



**KEYSTONE LOCAL SCHOOL DISTRICT
LORAIN COUNTY**

SINGLE AUDIT

FOR THE YEAR ENDED JUNE 30, 2004



**Auditor of State
Betty Montgomery**

**KEYSTONE LOCAL SCHOOL DISTRICT
LORAIN COUNTY**

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**Auditor of State
Betty Montgomery**

INDEPENDENT ACCOUNTANTS' REPORT

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

We have audited the accompanying financial statements of the governmental activities, each major fund, and the aggregate remaining fund information of the Keystone Local School District, Lorain County, Ohio (the District) as of and for the fiscal year ended June 30, 2004, which collectively comprise the District's basic financial statements as listed in the table of contents. These financial statements are the responsibility of the District's management. Our responsibility is to express opinions on these financial statements based on our audit.

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

In our opinion, the financial statements referred to above present fairly, in all material respects, the respective financial position of the governmental activities, each major fund, and the aggregate remaining fund information of the Keystone Local School District, Lorain County, Ohio as of June 30, 2004, and the respective changes in financial position and cash flows, where applicable, and the respective budgetary comparison for the General Fund thereof for the year then ended in conformity with accounting principles generally accepted in the United States of America.

In accordance with *Government Auditing Standards*, we have also issued our report dated March 22, 2005, on our consideration of the District's internal control over financial reporting and our tests of its compliance with certain provisions of laws, regulations, contracts and grants. That report is an integral part of an audit performed in accordance with *Government Auditing Standards* and should be read in conjunction with this report in considering the results of our audit.

Management's Discussion and Analysis is not a required part of the basic financial statements but is supplementary information the Government Accounting Standards Board requires. We have applied certain limited procedures, which consisted principally of inquiries of management regarding the methods of measurement and presentation of the required supplementary information. However, we did not audit the information and express no opinion on it.

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



Betty Montgomery
Auditor of State

March 22, 2005

Keystone Local School District
Lorain County

Management's Discussion and Analysis
For the Year Ended June 30, 2004
Unaudited

The discussion and analysis of Keystone Local School District's financial performance provides an overall review of the School District's financial activities for the fiscal year ended June 30, 2004. The intent of this discussion and analysis is to look at the School District's financial performance as a whole. Readers should also review the financial statements and notes to those respective statements to enhance their understanding of the School District's financial performance.

Financial Highlights

Key Financial Highlights for 2004 are as follows:

- In total, net assets decreased by \$54,365
- Revenues for governmental activities totaled \$13,709,955 in 2004. Of this total, 91.55% consisted of General Revenues while Program Revenues accounted for the balance of 8.45%
- Program expenses totaled \$13,764,320. Instructional expenses made up 56.91% of this total while support services accounted for 36.97%. Other expenses rounded out the remaining 6.12%
- A \$17.5 million bond issue was passed November 4, 2003. This translated in to 5.61 mills to be levied against our property owners.

Using this Annual Financial Report

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

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

Reporting the School District as a Whole

Statement of Net Assets and the Statement of Activities

While this document contains all the funds used by the School District to provide programs and activities, the view of the School District as a whole considers all financial transactions and asks the question, "How did we do financially during 2004?" The *Statement of Net Assets* and the *Statement of Activities* answers this question. These statements include all assets and liabilities using the accrual basis of accounting, similar to the accounting used by most private-sector companies. Accrual accounting takes into account all of the current year's revenues and expenses regardless of when cash is received or paid.

Keystone Local School District
Lorain County

Management's Discussion and Analysis
For the Year Ended June 30, 2004
Unaudited

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

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

Reporting the School District's Most Significant Funds

Fund Financial Statements

The analysis of the School District's major funds begins on page 13. Fund financial statements provide detailed information about the School District's major funds. The School District uses many funds to account for a multitude of financial transactions. However, these fund financial statements focus on the School District's most significant funds. The School District's major governmental funds are the General Fund, Debt Service Fund and Building Fund.

Governmental Funds

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

Keystone Local School District
Lorain County

Management's Discussion and Analysis
For the Year Ended June 30, 2004
Unaudited

The School District as a Whole

You may recall that the *Statement of Net Assets* provides the perspective of the School District as a whole. Table 1 provides a summary of the School District's net assets for 2004 compared to 2003.

Table 1
STATEMENT OF NET ASSETS

	<u>6/30/2004</u>	<u>6/30/2003</u>	<u>Change</u>
Assets			
Equity in pooled cash	\$ 39,293,545	\$ 4,854,754	\$ 34,438,791
Cash with fiscal agent	668,220	666,359	1,861
Accrued interest	52,613	19,317	33,296
Due from other governments	46,561	464,573	(418,012)
Inventories and supplies	6,977	6,315	662
Prepays	3,982	17,189	(13,207)
Taxes receivable	6,572,931	4,889,471	1,683,460
Capital assets			
Nondepreciable capital assets	1,403,293	399,414	1,003,879
Depreciable capital assets, net	4,285,217	4,359,081	(73,864)
Total assets	<u>52,333,339</u>	<u>15,676,473</u>	<u>36,656,866</u>
Liabilities			
Accounts and contracts payable	279,510	64,261	215,249
Accrued salaries, wages and benefits	1,098,769	1,021,137	77,632
Accrued interest payable	245,128	-	245,128
Claims payable	280,602	299,000	(18,398)
Due to other governments	305,934	298,144	7,790
Deferred revenue	5,834,556	4,734,830	1,099,726
Matured bond and interest payable	5,000	5,000	-
Notes payable	17,500,000	-	17,500,000
Long term liabilities			
Due within one year	455,392	120,416	334,976
Due in more than one year	18,128,712	879,584	17,249,128
Total liabilities	<u>44,133,603</u>	<u>7,422,372</u>	<u>36,711,231</u>
Net assets			
Invested in capital assets, net of related debt	5,688,510	4,758,495	930,015
Restricted for:			
Debt service	947,811	224,965	722,846
Capital projects	684,912	813,683	(128,771)
Other purposes	421,885	358,065	63,820
Unrestricted (deficit)	456,618	2,098,893	(1,642,275)
Total net assets	<u>\$ 8,199,736</u>	<u>\$ 8,254,101</u>	<u>\$ (54,365)</u>

Keystone Local School District
Lorain County

Management's Discussion and Analysis
For the Year Ended June 30, 2004
Unaudited

Table 2 shows the statement of activities for fiscal year 2004 as compared to 2003.

Table 2
STATEMENT OF ACTIVITIES

	2004 Amount	% of Total	2003 Amount	% of Total
General revenues				
Property taxes levied for:				
General purpose	\$ 4,306,050	31.41%	\$ 4,144,328	33.78%
Debt service	730,494	5.33%	-	0.00%
Capital improvements	214,036	1.56%	210,352	1.71%
Grants and entitlements not restricted to specific purposes	7,162,776	52.25%	6,184,796	50.42%
Investment earnings	69,031	0.50%	133,858	1.09%
Miscellaneous	68,816	0.50%	91,764	0.75%
Total general revenues	<u>12,551,203</u>	<u>91.55%</u>	<u>10,765,098</u>	<u>87.75%</u>
Program revenues	1,158,752	8.45%	1,502,475	12.25%
Total revenues	<u>13,709,955</u>	<u>100.00%</u>	<u>12,267,573</u>	<u>100.00%</u>
Governmental activities				
Instruction				
Regular	6,660,466	48.39%	6,309,447	48.52%
Special	984,184	7.15%	931,240	7.16%
Vocational	187,970	1.37%	171,846	1.32%
Supporting services				
Pupil	1,035,370	7.52%	957,635	7.36%
Instructional staff	404,004	2.94%	336,881	2.59%
Board of education	27,473	0.20%	32,385	0.25%
Administration	1,194,766	8.68%	1,138,460	8.76%
Fiscal services	357,675	2.60%	311,966	2.40%
Operation and maintenance	1,100,974	8.00%	1,023,388	7.87%
Pupil transportation	809,574	5.88%	877,702	6.75%
Central services	158,698	1.15%	135,321	1.04%
Operation of non-instructional				
Food service operation	436,982	3.17%	422,276	3.25%
Latchkey operations	41,780	0.30%	37,131	0.29%
Extracurricular activities	364,404	2.65%	311,879	2.40%
Debt service				
Interest	-	0.00%	5,174	0.04%
Totals	<u>13,764,320</u>	<u>100.00%</u>	<u>13,002,731</u>	<u>100.00%</u>
Change in net assets	<u>\$ (54,365)</u>		<u>\$ (735,158)</u>	

Keystone Local School District
Lorain County

Management's Discussion and Analysis
For the Year Ended June 30, 2004
Unaudited

Governmental Activities

The School District has carefully looked at its financial existence by forecasting its revenues and expenditures over the next five years. The School District has had a healthy cash carryover for the last couple of years. It had grown from over \$2 million in fiscal year 2000 to \$2.8 million in fiscal year 2004. We know we will need additional operating funds in the future. We are working on that timing now. FY04 was the second consecutive year for deficit spending. Deficit spending will continue into FY05.

