

**CONSTELLATION SCHOOLS: EASTSIDE ARTS ACADEMY
CUYAHOGA COUNTY, OHIO**

REGULAR AUDIT

FOR THE YEAR ENDED JUNE 30, 2012



Constellation Schools

"The Right Choice for Parents and a Real Chance for Children!"



Dave Yost • Auditor of State

Board of Trustees
Constellation Schools: Eastside Arts Academy
6700 Arts Academy
Cleveland, Ohio 44105

We have reviewed the *Independent Auditor's Report* of the Constellation Schools: Eastside Arts Academy, Cuyahoga County, prepared by Rea & Associates, Inc., for the audit period July 1, 2011 through June 30, 2012. Based upon this review, we have accepted these reports in lieu of the audit required by Section 117.11, Revised Code. The Auditor of State did not audit the accompanying financial statements and, accordingly, we are unable to express, and do not express an opinion on them.

Our review was made in reference to the applicable sections of legislative criteria, as reflected by the Ohio Constitution, and the Revised Code, policies, procedures and guidelines of the Auditor of State, regulations and grant requirements. The Constellation Schools: Eastside Arts Academy is responsible for compliance with these laws and regulations.

A handwritten signature in black ink that reads "Dave Yost".

Dave Yost
Auditor of State

January 29, 2013

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**CONSTELLATION SCHOOLS: EASTSIDE ARTS ACADEMY
CUYAHOGA COUNTY**

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November 27, 2012

The Board of Trustees
Constellation Schools: Eastside Arts Academy
6700 Lansing Avenue
Cleveland, OH 44105

INDEPENDENT AUDITOR'S REPORT

We have audited the accompanying financial statements of the Constellation Schools: Eastside Arts Academy, Cuyahoga County, Ohio (the School), as of and for the year ended June 30, 2012, which collectively comprise the School's basic financial statements as listed in the table of contents. These financial statements are the responsibility of the School's management. Our responsibility is to express an opinion on these financial statements based on our audit.

We conducted our audit in accordance with auditing standards generally accepted in the United States of America and the standards applicable to financial audits contained in *Government Auditing Standards*, issued by the Comptroller General of the United States. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation. We believe that our audit provides a reasonable basis for our opinion.

In our opinion, the financial statements referred to above present fairly, in all material respects, the respective financial position of the School, as of June 30, 2012, and the respective changes in financial position and cash flows, for the year then ended in conformity with accounting principles generally accepted in the United States of America.

In accordance with *Government Auditing Standards*, we have also issued our report dated November 27, 2012, on our consideration of the School'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. The purpose of that report is to describe the scope of our testing of internal control over financial reporting and compliance and the results of that testing, and not to provide an opinion on the internal control over financial reporting or on compliance. That report is an integral part of an audit performed in accordance with *Government Auditing Standards* and should be considered in assessing the results of our audit.

Accounting principles generally accepted in the United States of America require that the management's discussion and analysis information on pages 3 through 6 be presented to supplement the basic financial statements. Such information, although not a part of the basic financial statements, is required by the Government Accounting Standards Board who considers it to be an essential part of the financial reporting for placing the basic financial statements in an appropriate operational, economic, or historical context. We have applied certain limited procedures to the required supplementary information in accordance with auditing standards generally accepted in the United States of America, which consisted of inquiries of management about the methods of preparing the information and comparing the information for consistency with management's responses to our inquiries, the basic financial statements, and other knowledge we obtained during our audit of the basic financial statements. We do not express an opinion or provide any assurance on the information because limited procedures do not provide us with sufficient evidence to express an opinion or provide any assurance.

Hea & Associates, Inc.

CONSTELLATION SCHOOLS: EASTSIDE ARTS ACADEMY

Management's Discussion and Analysis For the Fiscal Year Ended June 30, 2012

The discussion and analysis of Constellation Schools: Eastside Arts Academy (EAA) financial performance provides an overall review of financial activities for the fiscal year ended June 30, 2012. The intent of this discussion and analysis is to look at the financial performance of EAA as a whole. Readers should also review the Notes to the Financial Statements and the Financial Statements to enhance their understanding of the financial performance of EAA.

Financial Highlights

Key financial highlights for 2012 include the following:

- The school began operations in August 2011 by enrolling grades kindergarten through 3 with 45 students and a teaching staff of five.
- In total, net assets increased \$60,477. The school opened with 45 students and received a \$153,000 contribution from Constellation Schools.
- Total assets increased \$70,592. This increase includes increases in cash, state basic aid receivable, federal grants receivable, security deposits and net capital assets.
- Liabilities increased \$10,115. Current liabilities include accounts payable, leases payable, interest payable and deferred revenue.
- Operating revenues were \$358,875. The majority of the revenue is from the State Foundation and Poverty Based Assistance program. Additional funding came from materials fees and food services.
- Operating expenses were \$486,009. The largest expenses are due to staffing, purchased services and materials and supplies.
- Non-operating revenues were \$187,611. This includes federal entitlement grants and a contribution from Constellation Schools.

Using this Financial Report

This report consists of three parts, Management's Discussion and Analysis, the Financial Statements and the Notes to the Financial Statements. The Financial Statements include a Statement of Net Assets; a Statement of Revenues, Expenses and Changes in Net Assets; and a Statement of Cash Flows.

