded and open to public inspection.

Every public body shall, by rule, establish a reasonable method whereby any person may determine the time and place of all regularly scheduled meetings and the time, place, and purpose of all special meetings. A public body shall not hold a special meeting unless at least twenty-four hours advance notice to the news media that have requested notification, except in the event of any emergency requiring immediate official action.

Ohio Revised Code Section 149.43 requires all public records shall be promptly prepared and made available to any member of the general public at all reasonable times during regular business hours for inspection. Upon request, a person responsible for public records shall make copies available at cost, within a reasonable period of time. In order to facilitate broader access to public records, governmental units shall maintain public records in such a manner that they can be made available for inspection.

AOS could not identify policies of notifying the general public and news media of when and where Board Meetings were to be held. AOS also could not identify policies or procedures as to how records are made available or cost of copies of minutes when requested.

We recommend the School develop policies and procedures to make all Board meeting minutes available for public inspection.

Client Response:

During fiscal year 2007, the Board began publishing its schedule meeting dates.

FINDING NUMBER	2005-003
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Fiscal Officer Designation Bonding Requirement

Ohio Revised Code Section 3314.011 provides the School designate an individual as the fiscal officer. The Ohio Administrative Code (OAC) Section 117-6-07 (B) requires the fiscal officer execute a bond prior to entering upon the duties of the fiscal officer. Subsection (B)(1) provides that the bond amount and surety is to be established by resolution of the governing authority. Subsection (B)(2) requires the bond be payable to the state of Ohio, and Subsection (B)(3) states that bonding is conditioned on the faithful performance of the employee's official duties. Additionally, Subsection (C) requires the bond be deposited with the governing authority, and Subsection (D) requires a copy of the bond certified by the governing authority be filed with the county auditor of the county in which the community school is located. Should an error or theft occur without a performance bond, the School may not be able to recover any funds that are lost.

**VIRTUAL SCHOOLHOUSE
CUYAHOGA COUNTY
FOR THE YEAR ENDED JUNE 30, 2005
(CONTINUED)**

FINDINGS RELATED TO THE FINANCIAL STATEMENTS REQUIRED TO BE REPORTED IN ACCORDANCE WITH GAGAS
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FINDING NUMBER	2005-003
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Fiscal Officer Designation Bonding Requirement (Continued)

In addition, Ohio Revised Code Section 3314.011 provides that prior to assuming the duties of fiscal officer, the fiscal officer designee shall be licensed as prescribed by Section 3301.074 of the Revised Code or shall complete not less than sixteen hours of continuing education classes in the area of school accounting as approved by the sponsor of the community school. Any fiscal officer who is not licensed under this section shall complete an additional twenty-four hours of continuing education within one year after assuming the duties of fiscal officer of the school.

The Board did not execute a bond for the position of fiscal officer (treasurer) nor did the Board set the amount of the surety, but the Board did designate an individual as a fiscal officer.

We recommend the School review the provisions of Ohio Revised Code Sections 3314.011 and 3301.074, as well as OAC Section 117-6-07 and take the necessary steps to ensure the fiscal officer identified by the Board is adequately bonded.

Client Response:

As of fiscal year 2006, a bond for the fiscal officer is on file at the school.

FINDING NUMBER	2005-004
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Capital Assets

We noted the following control weaknesses over fixed assets:

- A capital asset accounting system, which maintains a complete capital asset listing by location, with tag or other identification numbers and other pertinent information had not been developed;
- The School had not developed and implemented procedures to record assets as additions when purchased and deletions when disposed of through the year;
- Invoices and supporting documentation for items were not identified; and
- The fixed asset listing provided could not be verified for completeness.

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

**VIRTUAL SCHOOLHOUSE
CUYAHOGA COUNTY
FOR THE YEAR ENDED JUNE 30, 2005
(CONTINUED)**

FINDINGS RELATED TO THE FINANCIAL STATEMENTS REQUIRED TO BE REPORTED IN ACCORDANCE WITH GAGAS
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FINDING NUMBER	2005-004
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Capital Assets (Continued)

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

Client Response:

As of fiscal year 2006, the school has developed a capital assets policy and accounting system.

