



Mary Taylor, CPA
Auditor of State

THE ARTS ACADEMY
LORAIN COUNTY

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Mary Taylor, CPA

Auditor of State

INDEPENDENT ACCOUNTANTS' REPORT

The Arts Academy
Lorain County
4125 Leavitt Road
Lorain, Ohio 44052

To the Board of Trustees:

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

The Academy did not provide sufficient original supporting documentation for all non-payroll expenditures. Consequently, we were unable to verify the existence, accuracy, completeness and valuation of the amounts reported as expenditures for non-payroll purposes.

In the statement of cash flows, the amounts presented could not be supported for existence, accuracy, and completeness. In addition, in the notes to the financial statements, the litigation note does not reference a suit which was filed in the US District Court, Southern District of Ohio, Western Division on October 6, 2004.

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

In accordance with *Government Auditing Standards*, we have also issued our report dated May 15, 2007 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 do 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.

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. Since we were unable to express an opinion on the basic financial statements, we could not apply certain limited procedures to the required supplementary information. We did not audit the information and express no opinion on it.

A handwritten signature in cursive script that reads "Mary Taylor".

Mary Taylor, CPA
Auditor of State

May 15, 2007

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**THE ARTS ACADEMY
LORAIN COUNTY**

**MANAGEMENT'S DISCUSSION AND ANALYSIS
FOR THE FISCAL YEAR ENDED JUNE 30, 2005
UNAUDITED**

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

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

Financial Highlights

Key Financial Highlights for the School for the 2004-2005 school year are as follows:

Total assets were \$109,664, which made up cash and cash equivalents of \$26,705 and capital assets, net, of \$82,959 due to new leases for musical instruments.

Total net assets decreased by \$118,575.

Total operating revenues were \$1,390,048. Total operating expenses were \$1,528,902

USING THIS ANNUAL REPORT

This annual report consists of a series of financial statements. These statements are organized so the reader can understand the financial position of the School. Enterprise accounting uses a flow of economic resources measurement focus. With this measurement focus, all assets and all liabilities are included on the statement of net assets. The statement of net assets represents the basic statement of position for the School. The statement of revenues, expenses, and changes in net assets presents increases (e.g., revenues) and decreases (e.g., expenses) in net total assets. The statement of cash flows reflects how the School finances and meets its cash flow needs. Finally, the notes to the basic financial statements provide additional information that is essential to a full understanding of the data provided on the basic financial statements.

REPORTING SCHOOL AS A WHOLE

The view of the School as a whole looks at all financial transactions and asks, "How did we do financially during 2005?" The statement of net assets and the statement of revenues, expenses, and change in net assets answer 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. This basis of accounting considers all of the current year's revenues and expenses regardless of when cash is received or paid.

These two statements report the School's net assets and change in those assets. This change in net assets is important because it tells the reader that, for the School as a whole, the financial position of the School has improved or diminished. The cause of this may be the result of many factors, some financial, some not. Non-financial factors include the current laws in Ohio restricting revenue growth, facility conditions, required educational programs and other factors.

**THE ARTS ACADEMY
LORAIN COUNTY**

**MANAGEMENT'S DISCUSSION AND ANALYSIS
FOR FISCAL YEAR ENDED JUNE 30, 2005
UNAUDITED
(Continued)**

FINANCIAL ANALYSIS

The Arts Academy is not required to present government-wide financial statements as the School is engaged in only business-type activities. Therefore, no condensed financial information derived from government-wide financial statements is included in the discussion and analysis.

Table 1 provides a summary of the School's net assets for 2005:

Table 1
Statement of Net Assets

	<u>2005</u>
Assets:	
Current Assets	26,705
Capital Assets, Net of Accumulated	<u>82,959</u>
Total Assets	109,664
Liabilities:	
Current Liabilities	174,461
Due More than one Year	<u>52,762</u>
Total Liabilities	227,223
Net Assets:	
Investment in Capital Assets, Net of	82,959
Unrestricted	<u>(200,518)</u>
Total Net Assets	(\$117,559)

Total assets increased by \$109,664, while total liabilities increased by \$228,239. Cash and cash equivalents increased by \$26,705. The decrease of \$118,575 in total net assets was primarily due to large accounts payable and accrued wages at year end.

**THE ARTS ACADEMY
LORAIN COUNTY**

**MANAGEMENT'S DISCUSSION AND ANALYSIS
FOR FISCAL YEAR ENDED JUNE 30, 2005
UNAUDITED
(Continued)**

Table 2 shows the changes in net assets for fiscal year 2005:

Table 2
Change in Net Assets

	<u>2005</u>
<u>Operating Revenues:</u>	
State Aid	\$1,156,208
Classroom Fees	<u>87,376</u>
 Total Operating Revenues	 <u>1,390,048</u>
<u>Operating Expenses:</u>	
Salaries	686,799
Fringe Benefits	157,929
Purchased Services	478,025
Materials and Supplies	107,342
Depreciation	16,144
Other	<u>82,663</u>
 Total Operating Expenses	 <u>1,528,902</u>
 Net Operating Loss	 <u>(138,854)</u>
<u>Non-Operating Revenue(Expenses)</u>	
Grants	33,950
Interest on Capital Leases	<u>(12,655)</u>
 Total Non-Operating Revenue	 21,295
 Change in Net Assets	 <u>(117,559)</u>

Operating revenues were \$1,390,048 while operating expenses were \$1,528,902. Operating expense are due to services delivered for the increased enrollment, annual increases in service costs and additional services paid with non-operating revenues.