CONSTELLATION SCHOOLS: EASTSIDE ARTS ACADEMY

Management's Discussion and Analysis
For the Fiscal Year Ended June 30, 2012

Statement of Net Assets

The Statement of Net Assets looks at how well EAA has performed financially through June 30, 2012. This statement includes all of the assets, liabilities and net assets using the accrual basis of accounting, which is the accounting method used by most private-sector companies. This basis of accounting takes into account all revenues earned and expenses incurred during the year, regardless as to when the cash is received or expended.

The following schedule provides a summary Statement of Net Assets for fiscal year ended June 30, 2012 for EAA.

	<u>2012</u>
Assets	
Cash	\$10,773
Other Current Assets	15,232
Non-Current Assets	89
Capital Assets	<u>44,498</u>
 Total Assets	 <u>70,592</u>
Liabilities	
Current Liabilities	7,613
Long-Term Liabilities	<u>2,502</u>
 Total Liabilities	 <u>10,115</u>
Net Assets	
Investment in capital assets, net of related debt	41,148
Unrestricted	<u>19,329</u>
 Total Net Assets	 <u><u>\$60,477</u></u>

The school began operations in August 2011 therefore no comparison to the prior year is being made for this statement.

CONSTELLATION SCHOOLS: EASTSIDE ARTS ACADEMY

Management's Discussion and Analysis
For the Fiscal Year Ended June 30, 2012

Statement of Revenues, Expenses and Changes in Net Assets

The Statement of Revenues, Expenses and Changes in Net Assets reports operating and non-operating activities for the fiscal year ended June 30, 2012.

The following schedule provides a summary of the Statement of Revenues, Expenses and Changes in Net Assets for EAA for fiscal year ended June 30, 2012.

	<u>2012</u>
Revenues	
Foundation and Poverty Based Assistance Revenues	\$337,118
Other Operating Revenues	<u>21,757</u>
Total Operating Revenues	<u>358,875</u>
Federal and State Grants	34,611
Private Grants and Contributions	<u>153,000</u>
Total Non-Operating Revenues	<u>187,611</u>
Total Revenues	<u>546,486</u>
Expenses	
Salaries	202,124
Fringe Benefits	60,516
Purchased Services	163,161
Materials and Supplies	28,090
Capital Outlay	9,228
Depreciation and Amortization	10,654
Other Expenses	<u>12,236</u>
Total Expenses	<u>486,009</u>
Net Income/(Loss)	<u>60,477</u>
Net Assets at Beginning of the Year	<u>0</u>
Net Assets at End of Year	<u><u>\$60,477</u></u>

The school began operations in August 2011 therefore no comparison to the prior year is being made for this statement.

CONSTELLATION SCHOOLS: EASTSIDE ARTS ACADEMY

Management's Discussion and Analysis
For the Fiscal Year Ended June 30, 2012

Capital Assets

As of June 30, 2012, EAA had \$44,498 invested in building improvements, computers, technology, furniture and equipment, net of depreciation. This is a \$44,498 increase over June 30, 2011.

The following schedule provides a summary of Capital Assets as of June 30, 2012 for EAA:

	2012
Capital Assets (net of depreciation)	
Building Improvements	\$34,294
Computers and Technology	7,505
Furniture and Equipment	2,699
	<hr/>
Net Capital Assets	<u>\$44,498</u>

For more information on capital assets see the Notes to the Financial Statements.

Current Financial Issues

Constellation Schools: Eastside Arts Academy opened in August 2011. In its initial year of operations it had forty-five students, five teaching staff members and expenses of \$486,009. The school opened with grades kindergarten through three. For fiscal year 2013 the school is budgeted for 80 students.

During the past year as the nation has experienced a major economic downturn, the Board of Directors, school management and school staff have worked diligently to ensure that the school maintains the high level of educational services and financial integrity that we have always provided in all of our schools. Our goal is to provide a strong educational product for our students and families and to maintain the reputation we have developed during our previous years.

Contacting the School's Financial Management

This financial report is designed to provide our constituents with a general overview of the finances for EAA and to show accountability for the monies it receives. If you have any questions about this report or need additional information please contact Treasurer/CFO Thomas F. Babb, CPA, by mail at Constellation Schools LLC, 5730 Broadview Road, Parma, Ohio 44134; by e-mail at babb.thomas@constellationschools.com; by calling 216.712.7600; or by faxing 216.712.7601.

Constellation Schools: Eastside Arts Academy
Cuyahoga County
Statement of Net Assets
As of June 30, 2012

Assets:

Current Assets:

Cash	\$10,773
Due from Other Governments	15,232
<i>Total Current Assets</i>	26,005

Non-Current Assets:

Security Deposit	89
Capital Assets (Net of Accumulated Depreciation)	44,498
<i>Total Non-Current Assets</i>	44,587

<i>Total Assets</i>	70,592
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Liabilities:

Current Liabilities:

Accounts Payable	5,914
Interest Payable	21
Deferred Revenue	830
Capital Lease Equipment Payable	848
<i>Total Current Liabilities</i>	7,613

Long Term Liabilities:

Capital Lease Equipment Payable	2,502
<i>Total Long Term Liabilities</i>	2,502

<i>Total Liabilities</i>	10,115
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Net Assets:

Investment in capital assets, net of related debt	41,148
Unrestricted	19,329
	26,005

<i>Total Net Assets</i>	\$60,477
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The accompanying notes to the financial statements are an integral part of this statement.

