



**LORAIN MIDDLE SCHOOL DIGITAL ACADEMY
LORAIN COUNTY
REGULAR AUDIT
FOR THE YEAR ENDED JUNE 30, 2005**



**Auditor of State
Betty Montgomery**

**LORAIN MIDDLE SCHOOL DIGITAL ACADEMY
LORIAN COUNTY**

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**Auditor of State
Betty Montgomery**

INDEPENDENT ACCOUNTANTS' REPORT

Board of Directors
Lorain Middle School Digital Academy
Lorain County
2350 Pole Avenue
Lorain, Ohio 44052

We have audited the accompanying financial statements of the Lorain Middle School Digital Academy, Lorain County, Ohio, (the Academy) a component unit of the Lorain City School District, as of and for the years ended June 30, 2005 and June 30, 2004, which collectively comprise the Academy's basic financial statements as listed in the table of contents. These financial statements are the responsibility of the Academy's management. Our responsibility is to express opinions on these financial statements based on our audit.

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

In our opinion, the financial statements referred to above present fairly, in all material respects, the respective financial position of the Lorain Middle School Digital Academy, Lorain County, Ohio, as of June 30, 2005, and June 30, 2004, and the respective changes in financial position and cash flows for the year then ended in conformity with accounting principles generally accepted in the United States of America.

In accordance with *Government Auditing Standards*, we have also issued our report dated December 16, 2005, on our consideration of the Academy's internal control over financial reporting and our tests of its compliance with certain provisions of laws, regulations, contracts and grant agreements and other matters. While we did not opine on the internal control over financial reporting or on compliance, that report describes the scope of our testing of internal control over financial reporting and compliance and the results of that testing. That report is an integral part of an audit performed in accordance with *Government Auditing Standards*. You should read it in conjunction with this report in assessing the results of our audit.

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

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

Betty Montgomery
Auditor of State

December 16, 2005

Lorain Middle School Digital Academy
Management's Discussion and Analysis
For the Fiscal Year Ended June 30, 2005 and 2004
(Unaudited)

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

The Management's Discussion and Analysis (the "MD&A") is an element of the new reporting model adopted by the Governmental Accounting Standards Board (GASB) in their Statement No. 34 "Basic Financial Statements and Management's Discussion and Analysis – for State and Local Governments" issued in June of 1999.

Certain comparative information between the current fiscal year and the prior fiscal year is required to be presented in the MD&A. Due to the comparative presentation within the basic financial statements, a comparison analysis between fiscal year 2004 and fiscal year 2003 is also required.

The Lorain Middle School Academy began reporting operating transactions during fiscal year 2003. The primary activity reported was the receipt of \$45,000 in a Federal Charter School Grant and a \$25,700 State Community Schools Start-up Grant through the Ohio Department of Education. There were very minimal expenditures of these resources made during fiscal year 2003. Based on these factors, no further analysis comparison between fiscal year 2003 and fiscal year 2004 is considered needed.

Financial Highlights

Key financial highlights for the fiscal year ended June 30, 2005 are as follows:

- Net assets totaled \$355,630.
- Total current assets were \$306,800.
- Total capital assets were \$50,130.
- Operating revenues equaled \$285,194 and non-operating revenues were \$154,539.
- Operating expenses amounted to \$289,624.

Using this Annual Report

This annual report consists of the MD&A, the basic financial statements and the notes to the basic financial statements. The basic financial statements include a statement of net assets, a statement of revenues, expenses and changes in net assets, and a statement of cash flows.

Lorain Middle School Digital Academy
Management's Discussion and Analysis
For the Fiscal Year Ended June 30, 2005 and 2004
(Unaudited)

The statement of net assets and the statement of revenues, expenses and changes in net assets answer the question, "How did we do financially during fiscal year 2005?" The statement of net assets includes all assets and liabilities using the accrual basis of accounting and the economic resources measurement focus, which is similar to the accounting used by most companies in the private sector. This basis of accounting takes into account all of the current fiscal year's revenues and expenses regardless of when cash is received or paid.