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

As you can see in Table 2, 56.91% of the District's budget is used to fund instructional expenses. Additional supporting services for pupils, staff and business operations encompass an additional 36.97%. The remaining amount of program expenses, roughly 6.12%, is budgeted to facilitate other obligations of the District such as interest and fiscal charges, the food service program and numerous extracurricular activities.

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

Table 3

	Total Cost of Services	Net Cost of Services
Governmental activities		
Instruction		
Regular	\$ 6,660,466	\$ (6,486,330)
Special	984,184	(863,115)
Vocational	187,970	(187,970)
Supporting services		
Pupil	1,035,370	(880,468)
Instructional staff	404,004	(288,752)
Board of education	27,473	(27,473)
Administration	1,194,766	(1,184,355)
Fiscal services	357,675	(357,675)
Operation and maintenance	1,100,974	(1,086,947)
Pupil transportation	809,574	(778,181)
Central services	158,698	(155,838)
Operation of non-instructional		
Food service operation	436,982	(29,638)
Latchkey operations	41,780	(7,155)
Extracurricular activities	364,404	(271,671)
Totals	\$ 13,764,320	\$ (12,605,568)

Keystone Local School District
Lorain County

Management's Discussion and Analysis
For the Year Ended June 30, 2004
Unaudited

As one can see, the reliance upon local tax revenues for governmental activities is important. Almost 38.15% of expenses are directly supported by local property taxes. Grants and entitlements not restricted to specific programs support approximately 52.0%, while investment and other miscellaneous type revenues support the remaining activity costs. Program revenues only account for approximately 8.42% of all governmental expenses.

School District's Funds

Information regarding the School District's major funds can be found on page 13. Governmental Funds are accounted for using the modified accrual basis of accounting. All governmental funds had total revenues of \$13,858,098 and expenditures of \$ 14,528,752.

General Fund Budgeting Highlights

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

During the course of fiscal 2004, the School District amended its General Fund budget numerous times. The School District uses a site-based style of budgeting and has in place systems that are designed to tightly control expenses yet provide flexibility for site-based decision and management.

For the General Fund, the final budget basis revenue estimated totaled \$11,004,673. This was above the original budget estimate of \$10,920,248. The main difference between the original and final estimates was due to an increase in grants. Since the funds were not needed to appropriate, the budget basis expense estimate totaled \$12,992,671 compared to the original estimate of \$12,871,746. This difference was primarily due to changes in staffing costs throughout the year.

The School District's unencumbered ending cash balance totaled \$2,906,403, which was above the original budgeted amount.

Keystone Local School District
 Lorain County
Management's Discussion and Analysis
 For the Year Ended June 30, 2004
 Unaudited

Capital Assets and Debt Administration

Capital Assets

At the end of fiscal 2004, the School District had \$5,688,510 invested in land, buildings, equipment, vehicles and textbooks. Table 4 shows fiscal 2004 values compared to 2003.

Table 4
 Net Capital Assets at June 30th
 Governmental Activities

	2004	2003
Land	\$ 521,816	\$ 399,414
Construction in progress	881,477	-
Land improvements	244,908	188,946
Buildings and improvements	3,441,144	3,471,209
Furniture and equipment	183,305	224,658
Vehicles	415,860	474,268
	\$ 5,688,510	\$ 4,758,495

All capital assets, except land and construction in progress, are reported net of depreciation. As one can see, the increases in our capital assets during the fiscal year occurred in the categories of Land, Land improvements and Construction in progress. Those increases were due to the new high school construction project.

Debt

The School District passed a \$17.5 million bond issue on November 4, 2003. That bond issue will cover the construction of a new high school. The bonds were issued in May 2004 with the first interest and principal payment due December 1, 2004.

School District Outlook

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

The financial future of the School District beyond fiscal year 2005 is not without its challenges. These challenges are internal and external in nature. The internal challenges will continue to exist as the School District must rely on local property taxes to fund its operations. External challenges continue to evolve as the State of Ohio determines the amount of funding they will allocate to education through each of their biennium budgets.

Keystone Local School District
Lorain County

Management's Discussion and Analysis
For the Year Ended June 30, 2004
Unaudited

The School District receives approximately 38.30% of its revenue from local property taxes. The community support for the schools is good, but we have to be cautious since we usually have to go back several times before operating levies are passed. Since our 8-mill levy expired in 2002, we have dropped to the 20-mill floor for the Residential/Agricultural values. We also have two 1-mill continuing permanent improvement levies. The School District has communicated to the community that while we are grateful for their support of the \$17.5 million bond issue passed in November 2003, we will be needing additional operating funds and will be back on the ballot in 2005.

Externally, the State of Ohio was found by the Ohio Supreme Court in March 1997 to be operating an unconstitutional educational funding system, one that was neither "adequate" nor "equitable". Since 1997, the State has directed it additional financial support toward School Districts with little property tax wealth. In May of 2000, the Ohio Supreme Court again, ruled that, while the State had made some progress, the current funding system for schools is far too dependent on property taxes, which are inherently not "equitable" nor "adequate". The court directed the Governor and the legislature to address the fundamental issue creating the inequities. In September 2001, the Ohio Supreme Court issued another opinion regarding the funding system. The decision identified aspects of the current plan that require modification. In December 2002, the Court ruled again that the funding system is unconstitutional, but removed itself from the picture. There is no "heavy hammer" to require the legislature to make changes. Governor Taft did form a Blue Ribbon Task Force Committee to study the funding system and make recommendations before the next biennium budget.

Keystone Local School District has not anticipated any meaningful growth in State revenue due to the concerns over the State Budget. The State Budget itself is in trouble. They have used many one-time money sources to help balance their budget in 2003 and 2002. Without some major changes, the State just doesn't have money. The Blue Ribbon Task Force is completing its recommendations for the Governor with a preliminary release of those recommendations in November 2004.

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

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

Contacting the School District's Financial Management

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

KEYSTONE LOCAL SCHOOL DISTRICT
LORAIN COUNTY

STATEMENT OF NET ASSETS

JUNE 30, 2004

Assets	
Equity in pooled cash	\$ 39,293,545
Cash with fiscal agent	668,220
Accrued interest	52,613
Due from other governments	46,561
Inventories and supplies	6,977
Prepays	3,982
Taxes receivable	6,572,931
Capital assets	
Nondepreciable capital assets	1,403,293
Depreciable capital assets, net	4,285,217
Total assets	52,333,339
Liabilities	
Accounts and contracts payable	279,510
Accrued salaries, wages and benefits	1,098,769
Accrued interest payable	245,128
Claims payable	280,602
Due to other governments	305,934
Deferred revenue	5,834,556
Matured bond and interest payable	5,000
Notes payable	17,500,000
Long term liabilities	
Due within one year	455,392
Due in more than one year	18,128,712
Total liabilities	44,133,603
Net assets	
Invested in capital assets, net of related debt	5,688,510
Restricted for:	
Debt service	947,811
Capital projects	684,912
Other purposes	421,885
Unrestricted	456,618
Total net assets	\$ 8,199,736

See accompanying notes to the basic financial statements.

KEYSTONE LOCAL SCHOOL DISTRICT
LORAIN COUNTY
STATEMENT OF ACTIVITIES
FOR THE YEAR ENDED JUNE 30, 2004

	Expenses	Program Revenues		Net (Expense) Revenue and Changes in Net Assets
		Charges for Services and Sales	Operating Grants Interest and Contributions	
Governmental activities				
Instruction				
Regular	\$ 6,660,466	\$ 64,919	\$ 109,217	\$ (6,486,330)
Special	984,184	-	121,069	(863,115)
Vocational	187,970	-	-	(187,970)
Supporting services				
Pupil	1,035,370	51,713	103,189	(880,468)
Instructional staff	404,004	-	115,252	(288,752)
Board of education	27,473	-	-	(27,473)
Administration	1,194,766	-	10,411	(1,184,355)
Fiscal services	357,675	-	-	(357,675)
Operation and maintenance	1,100,974	-	14,027	(1,086,947)
Pupil transportation	809,574	-	31,393	(778,181)
Central services	158,698	-	2,860	(155,838)
Operation of non-instructional				
Food service operation	436,982	316,439	90,905	(29,638)
Latchkey operations	41,780	34,625	-	(7,155)
Extracurricular activities	364,404	92,733	-	(271,671)
Totals	<u>\$ 13,764,320</u>	<u>\$ 560,429</u>	<u>\$ 598,323</u>	<u>\$ (12,605,568)</u>

General revenues	
Property taxes levied for:	
General purpose	4,306,050
Debt service	730,494
Capital improvements	214,036
Grants and entitlements not restricted to specific purposes:	7,162,776
Investment earnings	69,031
Miscellaneous	68,816
Total general revenues	<u>12,551,203</u>

Change in net assets	(54,365)
Net assets at beginning of year	8,254,101
Net assets at end of year	<u>\$ 8,199,736</u>

See accompanying notes to the basic financial statements.