Capital Assets

The School had \$82,959 invested in capital assets net of depreciation. Detailed information regarding capital asset activity is included in the notes to the basic financial statements (Note 4).

**THE ARTS ACADEMY
LORAIN COUNTY**

**MANAGEMENT'S DISCUSSION AND ANALYSIS
FOR FISCAL YEAR ENDED JUNE 30, 2005
UNAUDITED
(Continued)**

Debt

At June 30, 2005, The Arts Academy has \$52,762 in long term liabilities. Note 12 summarizes all long term liabilities.

BUDGET

Unlike other public schools located in the State of Ohio, community schools are not required to follow budgetary provisions set forth in Ohio Rev. Code Chapter 5705, unless specifically provided in the Community School's contract with its Sponsor. The contract between the School and its Sponsor does not prescribe a budgetary process for the Arts Academy. The School has developed a five-year projection that is reviewed periodically by the Board of Trustees.

For the Future

The School has contracted with a new sponsor effective July 1, 2005. See Note 14 for further information.

Contacting the Art Academy's Financial Management

This financial report is designed to provide our citizen's, taxpayers, investors and creditors with a general overview of the School's finances and to show the School's accountability for the money it receives. If you have questions about this report or need additional information contact Mr. Andre Street of the Arts Academy at 4125 Leavitt Lorain, Ohio 44053.

THE ARTS ACADEMY
LORAIN COUNTY

Statement of Net Assets
June 30, 2005

Assets

Current Assets:

Cash and Cash Equivalents \$26,705

Total Current Assets 26,705

Noncurrent Assets:

Capital Assets:

Depreciable Capital Assets, net 82,959

Total Noncurrent Assets 82,959

Total Assets 109,664

Liabilities

Current Liabilities:

Accounts Payable 86,228

Accrued Wages and Benefits 59,568

Intergovernmental Payable 20,325

State Pension Payable 8,340

Total Current Liabilities 174,461

Long-Term Liabilities:

Due within one year 51,961

Due within more than one year 801

Total Long-Term Liabilities 52,762

Total Liabilities 227,223

Net Assets

Investment in Capital Assets, Net of Related Debt 82,959

Unrestricted (200,518)

Total Net Assets (\$117,559)

See accompanying notes to the basic financial statements

THE ARTS ACADEMY
LORAIN COUNTY

Statement of Revenues,
Expenses and Changes in Fund Net Assets
For the Fiscal Year Ended June 30, 2005

<u>Operating Revenues:</u>	
State Aid	\$1,156,208
Classroom Fees	87,376
Food Service	2,434
Other Operating	<u>144,030</u>
Total Operating Revenues	<u>1,390,048</u>
<u>Operating Expenses:</u>	
Salaries	645,364
Fringe Benefits	157,929
Purchased Services	519,460
Materials and Supplies	107,342
Depreciation	16,144
Other	<u>82,663</u>
Total Operating Expenses	<u>1,528,902</u>
Net Operating Loss	<u>(138,854)</u>
<u>Non-Operating Revenue(Expenses)</u>	
Grants	33,950
Interest on Capital Leases	<u>(12,655)</u>
Total Non-Operating Revenue	21,295
Change in Net Assets	<u>(117,559)</u>
Net Assets Beginning of Year	<u>-</u>
Net Assets End of Year	<u><u>\$ (117,559)</u></u>

See accompanying notes to the basic financial statements

THE ARTS ACADEMY
LORAIN COUNTY

Statement of Cash Flows
For the Fiscal Year Ended June 30, 2005

Increase (Decrease) in Cash and Cash Equivalents

Cash Flows from Operating Activities	
Cash Received from State of Ohio	\$1,175,669
Cash Received from Other Operating Sources	233,840
Cash Payments to Suppliers for Goods and Services	(484,768)
Cash Payments to Employees for Services	(655,082)
Cash Payments for Employee Benefits	(141,711)
Other Cash Payments	<u>(80,546)</u>
Net Cash Used for Operating Activities	47,402
Cash Flows from Noncapital Financing Activities	
Cash Received from Operating Grants	33,950
Cash Flows from Capital and Related Financing Activities	
Interest and Fiscal Charges	(12,655)
Cash Payments for Principal Payments	(41,992)
Net Cash Provided by (Used in) Capital Financing Activities	<u>(54,647)</u>
Net Decrease in Cash and Cash Equivalents	26,705
Cash and Cash Equivalents Beginning of Year	<u>0</u>
Cash and Cash Equivalents End of Year	<u><u>\$26,705</u></u>