**Constellation Schools: Eastside Arts Academy
Cuyahoga County
Statement of Revenues, Expenses and
Changes in Net Assets
For the Fiscal Year Ended June 30, 2012**

Operating Revenues:

Foundation and Poverty Based Assistance Revenues	\$337,118
Other Operating Revenues	<u>21,757</u>

<i>Total Operating Revenues</i>	<u>358,875</u>
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Operating Expenses:

Salaries	202,124
Fringe Benefits	60,516
Purchased Services	163,161
Materials and Supplies	28,090
Capital Outlay	9,228
Depreciation	10,654
Other Operating Expenses	<u>12,106</u>

<i>Total Operating Expenses</i>	<u>485,879</u>
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Operating Loss	<u>(127,004)</u>
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Non-Operating Revenues:

Interest Expense	(130)
Federal and State Grants	34,611
Private Grants and Contributions	<u>153,000</u>

<i>Total Non-Operating Revenues</i>	<u>187,481</u>
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Net Income	<u>60,477</u>
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Net Assets at Beginning of the Year	<u>0</u>
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Net Assets at End of Year	<u><u>\$60,477</u></u>
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The accompanying notes to the financial statements are an integral part of this statement.

**Constellation Schools: Eastside Arts Academy
Cuyahoga County
Statement of Cash Flows
For the Fiscal Year Ended June 30, 2012**

Increase (Decrease) in Cash:

Cash Flows from Operating Activities:

Cash Received from State of Ohio	\$324,020
Cash Payments to Suppliers for Goods and Services	(268,066)
Cash Payments to Employees for Services	(202,124)
Other Operating Revenues	<u>22,587</u>
Net Cash Used for Operating Activities	<u>(123,583)</u>

Cash Flows from Noncapital Financing Activities:

Private Grants and Contributions Received	153,000
Federal and State Grants Received	<u>33,377</u>
Net Cash Provided by Noncapital Financing Activities	<u>186,377</u>

Cash Flows from Capital and Related Financing Activities:

Payments for Capital Acquisitions	(55,152)
Proceeds for Equipment Lease	3,685
Equipment Lease Principal Payments	(335)
Equipment Lease Interest Payments	(130)
Increase in Security Deposits	<u>(89)</u>
Net Cash Used for Capital and Related Financing Activities	<u>(52,021)</u>
Net Increase in Cash	10,773
Cash at Beginning of Year	<u>0</u>
Cash at End of Year	<u><u>\$10,773</u></u>

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

**Constellation Schools: Eastside Arts Academy
Cuyahoga County
Statement of Cash Flows
For the Fiscal Year Ended June 30, 2012
(Continued)**

**Reconciliation of Operating Loss to Net
Cash Used for Operating Activities:**

Operating Loss	(\$127,004)
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**Adjustments to Reconcile Operating Loss to
Net Cash Used for Operating Activities:**

Depreciation	10,654
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Changes in Assets and Liabilities:

(Increase) in Due from Other Governments	(13,998)
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Increase in Accounts Payable	5,935
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Increase in Deferred Revenue	830
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Total Adjustments	3,421
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Net Cash Used for Operating Activities	(\$123,583)
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The accompanying notes to the financial statements are an integral part of this statement.

CONSTELLATION SCHOOLS: EASTSIDE ARTS ACADEMY
- A Community School -
Cuyahoga County

NOTES TO THE FINANCIAL STATEMENTS
FOR THE YEAR ENDED JUNE 30, 2012

I. Description of the School and Reporting Entity

Constellation Schools: Eastside Arts Academy (EAA), is a nonprofit corporation established on May 2, 2011 pursuant to Ohio Revised Code Chapters 3314 and 1702 to maintain and provide a school exclusively for any educational, literary, scientific and related teaching service that qualifies as an exempt organization under §501(c)(3) of the Internal Revenue Code. On October 16, 2012, EAA was issued a determination letter of tax-exempt status with the Internal Revenue Service under section 501(c)(3) of the Internal Revenue Code. Management is not aware of any course of action or series of events that have occurred that might adversely affect the tax-exempt status of EAA. EAA, which is part of Ohio's education program, is independent of any school district. EAA may sue and be sued, acquire facilities as needed, and contract for any services necessary for the operation of EAA.

EAA was approved for operation under a contract dated May 15, 2011 between the Governing Authority of EAA and St. Aloysius Orphanage (SAO) (the Sponsor). Approval to operate EAA and to open a school in Cleveland, Ohio during the fall of 2011 was made by SAO in August 2011. The contract with SAO has an expiration date of June 30, 2016. Under the terms of the contract SAO will provide sponsorship services for a fee. See Note XII for further discussion of the sponsor services. EAA entered into an agreement with Constellation Schools (CS) to provide management services for the fiscal year. See Note XII for further discussion of this management agreement.

EAA operates under a five member Board of Directors. 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 qualification of teachers. The Board of Directors controls EAA instructional facility staffed by five certificated full time teaching personnel who provided services to 45 students.

II. Summary of Significant Accounting Policies

The financial statements of EAA 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 to its governmental activities provided they do not conflict with or contradict GASB pronouncements. EAA also applies Financial Accounting Standards Board (FASB) statements and interpretations issued on or before November 30, 1989, to its proprietary activities unless those pronouncements conflict with or contradict GASB pronouncements. EAA has elected not to follow FASB guidance issued after November 30, 1989 for its proprietary activities. The more significant of EAA's accounting policies are described below.