KEYSTONE LOCAL SCHOOL DISTRICT
LORAIN COUNTY

BALANCE SHEET
GOVERNMENTAL FUNDS

JUNE 30, 2004

	General	Debt Service	Building Fund	Other Governmental Funds	Total Governmental Funds
Assets					
Equity in pooled cash	\$ 3,043,909	\$ 18,366,472	\$ 17,029,466	\$ 853,698	\$ 39,293,545
Restricted cash	-	5,000	-	-	5,000
Receivables, net of allowance					
Taxes, current	4,967,975	1,256,524	-	240,588	6,465,087
Taxes, delinquent	83,997	19,795	-	4,052	107,844
Accrued interest	2,843	-	49,770	-	52,613
Due from other governments	-	-	-	46,561	46,561
Due from general fund	-	21,417	-	-	21,417
Interfund receivable	10,000	-	-	-	10,000
Prepaid expenses	3,982	-	-	-	3,982
Inventories and supplies	-	-	-	6,977	6,977
Total assets and other debits	\$ 8,112,706	\$ 19,669,208	\$ 17,079,236	\$ 1,151,876	\$ 46,013,026
Liabilities and fund balances					
Liabilities					
Accounts and contracts payable	\$ 21,498	\$ -	\$ 235,776	\$ 22,236	\$ 279,510
Accrued wages and benefits	1,030,271	-	-	68,498	1,098,769
Accrued interest payable	-	21,417	148,750	-	170,167
Due to other governments	184,791	-	1,226	5,684	191,701
Due to debt service fund	21,417	-	-	-	21,417
Interfund payable	-	-	-	10,000	10,000
Deferred revenue	4,541,659	1,139,814	-	260,927	5,942,400
Compensated absences	114,544	-	-	2,994	117,538
Matured bond and interest payable	-	5,000	-	-	5,000
Notes payable	-	-	17,500,000	-	17,500,000
Total liabilities	5,914,180	1,166,231	17,885,752	370,339	25,336,502
Fund balances					
Reserved for prepaids	3,982	-	-	-	3,982
Reserved for property taxes	510,313	136,505	-	24,658	671,476
Reserved for inventories	-	-	-	6,977	6,977
Reserved for encumbrances	119,876	-	1,457,470	80,795	1,658,141
Unreserved, reported in					
General Fund	1,564,355	-	-	-	1,564,355
Special Revenue Funds	-	-	-	89,764	89,764
Debt Service Fund	-	18,366,472	-	-	18,366,472
Capital Projects Funds	-	-	(2,263,986)	579,343	(1,684,643)
Total fund balances	2,198,526	18,502,977	(806,516)	781,537	20,676,524
Total liabilities and fund balances	\$ 8,112,706	\$ 19,669,208	\$ 17,079,236	\$ 1,151,876	\$ 46,013,026

See accompanying notes to the basic financial statements.

KEYSTONE LOCAL SCHOOL DISTRICT
LORAIN COUNTY

RECONCILIATION OF TOTAL GOVERNMENTAL FUND BALANCES TO
NET ASSETS OF GOVERNMENTAL ACTIVITIES

JUNE 30, 2004

Total governmental funds balances	\$ 20,676,524
Amount reported for governmental activities in the statement of net assets are different because:	
Capital assets used in governmental activities are not financial resources and therefore not reported in the funds.	5,688,510
Other long term assets are not available to pay for current period expenditures and therefore are deferred in the funds. These deferrals are attributed to property taxes.	107,844
An internal service fund is used by management to charge the costs of insurance to individual funds. The assets and liabilities of the internal service fund are included in governmental activities in the statement of net assets.	382,618
Due to other governments includes contractually required pension contributions not expected to be paid with expendable available financial resources and therefore not reported in the funds.	(114,233)
Long term liabilities are not due and payable in the current period and therefore are not reported in the funds:	
Compensated absences	(966,566)
Bonds	(17,500,000)
Accrued interest payable	(74,961)
Net assets of governmental activities	<u>\$ 8,199,736</u>

See accompanying notes to the basic financial statements.

KEYSTONE LOCAL SCHOOL DISTRICT
LORAIN COUNTY

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

FOR THE YEAR ENDED JUNE 30, 2004

	General	Debt Service	Building Fund	Other Governmental Funds	Total Governmental Funds
Revenues					
Taxes	\$ 4,312,745	\$ 710,699	\$ -	\$ 214,737	\$ 5,238,181
Tuition and fees	98,444	-	-	-	98,444
Interest	57,633	-	179,363	105	237,101
Intergovernmental	7,056,798	69,030	-	635,271	7,761,099
Charges for services	-	-	-	316,439	316,439
Extracurricular	6,625	-	-	98,887	105,512
Other	61,288	-	-	40,034	101,322
Total revenues	11,593,533	779,729	179,363	1,305,473	13,858,098
Expenditures					
Current					
Instruction					
Regular	6,377,841	-	-	129,605	6,507,446
Special	843,080	-	-	140,069	983,149
Vocational	184,712	-	-	-	184,712
Supporting services					
Pupil	880,848	-	-	150,700	1,031,548
Instructional staff	257,926	-	-	143,853	401,779
Board of education	27,473	-	-	-	27,473
Administration	1,197,716	-	-	5,209	1,202,925
Fiscal services	332,797	10,345	1,540	12,462	357,144
Operation and maintenance	1,006,427	-	-	37,463	1,043,890
Pupil transportation	710,013	-	-	33,642	743,655
Central services	154,063	-	-	3,114	157,177
Operation of non-instructional					
Food service operation	-	-	-	433,690	433,690
Latchkey operations	43,000	-	-	-	43,000
Extracurricular activities	276,406	-	-	85,508	361,914
Capital outlay	-	-	835,589	300,687	1,136,276
Debt service					
Interest	-	-	148,750	-	148,750
Total expenditures	12,292,302	10,345	985,879	1,476,002	14,764,528
Excess (deficiency) of revenues over expenditures	(698,769)	769,384	(806,516)	(170,529)	(906,430)
Other financing sources (uses)					
Transfers-in	-	-	-	30,000	30,000
Proceeds from the sale of bonds	-	17,500,000	-	-	17,500,000
Premium on the sale of notes	-	8,628	-	-	8,628
Pass through	-	-	-	(1,100)	(1,100)
Transfers-out	(30,000)	-	-	-	(30,000)
Total other financing sources (uses)	(30,000)	17,508,628	-	28,900	17,507,528
Net change in fund balances	(728,769)	18,278,012	(806,516)	(141,629)	16,601,098
Fund balances, beginning of year	2,927,295	224,965	-	923,166	4,075,426
Fund balances, end of year	\$ 2,198,526	\$ 18,502,977	\$ (806,516)	\$ 781,537	\$ 20,676,524

See accompanying notes to the basic financial statements.

KEYSTONE LOCAL SCHOOL DISTRICT
LORAIN COUNTY

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

FOR THE YEAR ENDED JUNE 30, 2004

Net change in fund balances - total governmental funds \$ 16,601,098

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

Governmental funds report capital outlays as expenditures.

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

Capital outlay	1,091,413	
Depreciation expense	(161,398)	
Total	930,015	930,015

Revenues in the statement of activities that do not provide current financial resources are not reported as revenues in the funds. 12,399

Bond proceeds are an other financing source in the funds but increase long term liabilities in the statement of net assets (17,500,000)

In the statement of activities, interest is accrued on outstanding bonds, w hereas in governmental funds, an interest expense is reported w hen due. (74,961)

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

Compensated absences	(41,896)	
Pension obligations	(1,279)	
	(43,175)	(43,175)

The internal service fund used by management to charge the costs of insurance to individual funds is not reported in the district-w ide statement of activities. Governmental fund expenditures and the related internal service fund revenues are eliminated. The net revenue (expense) of the internal service fund is allocated among the govenmental activities. 20,259

Change in net assets of governmental activities \$ (54,365)

See accompanying notes to the basic financial statements.