**Reconciliation of Operating Gain (Loss) to Net Cash
Provided by (Used in) Operating Activities**

Operating Gain (Loss)	(\$117,559)
Adjustments:	
Depreciation	16,144
(Increase) Decrease in Assets and Liabilities:	
Accounts Payable	40,697
Accrued Wages	73,188
Intergovernmental Payable	20,325
State Pension Payable	<u>14,607</u>
Net Cash Provided by (Used in) Operating Activities	<u><u>\$47,402</u></u>

See accompanying notes to the basic financial statements

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**THE ARTS ACADEMY
LORAIN COUNTY**

**NOTES TO THE BASIC FINANCIAL STATEMENTS
JUNE 30, 2005**

1. DESCRIPTION OF THE REPORTING ENTITY

The Arts Academy (School) is a nonprofit corporation established pursuant to Ohio Revised Code Chapters 3314 and 1702. The School is an approved tax-exempt organization under Section 501(c)(3) of the Internal Revenue Code. Management is not aware of any course of action or series of events that have occurred that might adversely affect the School's tax-exempt status. The School's objective is to use the Lorain community to form partnerships for student learning. Individualized programs are used to meet student's needs. Parents and students are included in all decision-making. The School, which is part of the State's education program, is independent of any school district and is nonsectarian in its programs, admission policies, employment practices, and all other operations. The School may acquire facilities as needed and contract for any services necessary for the operation of the school.

The School was approved for operation under a contract with the Lucas County Educational Services Center (Sponsor) for a period of five years commencing July 13, 2004. The Sponsor is responsible for evaluating the performance of School and has the authority to deny renewal of the contract at its expiration or terminate the contract prior to its expiration. On July 27, 2005, the Sponsor assigned and transferred its contract to Ashe Culture Center, Inc.

The School operates under the direction of a seven-member Governing Board. The Governing Board is responsible for carrying out the provisions of the contract, which include but are not limited to, state-mandated provisions regarding student population, curriculum, academic goals, performance standards, admission standards, and qualifications of teachers. The Governing Board controls the School's one instructional/support facility staffed by 9 non-certified and 11 certificated full time teaching personnel who provide services to 194 students.

2. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

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

A. Basis of Presentation

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

**THE ARTS ACADEMY
LORAIN COUNTY**

**NOTES TO THE BASIC FINANCIAL STATEMENTS
JUNE 30, 2005
(Continued)**

2. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (Continued)

B. Measurement Focus and Basis of Accounting

Enterprise accounting uses a flow of economic resources measurement focus. With this measurement focus, all assets and all liabilities are included on the Statement of Net Assets. Operating statements present increases and decreases in net total assets. Basis of accounting refers to when revenues and expenses are recognized in the accounts and reported in the financial statements. Basis of accounting relates to the timing of the measurements made. The accrual basis of accounting is used for reporting purposes. Revenues are recognized when earned and expenses are recognized when they are incurred.

C. Budgetary Process

Unlike other public schools located in the State of Ohio, community schools are not required to follow budgetary provisions set forth in Ohio Revised Code Chapter 5705, unless specifically provided in the School's contract with its Sponsor. The contract between the School and its Sponsor does prescribe an annual budget requirement in addition to preparing a five-year forecast, which is to be updated annually.

D. Cash and Cash Equivalents

All monies received by the School are accounted for by the School's fiscal agent, the Ohio Community School Consultants. All cash received by the fiscal agent is maintained in separate bank accounts in the School's name. Monies for the School are maintained in these accounts or are temporarily used to purchase short-term investments. Investments of the cash management pool and with original maturities of three months or less at the time they are purchased by the School are considered to be cash equivalents.

E. Capital Assets and Depreciation

All capital assets are capitalized at cost (or estimated historical cost) and updated for additions and retirements during the year. Donated capital assets are recorded at their fair market values as of the date received. The School's capitalization threshold is one thousand hundred dollars. The School does not possess any infrastructure.

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.

Depreciation of furniture and equipment is computed using the straight-line method over an estimated life of five years.

**THE ARTS ACADEMY
LORAIN COUNTY**

**NOTES TO THE BASIC FINANCIAL STATEMENTS
JUNE 30, 2005
(Continued)**

2. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (Continued)

F. Intergovernmental Revenues

The School currently participates in the State Foundation Program, the State Disadvantaged Pupil Impact Aid (DPIA) Program, and the State Special Education Program, which are reflected under "State Aid" on the Statement of Revenues, Expenses and Changes in Net Assets. Revenues received from these programs are recognized as operating revenues in the accounting period in which all eligibility requirements have been met.

Non-exchange transactions, in which the School receives value without directly giving equal value in return, include grants, entitlements, and contributions. Grants, entitlements, and contributions are recognized as non-operating revenues in the accounting period in which all eligibility requirements have been met.

Eligibility requirements include timing requirements, which specify the year when the resources are required to be used or the fiscal year when use is first permitted; matching requirements, in which the School must provide local resources to be used for a specified purpose; and expenditure requirements, in which the resources are provided to the School on a reimbursement basis. Amounts awarded under the above programs for the 2006 school year totaled \$1,190,158.

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 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 School or through external restrictions imposed by creditors, grantors or laws or regulations of other governments. The School presently has no restricted net assets.