Table 1 provides a summary of the Academy's net assets for fiscal year 2005 and 2004 as follows:

Table 1
Net Assets at June 30

	2005	2004
Assets		
Current and Other Assets	\$ 306,800	\$ 192,018
Capital Assets	50,130	13,503
Total Assets	356,930	205,521
Liabilities		
Accounts Payable	1,300	0
Net Assets		
Invested in Capital Assets	50,130	13,503
Restricted for Other Purposes	151,539	150,000
Unrestricted	153,961	42,018
Total Net Assets	\$ 355,630	\$ 205,521

Total assets increased \$151,409 which includes an increase in cash of \$114,782 and an increase in capital assets of \$36,627. Liabilities which consisted of accounts payable increased \$1,300 and net assets increased \$150,109.

Lorain Middle School Digital Academy
Management's Discussion and Analysis
For the Fiscal Year Ended June 30, 2005 and 2004
(Unaudited)

Table 2 shows the changes in net assets for the fiscal year ended June 30, 2005 and 2004, as well as a listing of revenues and expenses.

Table 2
Changes in Net Assets

	2005	2004
Operating Revenues		
Foundation Payments	\$ 285,194	\$ 98,953
Non-Operating Revenues		
Grants and Contributions	154,539	255,000
Total Revenues	439,733	353,953
Operating Expenses		
Purchased Services	268,671	211,540
Materials and Supplies	14,632	6,598
Depreciation	6,321	1,014
Total Operating Expenses	289,624	219,152
Increase (Decrease) in Net Assets	\$ 150,109	\$ 134,801

The Academy's activities consist of enterprise activity. Community schools receive no support from taxes. The State Foundation Program and the Ohio Charter Schools Federal Sub-grant Program are, by far, the primary support for the Academy's students.

Revenues increased over 2004 due to receiving a full year of foundation payments, and expenses increased due to an increase in students.

Capital Assets

At the end of fiscal year 2005, the Academy invested \$50,130 in equipment, net of depreciation. See Note 5 to the basic financial statements for more information.

Lorain Middle School Digital Academy
Management's Discussion and Analysis
For the Fiscal Year Ended June 30, 2005 and 2004
(Unaudited)

Current Issues

The Academy has entered into a service contract for fiscal year 2005 with its Sponsor. In agreement with this contract, the Academy will purchase the following services from its Sponsor: personnel to administer and oversee the instruction and governance of the Academy, personnel to provide instructional services to the Academy, staff to provide support services to the Academy, marketing support, EMIS data transmission, insurance, and consulting.

The Academy received its initial State Foundation Program payment in March 2004; therefore, the Academy only received four months of State Foundation Program payments in fiscal year 2004. For future fiscal years, the Academy will receive a full fiscal year's worth of State Foundation Program payments.

The Academy will apply for two (2) additional start-up grant monies of \$150,000 for each grant under the Ohio Charter Schools Federal Sub-grant Program during fiscal year 2005. One of these grants has been included as an intergovernmental receivable for fiscal year 2005.

Contacting the Academy's Management

This financial report is designed to provide our citizens, investors and creditors with a general overview of the Academy's finances and to show the Academy's accountability for the money it receives. If you have any questions about this report or need additional financial information, contact James Estle, Treasurer, at Lorain Middle School Digital Academy, 2350 Pole Avenue, Lorain, OH 44052 or e-mail at jestle@lorainschools.org.

Lorain Middle School Digital Academy

Statements of Net Assets

June 30, 2005 and 2004

	<u>2005</u>	<u>2004</u>
Assets		
<i>Current assets:</i>		
Equity in pooled cash and investments	\$ 156,800	\$ 42,018
Intergovernmental receivables	<u>150,000</u>	<u>150,000</u>
<i>Total current assets</i>	<u>306,800</u>	<u>192,018</u>
<i>Noncurrent assets:</i>		
Capital assets (net of accumulated depreciation)	<u>50,130</u>	<u>13,503</u>
<i>Total assets</i>	<u>356,930</u>	<u>205,521</u>
Liabilities		
<i>Current liabilities:</i>		
Accounts payable	<u>1,300</u>	<u>0</u>
<i>Total current liabilities</i>	<u>1,300</u>	<u>0</u>
Net assets		
Invested in capital assets, net of related debt	50,130	13,503
Restricted in other purposes	151,539	150,000
Unrestricted	<u>153,961</u>	<u>42,018</u>
<i>Total net assets</i>	<u>\$ 355,630</u>	<u>\$ 205,521</u>

See accompanying notes to the basic financial statements.