KEYSTONE LOCAL SCHOOL DISTRICT
LORAIN COUNTY

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

FOR THE YEAR ENDED JUNE 30, 2004

	Budgeted Amounts		Actual	Variance Favorable (Unfavorable)
	Original	Final		
Revenues				
Taxes	\$ 4,104,174	\$ 4,104,174	\$ 4,294,068	\$ 189,894
Tuition and fees	66,470	91,975	98,444	6,469
Interest	116,565	116,565	95,524	(21,041)
Intergovernmental	6,592,969	6,613,469	7,056,798	443,329
Extracurricular	36,070	7,000	6,625	(375)
Other	4,000	71,490	61,288	(10,202)
Total revenues	<u>10,920,248</u>	<u>11,004,673</u>	<u>11,612,747</u>	<u>608,074</u>
Expenditures				
Current				
Instruction				
Regular	6,555,578	6,596,728	6,371,523	225,205
Special	972,104	956,386	900,894	55,492
Vocational	183,438	190,938	188,482	2,456
Supporting services				
Pupil	869,001	871,360	849,248	22,112
Instructional staff	301,472	287,310	268,653	18,657
Board of education	56,410	36,410	29,972	6,438
Administration	1,227,392	1,215,424	1,135,387	80,037
Fiscal services	343,264	352,864	341,462	11,402
Operation and maintenance	1,159,768	1,159,836	1,040,774	119,062
Pupil transportation	734,845	806,846	708,905	97,941
Central services	160,059	177,679	169,445	8,234
Operation of non-instructional				
Latchkey operations	-	47,175	43,389	3,786
Extracurricular activities	280,915	286,515	276,212	10,303
Capital outlay	27,500	7,200	-	7,200
Total expenditures	<u>12,871,746</u>	<u>12,992,671</u>	<u>12,324,346</u>	<u>668,325</u>
Excess (deficiency) of revenues over expenditures	<u>(1,951,498)</u>	<u>(1,987,998)</u>	<u>(711,599)</u>	<u>1,276,399</u>
Other financing sources (uses)				
Advances-in	18,000	-	-	-
Advances-out	(20,000)	(10,000)	(10,000)	-
Transfers-out	(50,000)	(42,000)	(30,000)	12,000
Total other financing sources (uses)	<u>(52,000)</u>	<u>(52,000)</u>	<u>(40,000)</u>	<u>12,000</u>
Excess (deficiency) of revenues over expenditures and other sources (uses)	<u>(2,003,498)</u>	<u>(2,039,998)</u>	<u>(751,599)</u>	<u>1,288,399</u>
Fund balances, beginning of year	3,540,426	3,540,426	3,540,426	-
Prior year encumbrances	<u>117,576</u>	<u>117,576</u>	<u>117,576</u>	<u>-</u>
Fund balances, end of year	<u>\$ 1,654,504</u>	<u>\$ 1,618,004</u>	<u>\$ 2,906,403</u>	<u>\$ 1,288,399</u>

See accompanying notes to the basic financial statements.

KEYSTONE LOCAL SCHOOL DISTRICT
LORAIN COUNTY

STATEMENT OF NET ASSETS
PROPRIETARY FUND

JUNE 30, 2004

	<u>Internal Service Fund - Self Insurance</u>
Assets	
Equity in pooled cash	\$ 663,220
Total assets	<u>663,220</u>
Liabilities	
Claims payable	<u>280,602</u>
Total liabilities	<u>280,602</u>
Net assets	
Unrestricted	<u>\$ 382,618</u>

See accompanying notes to the basic financial statements.

KEYSTONE LOCAL SCHOOL DISTRICT
LORAIN COUNTY
STATEMENT OF REVENUES, EXPENSES AND CHANGES IN NET ASSETS
PROPRIETARY FUND
FOR THE YEAR ENDED JUNE 30, 2004

	Internal Service Fund - Self Insurance
Operating revenues	
Charges for services	\$ 1,365,728
Operating expenses	
Purchased services	82,754
Claims	1,274,008
Total operating expenses	1,356,762
Operating income	8,966
Non-operating revenue	
Interest	11,293
Increase in net assets	20,259
Net assets, beginning of year	362,359
Net assets, end of year	\$ 382,618

See accompanying notes to the basic financial statements.

KEYSTONE LOCAL SCHOOL DISTRICT
LORAIN COUNTY
STATEMENT OF CASH FLOWS
PROPRIETARY FUND
FOR THE YEAR ENDED JUNE 30, 2004

Cash flows from operating activities	
Cash received from interfund services	\$ 1,365,728
Cash payments for goods and services	(82,754)
Cash payments for claims	(1,292,406)
Net (decrease) in cash and cash equivalents	<u>(9,432)</u>
Cash flow from investing activities	
Interest	11,293
Cash and cash equivalents, beginning of year	<u>661,359</u>
Cash and cash equivalents, end of year	<u><u>\$ 663,220</u></u>
Reconciliation of operating income to net cash used for operating activities	
Operating income	\$ 8,966
Adjustments	
Decrease in claims payable	<u>(18,398)</u>
Net cash used for operating activities	<u><u>\$ (9,432)</u></u>

See accompanying notes to the basic financial statements.

KEYSTONE LOCAL SCHOOL DISTRICT
LORAIN COUNTY
STATEMENT OF FIDUCIARY ASSETS AND LIABILITIES -
AGENCY FUND
JUNE 30, 2004

	<u>Student Activities</u>
Assets	
Equity in pooled cash	\$ 30,950
Total assets	<u> 30,950</u>
Liabilities	
Due to students	30,950
Total liabilities	<u>\$ 30,950</u>

See accompanying notes to the basic financial statements.

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KEYSTONE LOCAL SCHOOL DISTRICT
LORAIN COUNTY
NOTES TO THE BASIC FINANCIAL STATEMENTS
FOR THE YEAR ENDED JUNE 30, 2004

NOTE 1 - DESCRIPTION OF THE SCHOOL DISTRICT AND REPORTING ENTITY

The Keystone Local School District (the District) was established for the purpose of exercising the rights and privileges conveyed to it by the constitution and laws of the State of Ohio. The District is a local school district as defined by Section 3311.03 of the Ohio Revised Code. The District operates under an elected Board of Education consisting of five members and is responsible for providing public education to residents of the District. Average daily membership on, or as of, October 1, 2003 was 1,834. The District employs 123 certificated and 94 non-certificated employees.

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

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

The District is associated with the Lake Erie Educational Computer Association, the Lake Erie Regional Council (LERC) and the Lorain County Joint Vocational School District. These organizations and their relationships with the District are described in more detail in Notes 9 and 18 to these financial statements.

NOTE 2 - SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

The financial statements of the District have been prepared in conformity with generally accepted accounting principles (GAAP) as applied to governmental units. The Governmental Accounting Standards Board (GASB) is the accepted standard-setting body for establishing governmental accounting and financial reporting principles. The District also applies Financial Accounting Standards Board (FASB) statements and interpretations issued on or before November 30, 1989, to its governmental and business-type activities and to its proprietary funds provided they do not conflict with or contradict GASB pronouncements. The District has no business-type activities. The following are the more significant of the District's accounting policies.

A. BASIS OF PRESENTATION

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

KEYSTONE LOCAL SCHOOL DISTRICT
LORAIN COUNTY
NOTES TO THE BASIC FINANCIAL STATEMENTS
FOR THE YEAR ENDED JUNE 30, 2004
(CONTINUED)

NOTE 2 - SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (continued)

A. BASIS OF PRESENTATION (continued)

Government-wide Financial Statements

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

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

Fund Financial Statements

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

B. FUND ACCOUNTING

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

Governmental Funds

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

KEYSTONE LOCAL SCHOOL DISTRICT
LORAIN COUNTY
NOTES TO THE BASIC FINANCIAL STATEMENTS
FOR THE YEAR ENDED JUNE 30, 2004
(CONTINUED)

NOTE 2 - SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (continued)

B. FUND ACCOUNTING (continued)

Governmental Funds (continued)

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

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

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

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

Proprietary Fund

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

Fiduciary Funds

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

C. MEASUREMENT FOCUS

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

Fund Financial Statements - All governmental funds are accounted for using a flow of current financial resources measurement focus. With this measurement focus, only current assets and current liabilities generally are included on the balance sheet. The statement of revenues, expenditures and changes in fund balances reports on the sources (i.e., revenues and other financing sources) and uses (i.e., expenditures and other financing uses) of current financial resources. This approach differs from the manner in which the governmental activities of the government-wide financial statements are prepared. Governmental fund financial statements therefore include a reconciliation with brief explanations to better identify the relationship between the government-wide statements and the statements for governmental funds.

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

KEYSTONE LOCAL SCHOOL DISTRICT
LORAIN COUNTY
NOTES TO THE BASIC FINANCIAL STATEMENTS
FOR THE YEAR ENDED JUNE 30, 2004
(CONTINUED)

NOTE 2 - SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (continued)

D. BASIS OF ACCOUNTING

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

Revenues - Exchange and Non-exchange Transactions

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

Nonexchange transactions, in which the District receives value without directly giving equal value in return, include property taxes, grants, entitlements, and donations. On an accrual basis, revenue from property taxes is recognized in the fiscal year for which the taxes are levied (See Note 6). Revenue from grants, entitlements, and donations is recognized in the fiscal year in which all eligibility requirements have been satisfied. Eligibility requirements include timing requirements, which specify the year when the resources are required to be used or the year when use is first permitted; matching requirements, in which the District must provide local resources to be used for a specified purpose; and expenditure requirements, in which the resources are provided to the District on a reimbursement basis. On a modified accrual basis, revenue from nonexchange transactions must also be available before it can be recognized.

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

Deferred Revenue

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

Property taxes for which there is an enforceable legal claim as of June 30, 2004, but which were levied to finance fiscal year 2004 operations, have been recorded as deferred revenue. Grants and entitlements received before the eligibility requirements are met are also recorded as deferred revenue.