H. Operating Revenues and Expenses

Operating revenues are those revenues that are generated directly from the primary activity of the School. Operating expenses are necessary costs incurred to provide the service that is the primary activity of the school. All revenues and expenses not meeting this definition are reported as non-operating.

I. Estimates

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

**THE ARTS ACADEMY
LORAIN COUNTY**

**NOTES TO THE BASIC FINANCIAL STATEMENTS
JUNE 30, 2005
(Continued)**

3. DEPOSITS AND INVESTMENTS

Deposits: The carrying value of the School's deposits totaled \$27,413, and the bank balance totaled \$27,771 all of which was covered by federal depository insurance. Based on the criteria described in GASB Statement No. 40, "Deposits and Investment Risk Disclosures", as of June 30, 2006, \$27,413 of the School's bank balance of \$27,771 was exposed to custodial risk as discussed below, while \$100,000 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 School's deposits may not be returned. All deposits are collateralized with eligible securities in amounts equal to at least 105 percent 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 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 School.

4. CAPITAL ASSETS

At June 30, 2005, the following table represents the School's changes in capital assets. Capital assets are considered depreciable except for land:

	Balance 7/1/2004	Additions	Retirements	Balance 6/30/2005
Furniture and Equipment	-	99,103		99,103
Total	-	99,103		99,103
Less: Acc Depreciation	-	(16,144)		(16,144)
Net Capital Assets	\$ -	\$ 82,959	-	\$ 82,959

5. RISK MANAGEMENT

A. Insurance Coverage

The School is exposed to various risks of loss related to torts; theft of, damage to, and destruction of assets; errors and omissions; injuries to employees; and natural disasters. For the year ended 2005, the School contracted with the Peerless and Indiana Insurance Companies to have the following insurance coverage:

Commercial General Liability per occurrence	\$1,000,000
Commercial General Liability aggregate	2,000,000
Umbrella Liability per occurrence	1,000,000
Umbrella Liability aggregate	1,000,000
Workers Compensation and Employers' Liability	
Each Accident	1,000,000
Each Employee	1,000,000
Policy Limit	2,000,000
Other – CEO	
Each act	300,000
Aggregate	300,000
Defense Expense	100,000
Commercial Property Liability – Personal Property (\$1,000 Deductible)	2,000,000

**THE ARTS ACADEMY
LORAIN COUNTY**

**NOTES TO THE BASIC FINANCIAL STATEMENTS
JUNE 30, 2005
(Continued)**

5. RISK MANAGEMENT (continued)

B. Workers' Compensation

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

C. Employee Medical, Dental and Vision Benefits

The School has contracted through an independent agent to provide employee medical, dental, and vision insurance to its full-time employees who work 40 or more hours per week.

6. DEFINED BENEFIT PENSION PLANS

A. School Employees Retirement System

The School contributes to the School Employees Retirement System of Ohio (SERS), a cost sharing multiple-employer defined benefit pension administered by the School Employees Retirement Board. SERS provides retirement and disability benefits, annual cost-of-living adjustments, and death benefits to 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 financial report that includes financial statements and required supplementary information. The report may be obtained by contacting SERS, 300 East Broad Street, Suite 100, Columbus, Ohio 43215-3746 or by calling toll free (800) 878-5853. It is also posted on SERS' website, www.ohsers.org, under Forms and Publications.

For the fiscal year ended June 30, 2005, plan members are required to contribute 10 percent of their annual covered salary and the School was required to contribute an actuarially determined rate. The current rate is 14 percent of annual covered payroll. A portion of the School's contribution is used to fund pension obligations with the remainder being used to fund health care benefits: for fiscal year 2005, 10.57 percent of annual covered salary was the portion used to fund pension obligations. 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 School's required contribution for pension obligation to SERS for fiscal year June 30, 2005 was 16,342. For 2005, the School contributed \$10,532 and the remainder has been recorded as a payable to State Pension Systems.

B. State Teachers Retirement Systems (STRS)

The School participates in the State Teachers Retirement System of Ohio (STRS Ohio), a cost-sharing multiple-employer public employee retirement system. STRS Ohio provides retirement and disability benefits to members, and death and survivor benefits to beneficiaries. Benefits are established by Chapter 3307 of the Ohio Revised Code. STRS Ohio issues a stand-alone financial report that may be obtained by writing to STRS Ohio, 275 East Broad Street, Columbus, Ohio, 43215-3371 or by calling (614) 227-4090, or by visiting the STRS of Ohio web site at www.strsohio.org.

**THE ARTS ACADEMY
LORAIN COUNTY**

**NOTES TO THE BASIC FINANCIAL STATEMENTS
JUNE 30, 2005
(Continued)**

6. DEFINED BENEFIT PENSION PLANS (Continued)

B. State Teachers Retirement Systems (STRS) (Continued)

New members have a choice of three retirement plan options, a Defined Benefit (DB) Plan, a Defined Contribution (DC) Plan and a Combined Plan. The DB plan offers an annual retirement allowance based on final average salary times a percentage that varies based on years of service, or an allowance based on member contributions and earned interest matched by STRS Ohio funds times an actuarially determined annuity factor. The DC Plan allows members to place all their member contributions and employer contributions equal to 10.5% of earned compensation into an investment account. Investment decisions are made by members. A member is eligible to receive a retirement benefit at age 50 and termination of employment.