Lorain Middle School Digital Academy
Statements of Revenues, Expenses, and Changes in Net Assets
June 30, 2005 and 2004
(Unaudited)

	<u>2005</u>	<u>2004</u>
Operating revenues		
Foundation payments	\$ 285,194	\$ 98,953
<i>Total operating revenues</i>	<u>285,194</u>	<u>98,953</u>
Operating expenses		
Purchased services	268,671	211,540
Materials and supplies	14,632	6,598
Depreciation	<u>6,321</u>	<u>1,014</u>
<i>Total operating expenses</i>	<u>289,624</u>	<u>219,152</u>
<i>Operating income (loss)</i>	(4,430)	(120,199)
Non operating revenues (expenses)		
Grants	<u>154,539</u>	<u>255,000</u>
<i>Total non-operating revenues (expenses)</i>	<u>154,539</u>	<u>255,000</u>
<i>Change in net assets</i>	150,109	134,801
<i>Net assets at beginning of year</i>	<u>205,521</u>	<u>70,720</u>
<i>Net assets at the end of the year</i>	<u><u>\$ 355,630</u></u>	<u><u>\$ 205,521</u></u>

See accompanying notes to the basic financial statements.

Lorain Middle School Digital Academy
Statements of Cash Flows
For the Fiscal Year Ended June 30, 2005 and 2004

	2005	2004
Increase (decrease) in cash		
Cash flows from operating activities:		
Cash received from foundation payments	\$ 285,194	\$ 98,953
Cash payments for goods and services	<u>(282,003)</u>	<u>(218,138)</u>
<i>Net cash provided by (used for) operating activities</i>	<u>3,191</u>	<u>(119,185)</u>
Cash flows from non-capital financing activities:		
Grants received	<u>154,539</u>	<u>105,000</u>
<i>Net cash provided by (used for) non-capital activities</i>	<u>154,539</u>	<u>105,000</u>
Cash flows from capital and related financing activities:		
Purchase of capital assets	<u>(42,948)</u>	<u>(14,517)</u>
<i>Net cash provided by (used for) investing activities</i>	<u>(42,948)</u>	<u>(14,517)</u>
<i>Net increase (decrease) in cash and cash equivalents</i>	114,782	(28,702)
<i>Cash and cash equivalents at beginning of year</i>	<u>42,018</u>	<u>70,720</u>
<i>Cash and cash equivalents at end of year</i>	<u>\$ 156,800</u>	<u>\$ 42,018</u>
Reconciliation of operating income (loss) to net cash Provided By (Used For) Operating Activities:		
Operating income (loss)	\$ (4,430)	\$ (120,199)
Depreciation	6,321	1,014
Adjustments:		
Increase (decrease) in liabilities:		
Accounts payable	<u>1,300</u>	<u>0</u>
<i>Total adjustments</i>	<u>7,621</u>	<u>1,014</u>
<i>Net cash provided by (used for) operating activities</i>	<u>\$ 3,191</u>	<u>\$ (119,185)</u>

See accompanying notes to the basic financial statements.

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Lorain Middle School Digital Academy
Notes to the Basic Financial Statements
For the Fiscal Year Ended June 30, 2005 and 2004

Note 1 – Description of the Academy and Reporting Entity

The Lorain Middle School Digital Academy (the "Academy") is a nonprofit corporation established pursuant to the Ohio Revised Code Chapters 1702 and 3314 to address the needs of students in sixth through the eighth grade. The Academy is nonsectarian in its programs, admission policies, employment practices, and all other operations. The Academy may sue and be sued, acquire facilities as needed, and contract for any services necessary for the operation of the Academy. The Academy is considered a component unit of the Lorain City School District ("the Sponsor") for reporting purposes, in accordance with Governmental Accounting Standards Board (GASB) Statement No. 14.