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

KEYSTONE LOCAL SCHOOL DISTRICT
LORAIN COUNTY
NOTES TO THE BASIC FINANCIAL STATEMENTS
FOR THE YEAR ENDED JUNE 30, 2004
(CONTINUED)

NOTE 2 - SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (continued)

D. BASIS OF ACCOUNTING (continued)

Expenditures/Expenses

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

E. BUDGETARY PROCESS

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

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

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

F. CASH AND INVESTMENTS

Cash received by the District is deposited in one central bank account with individual fund balance integrity maintained through District records. Monies for all funds are maintained in this account or temporarily transferred to the State Treasurer's investment pool (STAROhio) or other short term investments. Under existing Ohio statutes, interest earnings are allocated to funds based on average monthly cash balances. Interest income earned for the year ended June 30, 2004, totaled \$237,101.

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

KEYSTONE LOCAL SCHOOL DISTRICT
LORAIN COUNTY
NOTES TO THE BASIC FINANCIAL STATEMENTS
FOR THE YEAR ENDED JUNE 30, 2004
(CONTINUED)

NOTE 2 - SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (continued)

F. CASH AND INVESTMENTS (continued)

The District has invested in the State Treasury Asset Reserve of Ohio (STAROhio) during the year. STAROhio is an investment pool managed by the State Treasurer's Office, which allows governments within the State to pool their funds for investment purposes. STAROhio is not registered with the SEC as an investment company, but does operate in a manner consistent with Rule 2a7 of the Investment Company Act of 1940. Investments in STAROhio are valued at STAROhio's share price, which is the price the investment could be sold for on June 30, 2004.

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

G. INVENTORY

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

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

H. RESTRICTED ASSETS

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

I. CAPITAL ASSETS

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

All capital assets are capitalized at cost (or estimated historical cost) and updated for additions and reductions during the year. Donated capital assets are recorded at their fair market values as of the date received. The District maintains a capitalization threshold of five thousand dollars. The District does not possess any infrastructure. Improvements are capitalized; the costs of normal maintenance and repairs that do not add to the value of the asset or materially extend an asset's life are not capitalized. Interest costs for capital asset construction within the government-wide statement of net assets are capitalized. Interest costs incurred during 2004 were \$223,711, of which all has been capitalized.

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

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

KEYSTONE LOCAL SCHOOL DISTRICT
LORAIN COUNTY
NOTES TO THE BASIC FINANCIAL STATEMENTS
FOR THE YEAR ENDED JUNE 30, 2004
(CONTINUED)

NOTE 2 - SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (continued)

J. INTERFUND BALANCES

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

K. COMPENSATED ABSENCES

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

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

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

L. ACCRUED LIABILITIES AND LONG-TERM OBLIGATIONS

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

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

M. NET ASSETS

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

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

KEYSTONE LOCAL SCHOOL DISTRICT
LORAIN COUNTY
NOTES TO THE BASIC FINANCIAL STATEMENTS
FOR THE YEAR ENDED JUNE 30, 2004
(CONTINUED)

NOTE 2 - SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (continued)

N. FUND BALANCE RESERVES AND DESIGNATIONS

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

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

O. OPERATING REVENUES AND EXPENSES

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

P. INTERFUND TRANSACTIONS

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

Q. ESTIMATES

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

NOTE 3– DEFICIT FUND BALANCE

At June 30, 2004, the Title VI B had a deficit fund balance of \$ 28,217, Title I had a deficit fund balance of \$ 7,711, Class Size Reduction had a deficit fund balance of \$ 1,070, and the Building Fund had a deficit fund balance of \$ 806,516. The General Fund is liable for deficits in the fund and provides transfers when cash is required, not when accruals occur. The deficit fund balances, resulted from adjustments for accrued liabilities.

KEYSTONE LOCAL SCHOOL DISTRICT
LORAIN COUNTY
NOTES TO THE BASIC FINANCIAL STATEMENTS
FOR THE YEAR ENDED JUNE 30, 2004
(CONTINUED)

NOTE 4 - BUDGETARY BASIS OF ACCOUNTING

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

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

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

Net Change in Fund Balance	
General Fund	
	General
Budget basis	\$ (751,599)
Adjustments, increase (decrease)	
Revenue accruals	(19,214)
Expenditure accruals	42,044
GAAP basis, as reported	\$ (728,769)

KEYSTONE LOCAL SCHOOL DISTRICT
LORAIN COUNTY
NOTES TO THE BASIC FINANCIAL STATEMENTS
FOR THE YEAR ENDED JUNE 30, 2004
(CONTINUED)

NOTE 5 - DEPOSITS AND INVESTMENTS

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

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

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

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

Interim monies may be invested in the following securities:

1. United States Treasury bills, bonds, notes, or any other obligation or security issued by the United States Treasury, or any other obligation guaranteed as to principal and interest by the United States;
2. Bonds, notes, debentures, or any other obligation or security issued by any federal government agency or instrumentality including, but not limited to, the Federal National Mortgage Association, Federal Home Loan Bank, Federal Farm Credit Bank, Federal Home Loan Mortgage Corporation, Government National Mortgage Association, and Student Loan Marketing Association. All federal agency securities shall be direct issuances of federal government agencies or instrumentalities;
3. Written repurchase agreements in the securities listed above provided that the market value of the securities subject to the repurchase agreement must exceed the principal value of the agreement by at least 2 percent and be marked to market daily, and the term of the agreement must not exceed thirty days;
4. Bonds and other obligations of the State of Ohio;
5. No-load money market mutual funds consisting exclusively of obligations described in division (1) or (2) and repurchase agreements secured by such obligations, provided that investments in securities described in this division are made only through eligible institutions;

KEYSTONE LOCAL SCHOOL DISTRICT
LORAIN COUNTY
NOTES TO THE BASIC FINANCIAL STATEMENTS
FOR THE YEAR ENDED JUNE 30, 2004
(CONTINUED)

NOTE 5 - DEPOSITS AND INVESTMENTS (continued)

6. The State Treasurer's investment pool (STAR Ohio);
7. Commercial paper and bankers' acceptances (if authorized by the Board of Education), and
8. Under limited circumstances, corporate debt interests rated in either of the two highest rating classifications by at least two nationally recognized rating agencies.

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

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

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

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

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

At fiscal year end, the carrying amount of the District's deposits was \$ 24,902,547 and the bank balance was \$ 25,069,326, all of which was covered by federal depository insurance or by collateral held by a qualified third party trustee in the name of the District.

The District's investments are categorized to give an indication of the level of risk assumed by the District at fiscal year end. Category 1 includes investments that are insured or registered for which the securities are held by the District or its agent in the District's name. Category 2 includes uninsured and unregistered investments for which the securities are held by the counterparty's trust department or agent in the District's name. Category 3 includes uninsured and unregistered investments for which the securities are held by the counterparty, or by its trust department or agent but not in the District's name. Investment in STAROhio, the State Treasurer's Investment Pool, is not classified by degree of credit risk since it is not evidenced by securities that exist in physical or book entry form.

The classification of cash and cash equivalents and investments on the combined financial statements is based on criteria set forth in GASB Statement No. 9, "Reporting Cash Flows of Proprietary and Non-Expendable Trust Funds and Governmental Entities That Use Proprietary Fund Accounting".

KEYSTONE LOCAL SCHOOL DISTRICT
LORAIN COUNTY
NOTES TO THE BASIC FINANCIAL STATEMENTS
FOR THE YEAR ENDED JUNE 30, 2004
(CONTINUED)

NOTE 5 - DEPOSITS AND INVESTMENTS (continued)

A reconciliation between the classification of cash and cash equivalents and investments on the combined financial statements and the classification of deposits and investments according to GASB Statement No. 3 is as follows:

	Category 3	Carrying Value
Federal Agency Obligations	\$ 13,975,388	\$ 13,975,388
Investment in State Treasurer's investment Pool	-	1,114,780
	\$ 13,975,388	\$ 15,090,168

	Cash and Cash Equivalents	Investments
GASB Statement No. 9	\$ 39,992,715	\$ -
Investment in State Treasurer's Investment Pool	(1,114,780)	1,114,780
Federal Agency Obligations	(13,975,388)	13,975,388
GASB Statement No. 3	\$ 24,902,547	\$ 15,090,168

NOTE 6 - PROPERTY TAXES

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

Property taxes include amounts levied against all real, public utility, and tangible personal (used in business) property located in the District. Real and public utility property tax revenues received in calendar year 2004 represent the collection of calendar year 2003 taxes. Real property taxes for 2004 were levied after April 1, 2003, on the assessed values as of January 1, 2003, the lien date. Assessed values for real property taxes are established by State statute at 35 percent of appraised market value. Real property taxes are payable annually or semiannually. The first payment is due January 20, with the remainder payable by June 20.

Public utility real and tangible personal property taxes received in 2004 were levied after April 1, 2003, on the assessed values as of December 31, 2002, the lien date. Public utility real property is assessed at 35 percent of true value; tangible personal property is currently assessed at varying percentages of true value. Public utility property taxes are payable on the same dates as real property taxes described previously.