CONSTELLATION SCHOOLS: EASTSIDE ARTS ACADEMY
- A Community School -
Cuyahoga County

NOTES TO THE FINANCIAL STATEMENTS
FOR THE YEAR ENDED JUNE 30, 2012

1. Basis of Presentation

Enterprise accounting is used to account for operations that are financed and operated in a manner similar to private business enterprises where the intent is that the costs (expenses, including depreciation) of providing goods or services to the general public on a continuing basis be financed or recovered primarily through user charges or where it has been decided that periodic determination of revenues earned, expenses incurred, and/or net income is appropriate for capital maintenance, public policy, management control, accountability or other purposes.

2. Measurement Focus and Basis of Accounting

The accounting and financial reporting treatment is determined by its measurement focus. Enterprise accounting uses a flow of economic resources measurement focus. With this measurement focus, all assets and all liabilities are included on the Statement of Net Assets. Operating statements present increases (e.g., revenues) and decreases (e.g., expenses) in net total assets.

Basis of accounting determines when transactions are recorded in the financial records and reported on the financial statements. EAA prepares financial statements using the accrual basis of accounting. Revenues resulting from exchange transactions, in which each party gives and receives essentially equal value, is recorded when the exchange takes place. Revenues resulting from non-exchange transactions, in which EAA receives value without directly giving equal value in return, such as grants and entitlements, are recognized in the fiscal year in which all eligibility requirements have been satisfied. Eligibility requirements include timing requirements, which specify the fiscal year when the resources are required to be used or the fiscal year when the use is first permitted; matching requirements, in which EAA must provide local resources to be used for a specified purpose; and expenditure requirements, in which resources are provided to EAA on a reimbursement basis. Expenses are recognized at the time they are incurred.

3. Cash

All monies received by EAA are deposited in demand deposit accounts.

4. Budgetary Process

Pursuant to Ohio Revised Code Chapter 5705.391 EAA prepares and adopts an annual budget which includes estimated revenues and expenditures for the fiscal year and a five year forecast of revenues and expenditures. EAA will from time to time adopt budget revisions as necessary.

CONSTELLATION SCHOOLS: EASTSIDE ARTS ACADEMY
- A Community School -
Cuyahoga County

NOTES TO THE FINANCIAL STATEMENTS
FOR THE YEAR ENDED JUNE 30, 2012

5. Due From Other Governments and Accounts Receivable

Monies due EAA for the year ended June 30, 2012 are recorded as Due From Other Governments and as Accounts Receivable. A current asset for the receivable amount is recorded at the time of the event causing the monies to be due.

6. Capital Assets and Depreciation

Capital assets are capitalized at cost and updated for additions and retirements during the year. Donated fixed assets are recorded at their fair market values as of the dates received. All items with a useful life of one year or greater and a value of \$500 or more 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.

All capital assets are depreciated. Depreciation of building improvements, computers, technology and furniture and equipment is computed using the straight line method over their estimated useful lives. Improvements to fixed assets are depreciated over the remaining useful lives of the related fixed assets or less. Estimated useful lives are as follows:

Capital Asset Classification	Years
Building Improvements	Up to 5
Computers and Technology	3
Furniture and Equipment	10

7. Intergovernmental Revenues

EAA currently participates in the State Foundation Program and the State Poverty Based Assistance Program. Revenues received from these programs are recognized as operating revenues in the accounting period in which all eligibility requirements have been met. EAA also participates in Federal Entitlement Programs, the Federal Lunch Reimbursement Program and various State Grant Programs. State and Federal Grants and Entitlements are recognized as non-operating revenues in the accounting period in which all eligibility requirements have been met. Amounts awarded under the above named programs for the 2012 school year totaled \$371,729.

8. Private Grants and Contributions

EAA receives grants and contributions from private sources to support the schools programs. Private grants and contributions are recognized as non-operating revenues in the accounting period in which they are received. Amounts received for the 2012 school year totaled \$153,000 from Constellation Schools, which provides management services to EAA (see Note XII).

CONSTELLATION SCHOOLS: EASTSIDE ARTS ACADEMY
- A Community School -
Cuyahoga County

NOTES TO THE FINANCIAL STATEMENTS
FOR THE YEAR ENDED JUNE 30, 2012

9. **Compensated Absences**

Vacation is taken in a manner which corresponds with the school calendar; therefore, EAA does not accrue vacation time as a liability.

Sick leave benefits are earned at the rate of one and one-quarter day per month and can be accrued up to a maximum of one hundred twenty days. EAA will accept the transfer of sick days from another school district up to the maximum accrual amount. No financial accrual for sick time is made since unused sick time is not paid to employees upon employment termination.

10. **Use of Estimates**

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

11. **Deferred Revenue**

Deferred revenue arises when assets are recognized before revenue recognition criteria have been satisfied. The deferred revenue for EAA consists of materials fees received in the current year which pertains to the next school year.

III. **Deposits**

At fiscal year end June 30, 2012, the carrying amount of EAA' deposits totaled \$10,773 and its bank balance was \$34,325. Based on the criteria described in GASB Statement No. 40, "Deposit and Investment Risk Disclosure," as of June 30, 2012, none of the bank balance was exposed to custodial risk as discussed below, while \$34,325 was covered by the Federal Depository Insurance Corporation.

Custodial credit risk is the risk that in the event of bank failure, EAA will not be able to recover the deposits. All deposits are collateralized with eligible securities in amounts equal to at least 105% of the carrying value of the deposits. Such collateral, as permitted by the Ohio Revised Code, is held in single financial institution collateral pools at the Federal Reserve Banks or at member banks of the federal reserve system, in the name of the respective depository bank and pledged as a pool of collateral against all of the public deposits it holds or as specific collateral held at the Federal Reserve Bank in the name of EAA.