The Academy is an innovative initiative that will be a cooperative effort between Lorain City Schools. It is a conversion community school sponsored by the Lorain City School District. Furthermore, the Academy uses the services of the Tri-Rivers Educational Computer Association (TRECA) and the TRECA Digital Academy to assist with overall programming and operations. The Academy will use the latest technology to reach a diverse student population. This population includes, but is not limited to home schoolers, children with special physical and mental needs, students removed from the classroom for discipline concerns, students who need an alternative to the traditional classroom including religious reasons, and students within the district that desire a specific course not currently offered. Enrollment is limited to students within the attendance area of the Lorain City School District.

The Academy was approved for sponsorship under resolution on May 13, 2002 with the Sponsor for a period of five years commencing on the first day of the 2002-2003 academic year. The Sponsor has designated three of its administrative officers to represent the Sponsor in the occupants' official capacities as members of the Academy's Board of Directors. The individuals who hold such office with the Sponsor shall be formally instructed by the Sponsor that, as directors of the Academy, they are to represent the Sponsor and its interests. From time to time in its discretion, the Sponsor may substitute other administrative positions for those previously designated for this purpose.

Pursuant to the Sponsor's authority under section 3314.08(G) of the Ohio Revised Code to provide the School with services, the Sponsor shall be the fiscal agent of the School and shall direct the Sponsor's treasurer to serve as the School's fiscal officer. The Sponsor shall evaluate the performance of the Academy according to the standards set forth in the Assessment and Accountability Plan. The Sponsor is not legally responsible for the final outcomes of the community school.

A service contract for the fiscal year 2004-2005 between the Academy and the Sponsor was also approved. In agreement with the contract, the Sponsor agrees to provide to the Academy professional, technical support and other services upon the Academy's request, but is subject to the availability of such services. The price for services rendered by the Sponsor to the Academy is established as the Sponsor's "cost of providing such services including, without limitation, employee salaries and fringe benefits, equipment costs if any, and administrative overhead." All personnel providing services to the Academy on behalf of the Sponsor under the service contract are considered employees of the Sponsor, and the Sponsor shall be solely responsible for all payroll functions.

Lorain Middle School Digital Academy
Notes to the Basic Financial Statements
For the Fiscal Year Ended June 30, 2005 and 2004

Note 2 – Summary of Significant Accounting Policies

The basic financial statements of the Academy have been prepared in conformity with generally accepted accounting principles (GAAP) as applied to governmental nonprofit organizations. GASB is the accepted standard-setting body for establishing governmental accounting and financial reporting principles. The Academy also applies Financial Accounting Standards Board (FASB) Statements and Interpretations issued on or before November 30, 1989, to its proprietary activities, provided they do not conflict with or contradict GASB pronouncements. The Academy has the option to also apply FASB Statements and Interpretations issued after November 30, 1989 to its proprietary activities, subject to the same limitation. The Academy has elected not to apply these FASB Statements and Interpretations. The more significant of the Academy's accounting policies are described below.

A. Basis of Presentation

The Academy's basic financial statements consist of a statement of net assets, a statement of revenues, expenses and changes in net assets, and a statement of cash flows.

Enterprise reporting focuses on the determination of the change in net assets, financial position and cash flows.

B. Measurement Focus

Enterprise accounting uses a flow of economic resources measurement focus. With this measurement focus, all assets and liabilities are included on the statement of net assets. The statement of revenues, expenses and changes in 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 Academy finances and meets the cash flow needs of its enterprise activities.

C. Basis of Accounting

Basis of accounting determines when transactions are recorded in the financial records and reported on the basic financial statements. The Academy's basic financial statements are prepared using the accrual basis of accounting.