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

KEYSTONE LOCAL SCHOOL DISTRICT
LORAIN COUNTY
NOTES TO THE BASIC FINANCIAL STATEMENTS
FOR THE YEAR ENDED JUNE 30, 2004
(CONTINUED)

NOTE 6 - PROPERTY TAXES (continued)

The District receives property taxes from Lorain County. The County Auditor periodically advances to the District its portion of the taxes collected. Second-half real property tax payments collected by the County by June 30, 2004, are available to finance fiscal year 2004/2005 operations. The amount available to be advanced can vary based on the date the tax bills are sent.

Accrued property taxes receivable represents delinquent taxes outstanding and real property, public utility property, and tangible personal property taxes which were measurable as of June 30, 2004 and for which there is an enforceable legal claim. Although total property tax collections for the next fiscal year are measurable, amounts to be received during the available period are not subject to reasonable estimation at June 30, nor were they levied to finance fiscal year 2004 operations. The receivable is therefore offset by a credit to deferred revenue for that portion not intended to finance current year operations. The amount available as an advance was recognized as revenue.

The amount available as an advance at June 30, 2004, was \$ 510,313 in the General Fund, \$ 136,505 in the Debt Service Fund and \$ 24,658 in the Capital Projects Fund.

The assessed values upon which the fiscal year 2004 taxes were collected are:

	2003 Second Half Collections		2004 First Half Collections	
	Amount	%	Amount	%
Agricultural/Residential	\$ 165,091,600	82.44	\$ 189,988,240	84.83
Commercial / Industrial	12,782,020	6.38	13,761,260	6.14
Public Utilities	46,060	0.02	47,750	0.02
Mineral	9,350	0.00	9,680	0.00
Tangible Personal Property	22,346,670	11.16	20,172,460	9.01
Total Assessed Value	<u>\$ 200,275,700</u>	<u>100.00</u>	<u>\$ 223,979,390</u>	<u>100.00</u>
Tax rate per \$1,000 of assessed valuation	<u>47.05</u>		<u>52.66</u>	

NOTE 7 - RECEIVABLES

Receivables at June 30, 2004, consisted of property taxes and amounts due from other governments, and accrued interest. All receivables are considered substantially collectible in full due to the ability to foreclose for the nonpayment of taxes, the stable condition of State programs, and the current year guarantee of federal funds. All receivables are expected to be collected within one year.

KEYSTONE LOCAL SCHOOL DISTRICT
LORAIN COUNTY
NOTES TO THE BASIC FINANCIAL STATEMENTS
FOR THE YEAR ENDED JUNE 30, 2004
(CONTINUED)

NOTE 7 – RECEIVABLES (continued)

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

	Amount
Governmental Activities	
Non-major funds	
Student intervention	\$ 36,806
IDEA Part B	378,475
Title I	139,080
Title V	8,148
Title IV	7,180
Title IV-R	53,286
Miscellaneous Federal grants	3,682
Food service	9,755
Total due from other governments	\$ 636,412

NOTE 8 - CAPITAL ASSETS

Capital asset activity for the fiscal year ended June 30, 2004, was as follows:

	Balance June 30, 2003	Additions	Disposals	Balance June 30, 2004
Governmental Activities				
Nondepreciable capital assets				
Land	\$ 399,414	\$ 122,402	\$ -	\$ 521,816
Construction in progress	-	881,477	-	881,477
Total nondepreciable capital assets	399,414	1,003,879	-	1,403,293
Depreciable capital assets				
Land improvements	316,984	108,994	-	425,978
Buildings and improvements	5,539,566	11,523	5,160	5,545,929
Furniture and equipment	413,270	-	30,790	382,480
Vehicles	871,119	-	-	871,119
Total capital assets being depreciated	7,140,939	120,517	35,950	7,225,506
Less accumulated depreciation				
Land improvements	128,038	53,032	-	181,070
Buildings and improvements	2,068,357	39,395	2,967	2,104,785
Furniture and equipment	188,612	10,563	-	199,175
Vehicles	396,851	58,408	-	455,259
Total accumulated depreciation	2,781,858	161,398	2,967	2,940,289
Depreciable capital assets, net of accumulated depreciation	4,359,081	(40,881)	32,983	4,285,217
Governmental activities capital assets, net	\$ 4,758,495	\$ 962,998	\$ 32,983	\$ 5,688,510

KEYSTONE LOCAL SCHOOL DISTRICT
LORAIN COUNTY
NOTES TO THE BASIC FINANCIAL STATEMENTS
FOR THE YEAR ENDED JUNE 30, 2004
(CONTINUED)

NOTE 8 - CAPITAL ASSETS (continued)

Depreciation expense was charged to governmental functions as follows:

Instruction		
Regular	\$	32,905
Special		1,503
Vocational		232
Supporting services		
Pupil		3260
Instructional staff		951
Adminstration		1441
Fiscal		387
Operation and maintenance of plant		57,202
Pupil transportation		55,777
Central services		1,111
Operation of noninstruction services		
Food service operation		4,231
Extracurricular activities		2,398
Total depreciation expense	\$	161,398

NOTE 9 - RISK MANAGEMENT

A. PROPERTY AND LIABILITY

The District is exposed to various risks of loss related to torts, theft of, damage to and destruction of assets, errors and omissions, injuries to employees and natural disasters. During fiscal year 2004, the District contracted with Indiana Insurance Company for property insurance. Professional liability is covered by the Nationwide Mutual Insurance Company with a \$ 5,000,000 aggregate limit. Automobile liability has a \$ 2,000,000 combined single limit of liability. Settled claims have not exceeded this commercial coverage in any of the past several years. Nationwide Mutual Insurance Company maintains performance bonds of \$ 20,000 for the Superintendent and the Board President, and a \$ 25,000 performance bond for the Treasurer.

B. WORKERS' COMPENSATION

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

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

KEYSTONE LOCAL SCHOOL DISTRICT
LORAIN COUNTY
NOTES TO THE BASIC FINANCIAL STATEMENTS
FOR THE YEAR ENDED JUNE 30, 2004
(CONTINUED)

NOTE 9 - RISK MANAGEMENT (continued)

C. EMPLOYEE MEDICAL BENEFITS

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

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

The LEEP Board of Directors has authority to return monies to an existing district subsequent to the settlement of all claims and expenses. This plan provides a medical/surgical and dental plan with a \$ 300 deductible for family coverage and a \$ 150 deductible for single coverage.

The claim liability of \$ 280,602 reported at June 30, 2004, was estimated by LERC and is based on the requirements of Governmental Standards Board Statement No. 10, which requires that a liability for unpaid claims costs, including estimates of costs related to incurred but not reported claims, be reported. The estimate was not affected by incremental claim adjustment expenses and does not include other allocated or unallocated claim adjustment expenses. Changes in balances of claims liability during the year ended June 30, 2004 and June 30, 2003 are summarized below.

	June 30, 2004	June 30, 2003
Unpaid claims, beginning of year	\$ 299,000	\$ 189,803
Incurred claims	1,274,008	1,229,402
Claims payments	(1,292,406)	(1,120,205)
Unpaid claims, end of year	<u>\$ 280,602</u>	<u>\$ 299,000</u>

NOTE 10 - DEFINED BENEFIT PENSION PLANS

A. SCHOOL EMPLOYEES RETIREMENT SYSTEM (SERS)

The District contributes to the School Employees Retirement System of Ohio (SERS), a cost-sharing multiple employer defined benefit pension plan. SERS provides retirement and disability benefits, annual cost of living adjustments, and death benefits to plan members and beneficiaries. Authority to establish and amend benefits is provided by state statute per Chapter 3309 of the Ohio Revised Code. SERS issues a publicly available, stand alone financial report that includes financial statements and required supplementary information. That report may be obtained by writing to the SERS, 300 East Broad St., Suite 100, Columbus, Ohio 43215-3746 or by calling (614) 222-5853.

KEYSTONE LOCAL SCHOOL DISTRICT
LORAIN COUNTY
NOTES TO THE BASIC FINANCIAL STATEMENTS
FOR THE YEAR ENDED JUNE 30, 2004
(CONTINUED)

NOTE 10 - DEFINED BENEFIT PENSION PLANS (continued)

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

Plan members are required to contribute 10 percent of their annual covered salary and the District is required to contribute at an actuarially determined rate. The current rate is 14 percent of annual covered payroll. The contribution requirements of plan members and employers are established and may be amended, up to statutory maximum amounts, by the SERS' Retirement Board. The District's contributions to SERS for the years ended June 30, 2004, 2003, and 2002 were \$ 243,000, \$ 221,100, and \$ 187,100, respectively. The full amount has been contributed for 2003 and 2002. For 2004, \$ 199,469 (82%) has been contributed with the remainder being reflected as an intergovernmental payable.

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

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

Plan options – New members have a choice of three retirement plan options. In addition to the Defined Benefit (DB) Plan, new members are offered a Defined Contribution (DC) Plan and a Combined Plan. The DC Plan allows members to invest all their member contributions and employer contributions equal to 10.5% of earned compensation. The Combined Plan offers features of the DC Plan and the DB plan. In the Combined Plan, member contributions are invested by the member, and employer contributions are used to fund the defined benefit payment at a reduced level from the regular DB Plan. Contributions into the DC Plan and the Combined Plan are credited to member accounts as employers submit their payroll information to STRS Ohio, generally on a bi-weekly basis. DC and Combined Plan members will transfer to the Defined Benefit Plan during their fifth year of membership unless they permanently select the DC or Combined Plan.