CONSTELLATION SCHOOLS: EASTSIDE ARTS ACADEMY
- A Community School -
Cuyahoga County

NOTES TO THE FINANCIAL STATEMENTS
FOR THE YEAR ENDED JUNE 30, 2012

IV. Operating Lease

EAA leases its facilities at 6804 Lansing Avenue, Cleveland, Ohio from The Roman Catholic Diocese of Cleveland, Immaculate Heart of Mary Parish under a five year lease agreement commencing August 1, 2011 and ending June 30, 2016. Monthly rent was \$2,350 through April 2012 and \$5,000 thereafter. Rent increases of 3% occur on July 1 of each year. Total rents paid during the fiscal year totaled \$31,150.

V. Capital Assets

A summary of capital assets at June 30, 2012 follows:

	Balance 6/30/11	Additions	Deletions	Balance 6/30/12
Capital Assets Being Depreciated				
Building Improvements	\$0	\$42,867	\$0	\$42,867
Computers and Technology	0	9,340	0	9,340
Furniture and Equipment	0	2,945	0	2,945
Total Capital Assets Being Depreciated	0	55,152	0	55,152
Less Accumulated Depreciation				
Building Improvements	0	(8,573)	0	(8,573)
Computers and Technology	0	(1,835)	0	(1,835)
Furniture and Equipment	0	(246)	0	(246)
Total Accumulated Depreciation	0	(10,654)	0	(10,654)
Total Capital Assets, Net of Accumulated Depreciation	\$0	\$44,498	\$0	\$44,498

CONSTELLATION SCHOOLS: EASTSIDE ARTS ACADEMY
- A Community School -
Cuyahoga County

NOTES TO THE FINANCIAL STATEMENTS
FOR THE YEAR ENDED JUNE 30, 2012

VI. Purchased Services

Purchased Services include the following:

Instruction	\$3,869
Pupil Support Services	16,978
Staff Development & Support	18,021
Administrative	32,076
Occupancy Costs	77,450
Food Services	<u>14,767</u>
 Total Purchased Services	 <u><u>\$163,161</u></u>

VII. Capital Equipment Lease Payable

During fiscal year 2012, EAA entered into a four year lease for technology equipment. This lease meets the criteria of a capital lease as defined by accounting standards, which defines a capital lease generally as one which transfers the benefits and risks of ownership of the lessee.

Assets of technology equipment totaling \$3,685 have been capitalized. This amount represents the actual purchase price of the equipment and is the same as the net present value of the minimum lease payments at the time of acquisition. Principal payments during fiscal year 2012 totaled \$335 and interest paid totaled \$130. Future minimum lease payments for principal and interest under the capital lease are as follows:

Year	Principal	Interest	Total
2013	\$848	\$219	\$1,067
2014	913	154	1,067
2015	982	85	1,067
2016	<u>607</u>	<u>14</u>	<u>621</u>
 Total	 <u><u>\$3,350</u></u>	 <u><u>\$472</u></u>	 <u><u>\$3,822</u></u>

VIII. Risk Management

1. Property and Liability Insurance

EAA 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 2012, EAA contracted with Cincinnati Insurance Company for all of its' insurance.

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Cuyahoga County

NOTES TO THE FINANCIAL STATEMENTS
FOR THE YEAR ENDED JUNE 30, 2012

General liability is covered at \$4,000,000 single occurrence limit and \$5,000,000 aggregated. Hired and Non-Owned Vehicles are covered at \$500,000 combined single limit of liability. Other coverage includes Employee Crime, School Leaders Errors & Omissions, Sexual Abuse and Misconduct, Electronic Data Processing and Business Interruption. Settled claims have not exceeded this coverage during the schools' first year of operations, nor has there been any significant reduction in insurance coverage during the year.

2. Workers' Compensation

EAA makes premium payments to the Ohio Worker's Compensation System for employee injury coverage. There have been no claims filed by EAA employees with the Ohio Worker's Compensation System between January 1, 2011 and June 30, 2012.

3. Employee Medical, Dental, Vision and Life Benefits

EAA provides medical, dental, vision and life insurance benefits to all full time employees. Employees participate in premium payments through pretax payroll deductions. Total insurance benefits paid by EAA for the fiscal year is \$22,178.

IX. Defined Benefit Pension Plans

1. State Teachers Retirement System

EAA participates in the State Teachers Retirement System of Ohio (STRS Ohio), a cost sharing, multiple-employer public employee retirement system. STRS Ohio provides retirement and disability benefits to members and death and survivor benefits to beneficiaries. STRS Ohio issues a stand-alone comprehensive annual financial report that may be obtained by writing to STRS Ohio, 275 E. Broad St., Columbus, Ohio 43215-3371, by calling toll-free 1-888-227-7877, or by visiting the STRS website at www.strsoh.org.

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 allocate all their member contributions and employer contributions equal to 10.5% of earned compensation among various investment choices. The Combined Plan offers features of the DC Plan and the DB Plan. In the Combined Plan, member contributions are allocated to investment choices by the member, and employer contributions are used to fund a 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 biweekly

CONSTELLATION SCHOOLS: EASTSIDE ARTS ACADEMY
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NOTES TO THE FINANCIAL STATEMENTS
FOR THE YEAR ENDED JUNE 30, 2012

basis. DC and Combined Plan members will transfer to the DB plan during their fifth year of membership unless they permanently select the DC or Combined Plan.