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. 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.

Existing members with less than five years of service credit as of June 30, 2001, were given the option of making a one time irrevocable decision to transfer their account balances from the existing DB Plan into the DC Plan or the Combined Plan. This option expired on December 31, 2001.

A DB or Combined Plan member with five or more years credited service who becomes disabled may qualify for a disability benefit. Eligible spouses and dependents of these active members who die before retirement may qualify for survivor benefits. Members in the DC Plan who become disabled are entitled only to their account balance. If a member dies before retirement benefits begin, the member's designated beneficiary is entitled to receive the member's account balance.

For the fiscal year ended June 30, 2005, members were required to contribute 9.3 percent of their annual covered salary and the School is required to contribute 14%; 13% was the portion used to fund pension obligations. Contribution rates are established by STRS, upon recommendation of its consulting actuary, not to exceed statutory maximum rates of 10 percent for members and 14 percent for employers. Chapter 3307 of the Ohio Revised Code provides statutory authority for member and employer contributions.

The School's required contributions for pension obligations to STRS for the year ended June 30, 2005 was \$69,745. For 2005, the School contributed \$60,948 and the remainder has been recorded as a payable to State Pension Systems.

7. POSTEMPLOYMENT BENEFITS

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

**THE ARTS ACADEMY
LORAIN COUNTY**

**NOTES TO THE BASIC FINANCIAL STATEMENTS
JUNE 30, 2005
(Continued)**

7. POSTEMPLOYMENT BENEFITS (continued)

The STRS Ohio Board has statutory authority over how much, if any, of the 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. By law, the cost of coverage paid from STRS Ohio is included in the employer contribution rate, currently 14% of covered payroll. For the fiscal year ended June 30, 2005, the STRS Ohio Board allocated employer contributions equal to 1 percent of covered payroll to the Health Care Reserve Fund. For the School, this amount equaled to \$6,939 during fiscal year 2005.

STRS pays health care benefits from the Health Care Stabilization Fund. At June 30, 2004, the balance in the Fund was 3.1 billion. For the fiscal year ended June 30, net health care costs paid by STRS were \$ 268,739,000 and STRS had 111, 853 eligible benefit recipients (the latest information available).

For SERS, coverage is made available to service retirees with ten or more years of qualifying service credit and to disability and survivor benefit recipients. Members retiring on or after August 1, 1989, with less than twenty-five years of service credit must pay a portion of their premium for health care. 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 percent for those who apply.

After the allocation for basic benefits, the remainder of the employer's 14 percent contribution is allocated to providing health care benefits. At June 30, 2005, the healthcare allocation is 3.43 percent. In addition, SERS levies a surcharge to fund health care benefits equal to 14 percent of the difference between a minimum pay and the member's pay, pro-rated for partial service credit. For fiscal year 2005, the minimum pay was established at \$27,400. The surcharge, added to the unallocated portion of the 14 percent employer contribution rate, provides for maintenance of the asset target level for the health care fund.

For the School, the amount to fund health care benefits, including surcharges, during 2005 was \$11,522.

Health care benefits are financed on a pay-as-you-go basis. Net health care costs for the year ending June 30, 2005 were \$178,221,113. The target level for the health care fund is 150 percent of the projected claims less premium contributions for the next fiscal year. As of June 30, 2005, the value of the health care fund was \$267.5 million, which is about 168% of next year's projected net health care costs of \$158,766,151. On the basis of actuarial projections, the allocated contributions will be insufficient, in the long term, to provide for a health care reserve equal to at least 150% of estimated annual net claim costs. SERS has 58,123 participants eligible to receive benefits.

8. 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..." Graham is currently unable to determine what effect, if any, this decision will have on its future State funding and on its financial operations.

**THE ARTS ACADEMY
LORAIN COUNTY**

**NOTES TO THE BASIC FINANCIAL STATEMENTS
JUNE 30, 2005
(Continued)**

9. CONTINGENCIES

A. Grants

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

B. Litigation

A suit was filed in Franklin County Common Pleas Court on May 14, 2001 alleging Ohio's Community (i.e., Charter) Schools program violates the state Constitution and state laws. On April 21, 2003 the court dismissed the counts containing constitutional claims and stayed the other counts pending appeal of the constitutional issues. The plaintiffs appealed to the Court of Appeals, the issues have been briefed, and the case was heard on November 18th, 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 effect of this suit, if any, on the School is not presently determinable.

C. Full-Time Equivalency Reviews

The Ohio Department of Education conducts reviews of enrollment data and full-time equivalency (FTE) calculations made by the School. These reviews are conducted to ensure the School is reporting accurate student enrollment data to the State, upon which state foundation funding is calculated. To date, a review of the fiscal year 2005 has not been conducted.