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

KEYSTONE LOCAL SCHOOL DISTRICT
LORAIN COUNTY
NOTES TO THE BASIC FINANCIAL STATEMENTS
FOR THE YEAR ENDED JUNE 30, 2004
(CONTINUED)

NOTE 10 - DEFINED BENEFIT PENSION PLANS (continued)

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

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

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

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

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

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

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

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

Chapter 3307 of the 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.

KEYSTONE LOCAL SCHOOL DISTRICT
LORAIN COUNTY
NOTES TO THE BASIC FINANCIAL STATEMENTS
FOR THE YEAR ENDED JUNE 30, 2004
(CONTINUED)

NOTE 10 - DEFINED BENEFIT PENSION PLANS (continued)

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

Contribution requirements and the contributions actually made for the fiscal year ended June 30, 2004 were 10% of covered payroll for members and 14% for employers. The District's contribution to STRS OHIO for the years ended June 30, 2004, 2003, and 2002 were \$ 854,000, \$ 795,700, and \$ 768,500, respectively. The full amount has been contributed for 2003 and 2002. For 2004, \$ 714,804 (84%) has been contributed with the remainder being reported as a liability within the respective funds.

STRS Ohio issues a stand-alone financial report. Copies of STRS Ohio's 2004 Comprehensive Annual Financial Report can be requested by writing STRS Ohio , 275 E. Broad St., Columbus, Ohio 43215-3371, or by calling 614-227-4090.

NOTE 11 - POSTEMPLOYMENT BENEFITS

A. SCHOOL EMPLOYEES RETIREMENT SYSTEM

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

After the allocation for basic benefits, the remainder of the employer's contribution is allocated to providing health care benefits. At June 30, 2004, the healthcare allocation rate is 4.91%. In addition, SERS levies a surcharge to fund health care benefits equal to 14% of the difference between a minimum pay and the member's pay, pro-rated for partial service credit. For fiscal 2004, the minimum pay has been established as \$ 24,500. The surcharge rate added to the unallocated portion of the 14% employer contribution rate provides for maintenance of the asset target level for the health care fund.

Health care benefits are financed on a pay-as-you-go basis. The target level for the health care reserve is 150% of annual health care expenses, before premium deduction. Gross expenses for health care at June 30, 2004 were \$ 223,443,805 and the target level was \$ 335.2 million. At June 30, 2004, the Retirement System's net assets available for payment of health care benefits was \$ 300.8million.

The number of benefit recipients receiving health care benefits is approximately 62,000. The portion of the District's contributions that were used to fund postemployment benefits amounted to \$ 174,775.

B. STATE TEACHERS RETIREMENT SYSTEM OF OHIO

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

KEYSTONE LOCAL SCHOOL DISTRICT
LORAIN COUNTY
NOTES TO THE BASIC FINANCIAL STATEMENTS
FOR THE YEAR ENDED JUNE 30, 2004
(CONTINUED)

NOTE 11 - POSTEMPLOYMENT BENEFITS (continued)

B. STATE TEACHERS RETIREMENT SYSTEM OF OHIO (continued)

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

The Retirement Board allocates employer contributions to the Health Care Stabilization Fund from which health care benefits are paid. For the fiscal year ended June 30, 2004 and June 30, 2003, the board allocated employer contributions equal to 1% (\$61,025 and \$56,835, respectively) of covered payroll to the Health Care Stabilization Fund. The balance in the Health Care Stabilization Fund was \$ 3.1 billion on June 30, 2004.

For the year ended June 30, 2004 net health care costs paid by STRS Ohio were \$ 268,739,000. There were 111,853 eligible benefit recipients.

NOTE 12 – NOTES PAYABLE

Notes payable at June 30, 2004 consisted of the following:

	Outstanding June 30, 2003	Additions	Deductions	Outstanding June 30, 2004
Bond anticipation note (2004) 1.75% through 2005	\$ -	\$ 14,500,000	\$ -	\$ 14,500,000
Bond anticipation note (2004) 1.75% through 2005	-	3,000,000	-	3,000,000
	<u>\$ -</u>	<u>\$ 17,500,000</u>	<u>\$ -</u>	<u>\$ 17,500,000</u>

NOTE 13 – BONDS PAYABLE

Bonds payable at June 30, 2004 consisted of the following:

	Outstanding June 30, 2003	Additions	Deductions	Outstanding June 30, 2004
General obligation bonds School Improvement, (2004) 4.84%, through 2030	\$ -	\$ 17,500,000	\$ -	\$ 17,500,000

NOTE 14 - LONG-TERM OBLIGATIONS

Changes in the District's long-term obligations during fiscal year 2004 were as follows:

	Outstanding June 30, 2003	Additions	Retired	Outstanding June 30, 2004	Amounts Due In One Year
Bonds payable	\$ -	\$ 17,500,000	\$ -	\$ 17,500,000	285,000
Compensated absences	1,000,000	144,990	60,886	1,084,104	170,392
	<u>\$ 1,000,000</u>	<u>\$ 17,644,990</u>	<u>\$ 60,886</u>	<u>\$ 18,584,104</u>	<u>\$ 455,392</u>

KEYSTONE LOCAL SCHOOL DISTRICT
LORAIN COUNTY
NOTES TO THE BASIC FINANCIAL STATEMENTS
FOR THE YEAR ENDED JUNE 30, 2004
(CONTINUED)

NOTE 15 – DEBT SERVICE REQUIREMENTS

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

Year ending June 30,	Principal	Interest	Total
2005	\$ 285,000	\$ 832,427	\$ 1,117,427
2006	475,000	760,575	1,235,575
2007	510,000	749,450	1,259,450
2008	605,000	735,512	1,340,512
2009	645,000	718,275	1,363,275
2010-2014	1,945,000	3,401,500	5,346,500
2015-2019	1,545,000	3,201,900	4,746,900
2020-2024	3,190,000	2,509,500	5,699,500
2025-2029	5,365,000	1,459,125	6,824,125
2030-2031	2,935,000	149,375	3,084,375
	<u>\$ 17,500,000</u>	<u>\$ 14,517,639</u>	<u>\$32,017,639</u>

NOTE 16 – OPERATING LEASES

The District is obligated under certain leases accounted for as operating leases. Operating leases do not give rise to property rights or lease obligations, and therefore, the results of the lease agreements are not reflected in the District's statement of net assets. During 2004, expenditures for operating leases totaled \$ 62,232.

The following is a schedule of future minimum rental payments required under operating leases that have initial or remaining noncancelable lease terms in excess of one year as of June 30, 2004.

Year ending June 30,	Amount
2005	\$ 62,232
2006	62,232
2007	62,232
2008	62,232
Total minimum lease payments	<u>\$ 248,928</u>

KEYSTONE LOCAL SCHOOL DISTRICT
LORAIN COUNTY
NOTES TO THE BASIC FINANCIAL STATEMENTS
FOR THE YEAR ENDED JUNE 30, 2004
(CONTINUED)

NOTE 17 - SET-ASIDES

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

The following cash basis information identifies the changes in the fund balance reserves for textbooks and capital improvements during fiscal year 2004.

	Textbook	Capital Maintenance	Total
Balance, July 1, 2003	\$ (518,615)	\$ -	\$ (518,615)
Required set aside	249,238	249,238	498,476
Offset credits	-	(242,097)	(242,097)
Qualifying expenditures	(597,420)	(132,858)	(730,278)
Totals	<u>\$ (866,797)</u>	<u>\$ (125,717)</u>	<u>\$ (992,514)</u>
Carry forward at June 30, 2004	<u>\$ (866,797)</u>	<u>\$ -</u>	<u>\$ (866,797)</u>

Expenditures and offset credits for textbooks and capital maintenance during the year were \$ 597,420 and \$ 374,955, respectively, which exceeded the required set-aside and the reserve balance. Textbook expenditures have exceeded statutory requirements by \$ 866,797 which may be used to offset future years' set aside requirements.

NOTE 18 - JOINTLY GOVERNED ORGANIZATIONS

A. LAKE ERIE EDUCATIONAL COMPUTER ASSOCIATION

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

LEECA is governed by a board of directors chosen from the general membership of the LEECA assembly. The board of directors consists of a representative from the fiscal agent, the chairman of each operating committee, and at least one assembly member from each county from which participating districts are located. Financial information can be obtained by contacting the Treasurer at the Educational Service Center of Lorain County, which serves as fiscal agent, located at 1885 Lake Avenue, Elyria, Ohio 44035. During the year ended June 30, 2004, the District paid \$ 350 to LEECA.