FINDING NUMBER	2005-005
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Condition of Accounting Records

Management is responsible for implementing and maintaining a system of controls designed to enable management to determine the accuracy of financial transactions of the School. Also, management is responsible for developing and maintaining complete and accurate financial records. In lieu of complete and accurate financial records, we noted that the records consisted of the following:

- Supporting documentation for non-payroll expenditures was lacking or non-existent;
- No records existed of Board approval for individual employee salary and/or wage rates; and,
- Supervisory approvals to vendor invoices which were on file were not always evident.

We recommend the School develop and maintain a system of controls and financial records which exhibit the financial position of the School, and at a minimum, consist of the following:

- Development of a system to document approvals for expenditures made;
- Files which consist of the original invoices received for all expenditures made which cross reference to the checks prepared for the payment of the invoices (if invoices are not filed with the canceled checks);
- Files of all canceled checks returned from the bank;
- Development by management of a complete system of controls to help ensure the completeness, accuracy, and validity of the School's financial transactions; and,
- Evidence of the Board approval of salaries and wages to be paid to the individual employees of the School.

**VIRTUAL SCHOOLHOUSE
CUYAHOGA COUNTY
FOR THE YEAR ENDED JUNE 30, 2005
(CONTINUED)**

FINDINGS RELATED TO THE FINANCIAL STATEMENTS REQUIRED TO BE REPORTED IN ACCORDANCE WITH GAGAS
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FINDING NUMBER	2005-005
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Condition of Accounting Records (Continued)

The School management has available numerous sources of information describing the process of internal controls, recordkeeping requirements and reporting procedures. It is the responsibility of management to ensure that all responsible parties have access to this literature and training sessions.

Client Response:

During fiscal year 2006, the School developed procedures to include supervisory approval of vendor invoices and the retainage of original supporting documentation.

FINDING NUMBER	2005-006
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Development and Implementation of Payroll Processing Procedures

We noted the Board did not approve salaries, of individual employees, within its minute records and there was no record of the Boards approval of salaries or wage rates in the payroll files of the employees. It is possible that employees could be paid incorrect amounts.

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

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

Although the Board held discussions concerning the rates of pay for the employees of the School the Board minute records did not approve the pay rates for the School employees.

The Board should formally approve employment contracts or pay scales for all employees. Without this approval, it is possible that employees could be paid amounts which were not in accordance with the direction of the Board. Also, we recommend the Board monitor the amounts paid to employees.

Client Response:

During fiscal year 2006, the Board of Trustees began approving the salaries and wages of the School's employees in the Board's minute records.

**VIRTUAL SCHOOLHOUSE
CUYAHOGA COUNTY
FOR THE YEAR ENDED JUNE 30, 2005
(CONTINUED)**

FINDINGS RELATED TO THE FINANCIAL STATEMENTS REQUIRED TO BE REPORTED IN ACCORDANCE WITH GAGAS
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FINDING NUMBER	2005-007
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Development and Implementation of Controls Over Non-Payroll Cash Disbursements

Government auditing standards require sufficient competent evidential matter be obtained through inspection, observation, inquiries, and confirmations to afford a reasonable basis for developing an opinion of the financial statements under audit.

During our testing of the non-payroll cash disbursements we noted the following deficiencies:

Although the School provided original invoices for professional and technical services, these invoices were not supported by original documentation which contained supervisory approvals.

Without appropriately approved original supporting documentation, which is the permanent record of the School, we were unable to determine if the expenditures made were for proper purposes and if payments were made to the proper vendors.

We recommend the School maintain files of all original documentation which were reviewed by the appropriate supervisors, and have been approved for payment. It is imperative that all transaction be supported by competent evidential matter.

Client Response:

During fiscal year 2006, the School developed procedures to include supervisory approval of vendor invoices and the retainage of original supporting documentation.



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VIRTUAL SCHOOLHOUSE

CUYAHOGA COUNTY

CLERK'S CERTIFICATION

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

Susan Babbitt

CLERK OF THE BUREAU

**CERTIFIED
OCTOBER 3, 2006**