10. PURCHASED SERVICES

For the period July 1, 2004 through June 30, 2005, purchased service expenses were payments for services rendered by various vendors, as follows:

	Purchased Services
Professional and Technical Services	217,579
Property Services	238,773
Communications	9,588
Utilities	27,119
Contracted Craft or Trade Services	22,812
Pupil Transportation Services	3,589
Total Purchased Services	519,460

**THE ARTS ACADEMY
LORAIN COUNTY**

**NOTES TO THE BASIC FINANCIAL STATEMENTS
JUNE 30, 2005
(Continued)**

11. OPERATING LEASES – LESSEE DISCLOSURE

The School entered into an operating lease commencing July 27, 2004 for a term of 36 months for a copier. The copier is owned by MT Business Technologies. The lease may be renewed continuously for consecutive months after the end of the term.

The following is a schedule of the future minimum payments required under the operating lease as of June 30, 2005.

<u>Year Ending June 30,</u>	<u>Copier</u>
2006	\$ 3,600
2007	3,600
2008	<u>3,600</u>
Total	\$ 10,800

The School entered into a lease agreement with the Church on the North Coast 4125 Leavitt Road, Lorain, Ohio (Church) for specific portions of the church property consisting of classrooms, gymnasium, kitchen indoor/outdoor common areas, parking lots, and playground facilities. The term of this lease shall commence on August 1, 2004 to July 31, 2006. The School has the option to renew this lease for two additional years. The School paid the Church \$ 138,000 during fiscal year 2005.

12. CAPITAL LEASES – LESSEE DISCLOSURE

The School has entered into three lease agreements for musical instruments. The leases meet the criteria of a capital lease as defined by *Statement of Financial Accounting Standards No. 13, Accounting for Leases,* which defines a capital lease generally as one which transfers benefits and risks of ownership to the lessee. Capital assets of \$94,753 have been recorded, which represents the present value of the minimum lease payments at time of acquisition. The accumulated depreciation for the capital lease assets was \$15,274 at June 30, 2005. Principal payments for fiscal year 2005 totaled \$41,599. The following is a schedule of the future minimum lease payments required under the capital leases and the present value of the minimum lease payments as of June 30, 2005.

<u>Fiscal Year End June 30,</u>	<u>Lease Payments</u>
2006	\$ 51,961
2007	<u>801</u>
Total Minimum Lease Payments	52,762
Less Interest	<u>5,237</u>
Present Value of Minimum Lease Payments	<u><u>\$ 47,525</u></u>

13. TAX EXEMPT STATUS

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

**THE ARTS ACADEMY
LORAIN COUNTY**

**NOTES TO THE BASIC FINANCIAL STATEMENTS
JUNE 30, 2005
(Continued)**

14. SUBSEQUENT EVENTS

The Schools sponsorship contract with Lucas County Educational Service Center was transferred to the Ashe Culture Center, Inc. effective July 27, 2005 for a period of five years ending June 30, 2010.



Mary Taylor, CPA

Auditor of State

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

The Arts Academy
Lorain County
4125 Leavitt Road
Lorain, Ohio 44052

We were engaged to audit the basic financial statements of the Arts Academy, Lorain County, Ohio, (the Academy) as of and for the year ended June 30, 2005 and have issued our report thereon dated May 15, 2007. Our report indicated that due to the lack of original supporting documentation for non-payroll expenditures, the amounts presented in the statement of cash flows that could not be supported, and the litigation note which does not reference a suit filed on October 6, 2004, we did not express an opinion on the financial statements.

Internal Control Over Financial Reporting

In planning and performing our engagement, we considered the Academy's internal control over financial reporting to determine our auditing procedures in order to express our opinion on the financial statements and not to opine on the internal control over financial reporting. However, we noted certain matters involving the internal control over financial reporting and its operation that we consider reportable conditions. Reportable conditions involve matters coming to our attention relating to significant deficiencies in the design or operation of the internal control over financial reporting that, in our judgment, could adversely affect the Academy's ability to record, process, summarize, and report financial data consistent with management's assertions in the financial statements. Reportable conditions are described in the accompanying schedule of findings as items 2005-006 and 2005-007.

A material weakness is a reportable condition in which the design or operation of one or more of the internal control components does not reduce to a relatively low level the risk that misstatements caused by error or fraud in amounts material to the financial statements which, we were engaged to audit, may occur and not be timely detected by employees when performing their assigned functions. Our consideration of the internal control over financial reporting would not necessarily disclose all matters in the internal control that might be reportable conditions and, accordingly, would not necessarily disclose all reportable conditions that are also considered material weaknesses. We consider reportable conditions 2005-006 and 2005-007 listed above to be material weaknesses. In a separate letter to the Academy's management dated May 15, 2007, we reported other matters involving internal control over financial reporting we did not deem reportable conditions.

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 instances of noncompliance or other matters we must report under *Government Auditing Standards* which are described in the accompanying schedule of findings as items 2005-001 through 2005-005

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

A handwritten signature in cursive script that reads "Mary Taylor".