The DB Plan benefits are established under Chapter 3307 of the Ohio 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 members' three highest salary years. The annual allowance is calculated by using a base percentage of 2.2% multiplied by the total number of years of 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 until 100% of the 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. The total is then divided by an actuarially determined annuity factor to determine the maximum annual retirement allowance. Benefits are increased annually by 3% of the original base amount for DB Plan participants.

DC Plan benefits are established under Sections 3307.80 to 3307.89 of the Ohio 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 member's account balance.

Member contributions in the Combined Plan are allocated by the member, and employer contributions are used to fund a defined benefit payment. A members' defined benefit is determined by multiplying 1% of the members' final average salary by the members' years of service credit. The defined portion of the Combined Plan 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.

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A retiree of STRS Ohio or another Ohio public retirement system is eligible for reemployment following the elapse of two months from the date of retirement. Contributions are made by the reemployed member and employer during reemployment. Upon termination of reemployment or age 65, whichever comes later, the retiree is eligible for an annuity benefit or equivalent lump-sum payment in addition to the original retirement allowance. A reemployed retiree may alternatively receive a refund of only member contributions with interest before age 65, once employment is terminated.

The DB and Combined Plan offer access to health coverage to eligible retirees who participated in the plans and their eligible dependents. Coverage under the current program includes hospitalization, physicians' fees, prescription drugs and partial reimbursement of monthly Medicare Part B premiums. By Ohio law, health care benefits are not guaranteed.

A DB or Combined Plan member with five or more years' credited service who becomes disabled may qualify for a disability benefit. Eligible spouses and dependents of 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 DB 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 members' beneficiaries.

Chapter 3307 of the Ohio Revised Code provides statutory authority for member and employer contributions. Contribution rates are established by the State Teachers Retirement Board, upon recommendation of its consulting actuary, not to exceed statutory maximum rates of 10% for members and 14% for employers. Contribution requirements and the contributions actually made for the fiscal year ended June 30, 2011 (the latest year available), were 10% of covered payroll for members and 14% for employers. The amount required to fund pension obligations during the year is 13%.

EAA's required contributions for pension obligations for the fiscal years ended June 30, 2012, 2011 and 2010 were \$22,562, \$-0- and \$-0-, respectively; 100% has been contributed for fiscal years 2012, 2011 and 2010. Member and employer contributions actually made for DB, DC and Combined Plan participants will be provided upon written request.

2. School Employees Retirement System

EAA contributes to the School Employees Retirement System of Ohio (SERS), a cost-sharing, multiple-employer defined benefit pension plan. SERS provides retirement, disability and survivor benefits; annual cost-of-living adjustments; and death benefits to plan members and beneficiaries. Authority to establish and amend benefits is

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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. The report can be obtained by contacting SERS, 300 E. Broad Street, Suite 100, Columbus, Ohio 43215-3746 or by calling toll free 1-800-878-5853. It is also posted on SERS' website at www.ohsers.org under Employers/Audit Resources.

Plan members are required to contribute 10% of their annual covered salary and EAA is required to contribute 14% of annual covered payroll. 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 Retirement Board acting with the advice of the actuary, allocates the employer contribution rate among four of the funds (Pension Trust Fund, Death Benefit Fund, Medicare B Fund and Health Care Fund) of the System. For fiscal year ending June 30, 2011, the allocation to pension and death benefits is 11.81%. The remaining 2.19% of the 14% employer contribution rate is allocated to the Health Care and Medicare B Funds. EAA's contributions to SERS for the fiscal years ended June 30, 2012, 2011 and 2010 were \$4,000, \$-0- and \$-0-, respectively; 100% has been contributed for fiscal years 2012, 2011 and 2010.

X. Post-Employment Benefits Other than Pension Benefits

1. State Teachers Retirement System

Ohio law authorizes STRS Ohio to offer a cost-sharing, multiple employer health care plans. STRS Ohio provides access to health care coverage to eligible retirees who participated in the Defined Benefit or Combined Plans. Coverage under the current program includes hospitalization, physicians' fees, prescription drugs and reimbursement of monthly Medicare Part B premiums.

Pursuant to Section 3307 of the Ohio Revised Code, the 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, for the most recent year, pay a portion of the health care costs in the form of a monthly premium.

Under Ohio law funding for post-employment health care may be deducted from employer contributions. Of the 14% employer contribution rate, 1% of covered payroll was allocated to post-employment health care. The 14% employer contribution rate is the maximum rate established under Ohio law. For the fiscal years ended June 30, 2012, 2011 and 2010 EAA's contributions to post-employment health care were \$1,736, \$-0-, and \$-0-, respectively; 100% has been contributed for fiscal years 2012, 2011 and 2010.

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2. School Employees Retirement System

In addition to a cost-sharing multiple-employer defined benefit pension plan the School Employees Retirement System of Ohio administers two post-employment benefit plans. The Medicare B Plan reimburses Medicare Part B premiums paid by eligible retirees and beneficiaries as set forth in Ohio Revised Code 3309.69. Qualified benefit recipients who pay Medicare Part B premiums may apply for and receive a monthly reimbursement from SERS. The reimbursement amount is limited by statute to the lesser of the January 1, 1999 Medicare Part B premium or the current premium. The Medicare Part B premium for calendar year 2011 was \$96.40 for most participants, but could be as high as \$369.10 per month depending on their income. SERS' reimbursement to retirees was \$45.50.