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.

Non-exchange transactions, in which the Academy receives value without directly giving equal value in return, include grants, entitlements and donations. 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 fiscal year when the resources are required to be used or the fiscal year when use is first permitted, matching requirements, in which the Academy must provide local resources to be used for a specified purpose, and expenditure requirements, in which the resources are provided to the Academy on a reimbursement basis.

Lorain Middle School Digital Academy
Notes to the Basic Financial Statements
For the Fiscal Year Ended June 30, 2005 and 2004

Grants and entitlements received before the eligibility requirements are met are recorded as deferred revenue.

Expenses are recognized at the time they are incurred.

D. Budgetary Process

The Academy shall operate in compliance with a bi-annual budget which must be reviewed and approved by the Academy's Board of Directors. The Academy must maintain financial records in a similar manner to those records of the Sponsor. The Academy complies with the policies and procedures regarding internal financial controls which are apparent under GASB and FASB. Also, the Auditor of State provides financial policy and procedure guidance to the Academies.

E. Cash

Cash held by the Academy is reflected as "Equity in pooled cash and investments" on the statement of net assets. Investments with an original maturity of three months or less at the time they are purchased are presented on the financial statements as cash equivalents. Investments with an initial maturity of more than three months are reported as investments. During fiscal years 2005 and 2004, the Academy had no investments.

F. Capital Assets

All capital assets are capitalized at cost and updated for additions and reductions during the fiscal year. Donated capital assets are recorded at their fair market value on the date donated. The Academy maintains a capitalization threshold of five hundred dollars. The Academy does not have 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.

All capital assets are depreciated. Improvements are depreciated over the remaining useful lives of the related capital assets. Depreciation is computed using the straight-line method. Furniture is depreciated over 20 years and computers are depreciated over five years.

G. 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 balance of any borrowing 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 through the Academy or through external restrictions imposed by creditors, grantors, or laws or regulations of other governments. The Academy first applies restricted resources when an expense is incurred for which both restricted and unrestricted net assets are available. Net assets restricted for other purposes are primarily for student instruction.

Lorain Middle School Digital Academy
Notes to the Basic Financial Statements
For the Fiscal Year Ended June 30, 2005 and 2004

H. Operating Revenues and Expenses

Operating revenues are those revenues that are generated directly from the primary activities. For the Academy, these revenues are payments from the State Foundation Program. Operating expenses are necessary costs incurred to provide the goods or services that are the primary activities of the Academy. All revenues and expenses not meeting these definitions are reported as non-operating.

I. Intergovernmental Revenues

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

The Academy also participates in the Federal Charter School Grant Program and the State Community Schools Start-up Grant through the Ohio Department of Education.

In addition, the Academy participates in the State Education Management Information System ("EMIS") through the Ohio Department of Education.

J. Estimates

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

Note 3 – Deposits

At June 30, 2005 and June 30, 2004, the carrying amount of all Academy deposits was \$156,800 and \$42,018. Based on the criteria described in GASB Statement No. 40, "Deposit and Investment Risk Disclosures," as of June 30, 2005, \$56,800 of the Academy's bank balance of \$156,800 was exposed to custodial risk as discussed below, while \$100,000 was covered by the Federal Deposit Insurance Corporation. As of June 30, 2004, none of the Academy's bank balances of \$42,018 was exposed to custodial risk as discussed below, while all of the bank balance was covered by the Federal Deposit Insurance Corporation.

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

Lorain Middle School Digital Academy
Notes to the Basic Financial Statements
For the Fiscal Year Ended June 30, 2005 and 2004

Note 4 – Receivables

Receivables at June 30, 2005 and 2004 consisted of intergovernmental grants and entitlements. All receivables are considered collectible in full due to the stable condition of state programs. All receivables are expected to be collected within one fiscal year.