Mary Taylor, CPA
Auditor of State

May 15, 2007

THE ARTS ACADEMY
LORAIN COUNTY

SCHEDULE OF FINDINGS
FOR THE YEAR ENDED JUNE 30, 2005

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

FINDING NUMBER	2005-001
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Financial Report Filing

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

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

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

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

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

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

Officials' Response:

The Arts Academy contracted with the Ohio Community School Consultants to manage all fiscal operations for the school. We were assured that all financial statements were filed correctly. As noted in the contract, the Ohio Community Schools Consultants were responsible for processing non-public items.

THE ARTS ACADEMY
LORAIN COUNTY

SCHEDULE OF FINDINGS
FOR THE YEAR ENDED JUNE 30, 2005
(Continued)

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

FINDING NUMBER

2005-002

Expenditure of Public Funds/Proper "Proper Purpose"

1982 Op. Att'y Gen. No. 82-006 addresses the expenditure of funds for public purposes. This opinion, citing the Ohio Supreme Court case of State ex rel. McClure v. Hagerman, 155 Ohio St. 320 (1951), provides guidance as to what may be construed as a public purpose. There are two criteria that demonstrate whether an expenditure is for a public purpose. First, the expenditure is required for the general good of all inhabitants. Second, the primary objective of the expenditure is to further a public purpose, even if an incidental private end is advanced.

The determination of what constitutes a public purpose is primarily a legislative function. As such, the decision to expend public funds "...must be made in accordance with the procedural formalities governing the exercise of legislative power. Specifically, the decision must be memorialized by a duly enacted ordinance or resolution and may have prospective effect only." 1982 Op. Atty. Gen No.82-006.

During our testing of non-payroll expenditures, we noted 16 out of 60 transactions tested had no supporting documentation and 22 out of a total of 60 items tested for which photo copies of invoices were included as the support for the expenditure made. 1982 Op. Att'y Gen. No. 82-006 provides guidance concerning the expenditure of monies for a proper public purpose. Without original supporting documentation we were unable to determine if these expenditures were proper.

We recommend the Academy not expend public monies unless the original supporting documentation is attached to attest to the authenticity of and validity of the expenditure made.

Officials' Response:

As noted in the contract the Ohio Community Schools Consultants were responsible for processing non-payroll items. After review of our files we believe that the missing supporting documentation may have been sent to Ohio Community Schools Consultants and not returned.

FINDING NUMBER

2005-003

Books, Records of Accounts, and Minutes

Ohio Revised Code Section 1702.15 provides, in part, that "[e]ach corporation shall keep correct and complete books and records of account, together with minutes of the proceedings of its incorporators, members, directors, and committees of its directors or members."

The Academy failed to maintain files of original supporting documentation for non-payroll payments made and maintain a complete file of canceled checks. The Disclaimer of Opinion issued, with this report, is a direct result of the Academy's failure to maintain original supporting documentation.

THE ARTS ACADEMY
LORAIN COUNTY

SCHEDULE OF FINDINGS
FOR THE YEAR ENDED JUNE 30, 2005
(Continued)

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

FINDING NUMBER	2005-003
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Books, Records of Accounts, and Minutes (Continued)

We recommend the Academy maintain financial records which are complete and accurate. If necessary the Academy should review all of the available training and obtain the training necessary to maintain complete and accurate records of account.

Officials' Response:

As noted in the contract the Ohio Community Schools Consultants were responsible for processing non-payroll items. After review of our files we believe that the missing supporting documentation may have been sent to Ohio Community Schools Consultants and not returned.

FINDING NUMBER	2005-004
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Special Education Services

Ohio Rev. Code § 3314.12 provides that on or before the first day of November each year, the sponsor of each community school established under this chapter shall submit to the department of education, in accordance with guidelines adopted by the department for purposes of this section, a report that describes the special education and related services provided by that school to enrolled students during the previous fiscal year and the school's expenditures for those services.

The report that describes the special education and related services provided by that school to enrolled students was not properly submitted.

Officials' Response:

According to 3314.12 a charter School cannot be approved to receive a charter without having and submitting a special education plan. This plan was submitted to the Sponsor.

Auditor of State's Analysis:

When the sponsor was contacted, they indicated the report was not received.

**THE ARTS ACADEMY
LORAIN COUNTY**

**SCHEDULE OF FINDINGS
FOR THE YEAR ENDED JUNE 30, 2005
(Continued)**

FINDINGS RELATED TO THE FINANCIAL STATEMENTS REQUIRED TO BE REPORTED IN ACCORDANCE WITH GAGAS
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FINDING NUMBER	2005-005
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Five-Year Revenue and Expenditure Projection

Ohio Revised Code Section 3314.03(A)(15) provides that the contract entered into between a sponsor and the governing authority of a community school shall specify a financial plan detailing an estimated school budget for each year of the period of the contract and specify the total estimated per pupil expenditure amount for each such year. The plan shall specify the yearly base formula amount that will be used for purposes of funding calculations under section 3314.08 of the Ohio Revised Code. This base formula amount for any year shall not exceed the formula amount defined under section 3317.02 of the Revised Code. The plan may also specify for any year a percentage figure to be used for reducing the per pupil amount of the subsidy calculated pursuant to section 3317.029 of the Revised Code the school is to receive that year under 3314.08 of the Revised Code.