The Retirement Board, acting with the advice of the actuary, allocates a portion of the current employer contribution rate to the Medicare Part B Fund. For fiscal year 2011 the actuarially required allocation is .76%. For the fiscal years ended June 30, 2012, 2011 and 2010 EAA contributions to Medicare Part B were \$217, \$-0- and \$-0-, respectively; 100% has been contributed for fiscal years 2012, 2011 and 2010.

Ohio Revised Code 3309.375 and 3309.69 permit SERS to offer health care benefits to eligible retirees and beneficiaries. SERS' Retirement Board reserves the right to change or discontinue any health plan or program. SERS offers several types of health plans from various vendors, including HMOs, PPOs, Medicare Advantage and traditional indemnity plans. A prescription drug program is also available to those who elect health coverage. SERS employs two third-party administrators and a pharmacy benefit manager to manage the self-insurance and prescription drug plans, respectively. The Ohio Revised Code provides a statutory authority to fund SERS' postemployment benefits through employee contributions. Active members do not make contributions to the postemployment plans.

The Health Care Fund was established under, and is administered in accordance with Internal Revenue Code 105(e). Each year after the allocation for statutorily required benefits, the Retirement Board allocates the remainder of the employer 14% contribution to the Health Care Fund. For the year ended June 30, 2011 the health care allocation is 1.43%. An additional health care surcharge on employers is collected for employees earning less than an actuarially determined minimum compensation amount, pro-rated according to service credit earned. Statutes provide that no employer shall pay a health care surcharge greater than 2% of that employer's SERS covered payroll; nor may SERS collect in aggregate more than 1.5% of the total statewide SERS-covered payroll for the health care surcharge. For fiscal year 2012, the minimum compensation level was established at \$35,800. The surcharge, added to the unallocated portion of the 14% employer contribution rate is the total amount assigned to the Health Care Fund. For the fiscal years ended June 30, 2012, 2011 and

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2010 EAA contributions to the Health Care Plan, including the surcharge were \$841, \$-0- and \$-0-, respectively; 48.6% has been contributed for fiscal year 2012 and 100% for fiscal years 2011 and 2010. \$432 representing the unpaid surcharge due for fiscal year 2012 is recorded as a liability within the respective funds.

XI. Contingencies

1. Grants

EAA received financial assistance from Federal and State agencies in the form of grants. The disbursement of funds received under these programs requires compliance with terms and conditions, specified in the grant agreements and are subject to audit by the grantor agencies. Any disallowed claims resulting from such audits could become a liability of EAA. However, in the opinion of management, any such disallowed claims will not have a material adverse effect on the overall financial position of EAA at June 30, 2012.

2. Enrollment FTE

The Ohio Department of Education conducts reviews of enrollment and full-time equivalency (FTE) calculations made by the schools. These reviews are conducted to ensure the schools are reporting accurate student enrollment data to the State, upon which state foundation funding is calculated. The conclusions of this review could result in state funding being adjusted. Adjustments to the state funding received during fiscal year 2012 are material and are included in Due From Other Governments for fiscal year 2012.

3. Student Attendance Data Review

The Auditor of State is currently performing a statewide review of supporting documentation for student attendance data reported to the Ohio Department of Education. The results of this review are still pending and will be reported separately to the Ohio Department of education at a later date.

EAA 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 are 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 fund. This also encompasses the Auditor of State's ongoing review of student attendance data. The effect of any such disallowed claims on the overall financial position of the school as of June 30, 2012, if applicable, cannot be determined at this time.

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XII. Sponsorship and Management Agreements

EAA entered into an agreement with St. Aloysius Orphanage (SAO) to provide sponsorship and oversight services as required by law. The agreement is effective until June 30, 2016. Sponsorship fees are calculated as 3% of the Fiscal Year 2012 Foundation payments received by EAA, from the State of Ohio. The total amount due from EAA for fiscal year 2012 was \$9,721, all of which was paid prior to June 30, 2012.

EAA entered into an agreement with Constellation Schools LLC to provide legal, financial, and business management services for fiscal year 2012. The agreement was for a period of one year, effective July 1, 2011. Management fees are calculated as 6.25% of the Fiscal Year 2012 Foundation and State Fiscal Stabilization Funds payment received by EAA from the State of Ohio plus a fixed fee of \$41,250. The total amount due from EAA for the fiscal year ending June 30, 2012 was \$62,320. In June 2012 CS issued a credit to EAA for the entire amount of the management fee due for 2012, therefore there was no management fee due CS for the 2012 fiscal year.

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November 27, 2012

To the Board of Trustees
Constellation Schools: Eastside Arts Academy
6700 Lansing Avenue
Cleveland, Ohio 44105

**INDEPENDENT AUDITOR'S REPORT ON INTERNAL CONTROL OVER FINANCIAL REPORTING
AND ON COMPLIANCE AND OTHER MATTERS BASED ON AN AUDIT OF FINANCIAL
STATEMENTS PERFORMED IN ACCORDANCE WITH GOVERNMENT AUDITING STANDARDS**

We have audited the financial statements of Constellation Schools: Eastside Arts Academy, Cuyahoga County, Ohio (the School) as of and for the year ended June 30, 2012, and have issued our report thereon dated November 27, 2012. We conducted our audit in accordance with auditing standards generally accepted in the United States of America and the standards applicable to financial audits contained in *Government Auditing Standards*, issued by the Comptroller General of the United States.