Note 5 – Capital Assets

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

	Balance 6/30/04	Additions	Reductions	Balance 6/30/05
<i>Capital Assets being depreciated</i>				
Equipment	\$ 14,517	\$ 42,948	\$ 0	\$ 57,465
Less Accumulated Depreciation	(1,014)	(6,321)	0	(7,335)
Capital Assets, Net	<u>\$ 13,503</u>	<u>\$ 36,627</u>	<u>\$ 0</u>	<u>\$ 50,130</u>

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

	Balance 6/30/03	Additions	Reductions	Balance 6/30/04
<i>Capital Assets being depreciated</i>				
Equipment	\$ 0	\$ 14,517	\$ 0	\$ 14,517
Less Accumulated Depreciation	0	(1,014)	0	(1,014)
Capital Assets, Net	<u>\$ 0</u>	<u>\$ 13,503</u>	<u>\$ 0</u>	<u>\$ 13,503</u>

Note 6 – Purchased Services

For the fiscal year ended June 30, 2005, purchased services were as follows:

Instructional Services	\$ 107,926
Other Professional and Technical Services	118,056
Other Travel and Meeting Expenses	227
Other Communications Service	<u>42,462</u>
	<u>\$ 268,671</u>

Lorain Middle School Digital Academy
Notes to the Basic Financial Statements
For the Fiscal Year Ended June 30, 2005 and 2004

For the fiscal year ended June 30, 2004, purchased services were as follows:

Instructional Services	\$ 25,672
Other Professional and Technical Services	22,611
Other Travel and Meeting Expenses	140
Other Communications Service	<u>163,117</u>
	<u>\$ 211,540</u>

Note 7 - Risk Management

The Academy is exposed to various risks of loss related to torts; theft of, damage to, and destruction of assets; errors and omissions; injuries to employees and natural disasters. During fiscal year 2005 and 2004, the Academy was covered under their own insurance for property, and liability coverage.

Note 8 – Agreements with the Tri-Rivers Educational Computer Association

The Academy entered into agreements with the Tri-Rivers Educational Computer Association (“TRECA”), which is a data acquisition site and member of the Ohio Education Computer Network established in accordance with Ohio Revised Code Section 3301.075.

On January 7, 2003, the Academy entered into another agreement with TRECA. TRECA provided the Academy with instructional, supervisory/administrative, and technical services sufficient to effectively implement the Academy’s educational plan, and the Academy’s assessment and accountability plan. All personnel providing services in fulfillment of TRECA’s responsibilities hereunder shall be employees or contractors of TRECA and TRECA is solely responsible for all payroll functions including retirement system contributions and all other legal withholding and/or payroll taxes, with respect to its employees. All personnel providing such services possess any certification or licensure which may be required by law. The technical services provided by TRECA to the Academy include access to, and the use of, computer software, computer hardware, networking hardware, network services and the services of technical support personnel necessary to implementation. During the years ended June 30, 2005 and 2004, the Academy paid \$10,800 and \$46,570, respectively to TRECA.

Beginning August 2005, the Academy entered into a four year agreement with TRECA where the Academy will no longer pay the annual fee, they will only be charged on a per student basis.

Lorain Middle School Digital Academy
Notes to the Basic Financial Statements
For the Fiscal Year Ended June 30, 2005 and 2004

Note 9 – Contingencies

A. Grants

The Academy received financial assistance from Federal and State agencies in the form of grants. The disbursements of funds received under these programs generally require compliance with terms and conditions specified in the grant agreements and are subject to audit by the grantor agencies. Any disallowed claims resulting from such audits could become a liability of the Academy. However, in the opinion of management, any disallowed claims will not have a material adverse effect on the overall financial position of the Academy at June 30, 2005.

B. Litigation

A suit was filed in Franklin County Common Pleas Court on May 14, 2001, alleging that Ohio's Community (i.e., Charter) Schools program violates the State Constitution and State laws. On April 21, 2003, the Common Pleas Court dismissed the counts containing constitutional claims and stayed the other counts pending appeal of the constitutional issues. The plaintiffs appealed to the Court of Appeals; the issues have been briefed, and the case was heard for oral argument on November 18, 2003. On August 24, 2004, the Court of Appeals rendered a decision that Community Schools are part of the state public educational system and this matter was sent to the Ohio Supreme Court. The Ohio Supreme Court accepted the appeal from the Court of Appeals for review on February 16, 2005. Oral argument occurred November 29, 2005. The effect of this suit, if any, on the Academy is not presently determinable.