KEYSTONE LOCAL SCHOOL DISTRICT
LORAIN COUNTY
NOTES TO THE BASIC FINANCIAL STATEMENTS
FOR THE YEAR ENDED JUNE 30, 2004
(CONTINUED)

NOTE 18 - JOINTLY GOVERNED ORGANIZATIONS (continued)

B. LAKE ERIE REGIONAL COUNCIL OF GOVERNMENTS (LERC)

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

The LERC assembly consists of a superintendent or designated representative from each participating district and the fiscal agent. A board of directors chosen from the general membership governs LERC. The degree of control exercised by any participating district is limited to its representation on the board. Financial information can be obtained by contacting the Treasurer at the Educational Service Center of Lorain County located at 1885 Lake Avenue, Elyria, Ohio 44035. During the year ended June 30, 2004, the District paid approximately \$ 1,384,655 to LERC.

C. LORAIN COUNTY JOINT VOCATIONAL SCHOOL DISTRICT

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

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

NOTE 19 - SCHOOL FOUNDATION PROGRAM

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

NOTE 20 - INTERFUND TRANSFERS

During the year ended June 30, 2004, the General Fund transferred \$ 30,000 to the Food Service Fund to provide for the payment of expenditures and maintain food service operations for students.

NOTE 21 - CONTINGENCIES

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

Any disallowed claims resulting from such audits could become a liability of the General Fund or other applicable funds. However, in the opinion of management, any such disallowed claims will not have a material adverse effect on the overall financial position of the District at June 30, 2004.

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KEYSTONE LOCAL SCHOOL DISTRICT
Lorain County

Schedule of Federal Awards Receipts and Expenditures
For the Year Ended June 30, 2004

Federal Grantor/ Pass-Through Grantor/ Program Title	Pass-Through Entity Number	CFDA Number	Receipts	Non-Cash Receipts	Disbursements	Non-Cash Disbursements
U. S. Department of Agriculture						
<i>Passed Through the Ohio Department of Agriculture</i>						
Nutrition Cluster:						
Food Distribution	N/A	10.550	\$0	\$21,668	\$0	\$20,761
National School Lunch Program	LL-P402 - 04	10.555	66,972	0	66,972	
Total U. S. Department of Agriculture - Nutrition Cluster			66,972	21,668	66,972	20,761
U. S. Department of Education						
<i>Passed Through the Ohio Department of Education</i>						
Special Education Cluster:						
Special Education - Grants to States	6BSF-2003-P	84.027	0	0	19,317	0
Special Education - Grants to States	6BSF-2004-P	84.027	209,990	0	217,567	0
Total of Special Education			209,990	0	236,884	0
Title I Grants to Local Education Agencies	C1S1-2004	84.010	140,183	0	129,208	0
Innovative Educational Program Strategies	C2S1-2004	84.298	10,964	0	10,964	0
Safe and Drug Free Schools and Community State Grants	DRS1-2003	84.186	(297)	0	0	0
Safe and Drug Free Schools and Community State Grants	DRS1-2004	84.186	6,958	0	6,958	0
			6,661	0	6,958	0
Title II-D Technology Literacy Challenge Fund Grants	TJS1-2004	84.318	3,888	0	3,813	0
Improving Teacher Quality State Grants	TRS1-2003	84.367	0	0	7,023	0
Improving Teacher Quality State Grants	TRS1-2004	84.367	53,347	0	46,902	0
Total Assistive Technology			53,347	0	53,925	0
Total US Department of Education			425,033	0	441,752	0
U. S. Department of Health and Human Services						
<i>Passed Through the Ohio Department of Mental Retardation and Developmental Disabilities</i>						
Medical Assistance Program - Community Alternative Fund System (Medicaid)	N/A	93.778	20,135	0	20,135	0
Total Federal Assistance			\$512,140	\$21,668	\$528,859	\$20,761

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

**KEYSTONE LOCAL SCHOOL DISTRICT
LORAIN COUNTY**

**NOTES TO THE SCHEDULE OF FEDERAL AWARDS RECEIPTS AND EXPENDITURES
FOR THE YEAR ENDED JUNE 30, 2004**

NOTE A - SIGNIFICANT ACCOUNTING POLICIES

The accompanying Schedule of Federal Awards Receipts and Expenditures (Schedule) summarizes activity of the District's federal award programs. The Schedule has been prepared on the cash basis of accounting. The information in this Schedule is presented in accordance with the requirements of OMB Circular A-133, *Audits of States, Local Governments, and Non-Profit Organizations*. Therefore, some amounts presented in this Schedule may differ from amounts presented in, or used in the preparation of, the basic financial statements.

NOTE B – CHILD NUTRITION CLUSTER

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

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

NOTE C – NEGATIVE RECEIPTS

The negative receipt of (\$297) reflected in the Safe and Drug Free Schools and Community State Grants (CFDA #84.186) represents a transfer of grant funds made by the Ohio Department of Education from the programs' 2003 grant to the 2004 grant.

N/A – Not Applicable

CFDA – Catalog of Federal Domestic Assistance



Auditor of State Betty Montgomery

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

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

We have audited the financial statements of the governmental activities, each major fund and the aggregate remaining fund information of Keystone Local School District, Lorain County, Ohio (the District) as of and for the years ended June 30, 2004 which collectively comprise the District's basic financial statements and have issued our report thereon dated March 22, 2005. We conducted our audit in accordance with auditing standards generally accepted in the United States of America and the standards applicable to financial audits contained in *Government Auditing Standards*, issued by the Comptroller General of the United States.

Internal Control over Financial Reporting

In planning and performing our audit, we considered the District's internal control over financial reporting in order to determine our auditing procedures to express our opinion on the financial statements and not to opine on the internal control over financial reporting. Our consideration of the internal control 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 to be material weaknesses. A material weakness is a reportable condition in which the design or operation of one or more of the internal control components does not reduce to a relatively low level the risk that misstatements caused by error or fraud in amounts material to the financial statements we audited may occur and not be timely detected by employees when performing their assigned functions. We noted no matters involving the internal control over financial reporting and its operation that we consider material weaknesses. In a separate letter to the District's management dated March 22, 2005, we reported other matters involving internal control over financial reporting.

Compliance and Other Matters

As part of reasonably assuring whether the District's financial statements are free of material misstatement, we tested its compliance with certain provisions of laws, regulations, contracts and grant agreements, noncompliance with which could directly and materially affect the determination of financial statement amounts. However, providing an opinion on compliance with those provisions was not an objective of our audit and, accordingly, we do not express an opinion. The results of our tests disclosed no instances of noncompliance or other matters we must report under *Government Auditing Standards*. In a separate letter to the District's management dated March 22, 2005, we reported an other matter related to compliance we deemed immaterial.

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Keystone Local School District
Lorain County
Independent Accountants' Report On Internal Control Over
Financial Reporting And Compliance And Other Matters
Required By *Government Auditing Standards*
Page 2

We intend this report solely for the information and use of the management, the Board of Education, and federal awarding agencies and pass-through entities. It is not intended for anyone other than these specified parties.

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

Betty Montgomery
Auditor of State

March 22, 2005



Auditor of State Betty Montgomery

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

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

Compliance

We have audited the compliance of the Keystone Local School District, Lorain County, Ohio, (the District) with the types of compliance requirements described in the *U.S. Office of Management and Budget (OMB) Circular A-133, Compliance Supplement* that are applicable to its major federal program for the year ended June 30, 2004. The District's major federal program is identified in the summary of auditor's results section of the accompanying schedule of findings. Compliance with the requirements of laws, regulations, contracts and grants applicable to its major federal program is the responsibility of the District's management. Our responsibility is to express an opinion on the District's compliance based on our audit.

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

In our opinion, the District complied, in all material respects, with the requirements referred to above that are applicable to its major federal program for the year ended June 30, 2004.

Internal Control Over Compliance

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

Our consideration of the internal control over compliance would not necessarily disclose all matters in the internal control that might be material weaknesses. A material weakness is a condition in which the design or operation of one or more of the internal control components does not reduce to a relatively low level the risk that noncompliance with applicable requirements of laws, regulations, contracts and grants that would be material in relation to a major federal program being audited may occur and not be detected within a timely period by employees in the normal course of performing their assigned functions. We noted no matters involving the internal control over compliance and its operation that we consider to be material weaknesses.

This report is intended for the information and use of the management, the Board of Education, and federal awarding agencies and pass-through entities, and is not intended to be and should not be used by anyone other than these specified parties.



Betty Montgomery
Auditor of State

March 22, 2005

**KEYSTONE LOCAL SCHOOL DISTRICT
LORAIN COUNTY**

**SCHEDULE OF FINDINGS
OMB CIRCULAR A -133 § .505
JUNE 30, 2004**

1. SUMMARY OF AUDITOR'S RESULTS

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

KEYSTONE LOCAL SCHOOL DISTRICT
LORAIN COUNTY

SCHEDULE OF FINDINGS
OMB CIRCULAR A -133 ' .505
JUNE 30, 2004
(Continued)

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

None

3. FINDINGS FOR FEDERAL AWARDS

None.



**Auditor of State
Betty Montgomery**

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KEYSTONE LOCAL SCHOOL DISTRICT

LORAIN COUNTY

CLERK'S CERTIFICATION

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

Susan Babbitt

CLERK OF THE BUREAU

**CERTIFIED
MAY 10, 2005**