Internal Control Over Financial Reporting

Management of the School is responsible for establishing and maintaining effective internal control over financial reporting. In planning and performing our audit, we considered the School's internal control over financial reporting as a basis for designing our audit procedures for the purpose of expressing our opinion on the financial statements, but not for the purpose of expressing an opinion on the effectiveness of the School's internal control over financial reporting. Accordingly, we do not express an opinion on the effectiveness of the School's internal control over financial reporting.

A deficiency in internal control exists when the design or operation of a control does not allow management or employees, in the normal course of performing their assigned functions, to prevent, or detect and correct misstatements on a timely basis. A material weakness is a deficiency, or combination of deficiencies, in internal control, such that there is a reasonable possibility that a material misstatement of the entity's financial statements will not be prevented, or detected and corrected on a timely basis.

Our consideration of internal control over financial reporting was for the limited purpose described in the first paragraph of this section and was not designed to identify all deficiencies in internal control over financial reporting that might be deficiencies, significant deficiencies, or material weaknesses. We did not identify any deficiencies in internal control over financial reporting that we consider material weaknesses, as defined above.

Constellation Schools: Eastside Arts Academy
Independent Auditors Report on Internal Control Over
Financial Reporting and on Compliance and Other
Matters Based on an Audit of Financial Statements
Performed in Accordance with *Government Auditing Standards*
Page 2

Compliance and Other Matters

As part of obtaining reasonable assurance about whether the School's financial statements are free of material misstatement, we performed tests of its compliance with certain provisions of laws, regulations, contracts and grant agreements, noncompliance with which could have a direct and material effect on the determination of financial statement amounts. However, providing an opinion on compliance with those provisions was not an objective of our audit and, accordingly, we do not express such an opinion. The results of our tests disclosed no instances of noncompliance or other matters that are required to be reported under *Government Auditing Standards*.

This report is intended solely for the information and use of the Board of Trustees, audit committee, management and the School's sponsor, and is not intended to be and should not be used by anyone other than those specified parties

Rea & Associates, Inc.

Independent Accountant's Report on Applying Agreed-Upon Procedures

Board of Trustees
Constellation Schools: Eastside Arts Academy
6700 Lansing Avenue
Cleveland, OH 44105

November 27, 2012

To the Board of Trustees:

Ohio Rev. Code Section 117.53 states "the auditor of state shall identify whether the school district or community school has adopted an anti-harassment policy in accordance with Section 3313.666 of the Revised Code. This determination shall be recorded in the audit report. The auditor of state shall not prescribe the content or operation of any anti-harassment policy adopted by a school district or community school."

Accordingly, we have performed the procedures enumerated below, which was agreed to by the Board, solely to assist the Board in evaluating whether the Constellation Schools: Eastside Arts Academy, Cuyahoga County, Ohio (the School) has adopted an anti-harassment policy in accordance with Ohio Rev. Code Section 3313.666. Management is responsible for complying with this requirement. This agreed-upon procedures engagement was conducted in accordance with attestation standards established by the American Institute of Certified Public Accountants. The sufficiency of these procedures is solely the responsibility of the Board. Consequently; we make no representation regarding the sufficiency of the procedure described below either for the purpose for which this report has been requested or for any other purpose.

1. We noted the Board adopted an anti-harassment policy at its meeting on April 25, 2011.
2. We read the policy, noting it included the following requirements from Ohio Rev. Code Section 3313.666(B):
 - (1) A statement prohibiting harassment, intimidation, or bullying of any student on school property or at school-sponsored events;
 - (2) A definition of harassment, intimidation, or bullying that shall include the definition in division (A) of Ohio Rev. Code Section 3313.666;
 - (3) A procedure for reporting prohibited incidents;
 - (4) A requirement that school personnel report prohibited incidents of which they are aware to the school principal or other administrator designated by the principal;

- (5) A requirement that parents or guardians of any student involved in a prohibited incident be notified and, to the extent permitted by section 3319.321 of the Revised Code and the "Family Educational Rights and Privacy Act of 1974," 88 Stat. 571, 20 U.S.C. 1232q, as amended, have access to any written reports pertaining to the prohibited incident;
- (6) A procedure for documenting any prohibited incident that is reported;
- (7) A procedure for responding to and investigating any reported incident;
- (8) A strategy for protecting a victim from additional harassment, intimidation, or bullying, and from retaliation following a report;
- (9) A disciplinary procedure for any student guilty of harassment, intimidation, or bullying, which shall not infringe on any student's rights under the first amendment to the Constitution of the United States;
- (10) A requirement that the district administration semiannually provide the president of the district board a written summary of all reported incidents and post the summary on its web site, if the district has a web site, to the extent permitted by section 3319.321 of the Revised Code and the "Family Educational Rights and Privacy Act of 1974," 88 Stat. 571, 20 U.S.C. 1232q, as amended.
- (11) A statement to include violence within a dating relationship within its definition of harassment, intimidation or bullying.

We were not engaged to and did not conduct an examination, the objective of which would be the expression of an opinion on compliance with the anti-harassment policy. Accordingly, we do not express such an opinion. Had we performed additional procedures, other matters might have come to our attention that would have been reported to you.

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

Kea & Associates, Inc.



Dave Yost • Auditor of State

EASTSIDE ARTS ACADEMY

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
FEBRUARY 12, 2013**