Note 10 – State School Funding Decision

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

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

The School District is currently unable to determine what effect, if any, this decision will have on its future State funding and its financial operations.

Note 11 – State Foundation Funding

The Ohio Department of Education conducts reviews of enrollment data and full-time equivalency (FTE) calculations made by the schools. These reviews are conducted to ensure the schools are reporting accurate student enrollment data to the State, upon which state foundation funding is calculated. The Academy was reviewed two times during this initial year of operations and zero errors were found in enrollment, withdrawals, and attendance.

Lorain Middle School Digital Academy
Notes to the Basic Financial Statements
For the Fiscal Year Ended June 30, 2005 and 2004

Note 12 – Change in Accounting Principles

For fiscal year 2005, the Academy has implemented GASB Statement No. 39, “Determining Whether Certain Organizations are Component Units,” GASB Statement No. 40, “Deposit and Investment Risk Disclosures,” GASB Statement No. 46, “Net Assets Restricted by Enabling Legislation” and GASB Technical Bulletin No. 2004-2, “Recognition of Pension and Other Postemployment Benefit Expenditures/Expense and Liabilities by Cost-Sharing Employers.”

GASB Statement No. 39 states that entities for which a primary government is not financially accountable may still be reported as component units based on the nature and significance of their relationship with the primary government.

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

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

GASB Technical Bulletin No. 2004-2 addresses the amount that should be recognized as expenditure/expense and as a liability each period by employers participating in a cost-sharing multiple-employer pension and other postemployment benefit (OPEB) plans.

The implementation of GASB Statement No. 39, GASB Statement No. 46 and GASB Technical Bulletin No. 2004-2 did not affect the presentation of the financial statements of the Academy.



Auditor of State Betty Montgomery

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

Board of Directors
Lorain Middle School Digital Academy
Lorain County
2350 Pole Avenue
Lorain, Ohio 44052

We have audited the financial statements of the Lorain Middle School Digital Academy, Lorain County, Ohio, (the Academy) a component unit of the Lorain City School District, as of and for the years ended June 30, 2005 and June 30, 2004 which collectively comprise the Academy's basic financial statements and have issued our report thereon dated December 16, 2005. We conducted our audit in accordance with auditing standards generally accepted in the United States of America and the standards applicable to financial audits contained in the Comptroller General of the United States' *Government Auditing Standards*.

Internal Control Over Financial Reporting

In planning and performing our audit, we considered the Academy's internal control over financial reporting to determine our auditing procedures in order to express our opinions on the financial statements and not to opine on the internal control over financial reporting. Our consideration of the internal control would not necessarily disclose all matters in the internal control over financial reporting that might be material weaknesses. A material weakness is a reportable condition in which the design or operation of one or more of the internal control components does not reduce to a relatively low level the risk that misstatements caused by error or fraud in amounts material to the financial statements we audit may occur and not be timely detected by employees when performing their assigned functions. We noted no matters involving the internal control over financial reporting and its operation that we consider material weaknesses. In a separate letter to the Academy's management dated December 16, 2005, we reported a matter involving internal control over financial reporting we did not deem a reportable condition.

Compliance and Other Matters

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

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Lorain Middle School Digital Academy
Lorain County
Independent Accountants' Report on Internal Control Over
Financial Reporting and on Compliance and Other Matters
Required by *Government Auditing Standards*
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We intend this report solely for the information and use of the audit committee, management and the Board of Directors. It is not intended for anyone other than these specified parties.

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

Betty Montgomery
Auditor of State

December 16, 2005



**Auditor of State
Betty Montgomery**

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Facsimile 614-466-4490

**LORAIN MIDDLE SCHOOL DIGITAL ACADEMY
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
DECEMBER 30, 2005**