Contrary to the information contained in the MD&A, we could not find evidence the Academy had prepared a projected budget for each year of the period of the contract or locate any evidence the Academy prepared the financial plan as required. Consequently, the Board was not able to approve a spending plan or approve the assumptions of the financial management in dealing with the finances of the Academy. This could lead to unplanned future deficits.

We recommend the Academy review the requirements of Ohio Revised Code Section 3314.03 and take the necessary steps to meet this requirement, including obtaining the approval of the governing board and reviewing the appropriateness of the amounts included in the estimated budget.

Officials' Response:

The Arts Academy was required to submit a budget to the Ohio Department of Education during the submission process for a school Charter.

Auditor of State's Analysis:

The Academy provided additional documentation to support the preparation of the five year revenue and expenditure projection. However, the Academy did not provide documentation to support Board approval.

**THE ARTS ACADEMY
LORAIN COUNTY**

**SCHEDULE OF FINDINGS
FOR THE YEAR ENDED JUNE 30, 2005
(Continued)**

FINDINGS RELATED TO THE FINANCIAL STATEMENTS REQUIRED TO BE REPORTED IN ACCORDANCE WITH GAGAS
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FINDING NUMBER	2005-006
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Developing and Implementing an Effective Monitoring Control System

Monitoring controls are comprised of regular management and supervisory activities established to oversee whether management's objectives are being achieved. Effective monitoring controls should assist management in assessing the quality of internal control performance over time. This process involves assessing the design and operation of controls on a timely basis and taking necessary corrective actions. Monitoring controls should assist management in identifying unexpected results and/or possible misstatements.

Some effective monitoring controls include:

- Regular review of monthly financial statements;
- Review of revenues and expenses with independently accumulated information (budgets, past performances, peer group representatives, etc.);
- Review of large or unusual transactions;
- Identification of unusual fluctuations;
- Comparison of financial statement position with financial projections and other internally prepared projections of financial position and operating results;
- Comparison of predefined key performance indicators based on the financial statements;
- Review of items which have been outstanding for extended periods of time (outstanding check listing for payroll and non payroll transactions);
- Monitoring compliance with grant agreements;
- Ensuring that an adequate segregation of duties exists; and,
- Review of monthly bank reconciliations by someone independent of their preparation.

The lack of effective monitoring controls could lead to the misallocation or misstatement of Academy funds, expenditure of funds contrary to the directives of the governing board, non-compliance with federal or state laws or regulations, which could result in a loss of funding from these sources, and errors or irregularities occurring in financial transactions affecting the bank reconciliations which go undetected.

We recommend that management prepare monthly financial statements and submit them to the Board at each regularly scheduled meeting. The Board should then review these financial statements and when satisfied as to their accuracy approve them through the minute records. In addition, management should ensure that any reports required by the grantor agencies, per the terms of grant agreements, are completed accurately and filed with the respective grantor agencies in a timely manner. Management should also ensure that proper segregation of duties exists, including an independent review of the monthly bank reconciliations.

**THE ARTS ACADEMY
LORAIN COUNTY**

**SCHEDULE OF FINDINGS
FOR THE YEAR ENDED JUNE 30, 2005
(Continued)**

FINDINGS RELATED TO THE FINANCIAL STATEMENTS REQUIRED TO BE REPORTED IN ACCORDANCE WITH GAGAS
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FINDING NUMBER	2005-006
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Developing and Implementing an Effective Monitoring Control System (Continued)

Officials' Response:

Review of revenues and expenditures. Based on our initial contract it was our belief that the controls put in place by the Ohio Community School Consultants were acceptable.

After your audit we are now implementing the proper monitoring controls and procedures to assure that the Arts Academy is compliant.

FINDING NUMBER	2005-007
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Professional Services Contracts

During our review of the non-payroll cash disbursements we noted 7 payments totaling \$15,129 to Art Fusion Curriculum for the development of the school curriculum. The documentation indicated that Alexis Rainbow, who is the Head of the School, was the vendor. A review of the canceled checks available revealed these checks were endorsed by Alexis Rainbow. Also, the minute record of the Board of Trustees did not reveal any requests for proposals or discussions with any other vendors to provide the school curriculum.

We recommend the Board request proposals from several different sources to help ensure the Academy is accepting the best possible proposal.

Officials' Response:

Based on Alexis Rainbow's skill level, research, and expertise in developing artistic educational programming/curriculum, her services were used, by the school, to develop the school's initial overall design. This was a new concept created by Alexis Rainbow. There are no other arts integration conceptual schools in Lorain County or surrounding counties. The services rendered to the Arts Academy for charter and curriculum development began in November 2003. From November 2003 to December 2004 Alexis Rainbow was not compensated for the work she performed to develop the schools concept. It would have been difficult to utilize another entity given the fact that the total concept, mission, and vision were conceived by Alexis Rainbow. The fact that the check was signed by Alexis Rainbow occurred because she was instructed to do so by the Treasurer of the school.

However our future plans are to use "Requests for Proposals", RFP's for professional services contracts.



Mary Taylor, CPA
Auditor of State

THE ARTS 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
AUGUST 9, 2007**