ACADEMY OF ARTS AND SCIENCES
LORAIN COUNTY

REGULAR AUDIT

FOR THE YEAR ENDED JUNE 30, 2007

Mary Taylor, CPA
Auditor of State

ACADEMY OF ARTS AND SCIENCES
LORAIN COUNTY

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Mary Taylor, CPA
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INDEPENDENT ACCOUNTANTS' REPORT

Academy of Arts and Sciences
Lorain County
201 West Erie Street
Lorain, Ohio 44052

To the Board of Directors:

We have audited the accompanying basic financial statements of the Academy of Arts and Sciences, Lorain County, Ohio (the Academy), as of and for the year ended June 30, 2007, as listed in the table of contents. These financial statements are the responsibility of the Academy's management. Our responsibility is to express an opinion on these financial statements based on our audit.

We conducted our audit in accordance with auditing standards generally accepted in the United States of America and the standards applicable to financial audits contained in 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 that our audit provides a reasonable basis for our opinion.

In our opinion, the financial statements referred to above present fairly, in all material respects, the financial position of the Academy of Arts and Sciences, Lorain County, Ohio, as of June 30, 2007, and the changes in its financial position and its cash flows for the year then ended in conformity with accounting principles generally accepted in the United States of America.

As discussed in Note 18 to the financial statements, the Academy experienced certain financial difficulties during the year. Note 18 describes management's plans regarding these issues.

In accordance with *Government Auditing Standards*, we have also issued our report dated December 8, 2008 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.

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www.auditor.state.oh.us

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.

Mary Taylor

Mary Taylor, CPA
Auditor of State

December 8, 2008

The discussion and analysis of the Academy of Arts and Sciences (the "Academy") financial performance provides an overall review of the Academy's financial activities for the fiscal year ended June 30, 2007. The intent of this discussion and analysis is to look at the Academy's financial performance as a whole. Readers should also review the financial statements and notes to the financial statements to enhance their understanding of the Academy's financial performance. The first year of the Academy's operations was 2006.

FINANCIAL HIGHLIGHTS

- Net assets increased $160,871 as compared to a decrease of $168,798 in the prior fiscal year.

- Operating expenses accounted for $1,370,630 of the total expenses of $1,387,155.

- Operating revenues accounted for $1,048,448 of the Academy's funding.

- The Academy had an operating loss of ($322,182) compared to an operating loss of ($218,633) in the prior fiscal year. However, in 2007 the operating loss was alleviated by federal and state funding of $499,578.

OVERVIEW OF THE FINANCIAL STATEMENTS

The financial report consists of three parts – management's discussion and analysis, the basic financial statements, and the notes to the financial statements. These statements are organized so the reader can understand the financial position of the Academy. 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 statement of position of the Academy. 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 Academy 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.

FINANCIAL ANALYSIS OF THE ACADEMY AS A WHOLE

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

Table 1 provides a summary of the Academy's nets assets for 2007 as compared to 2006:

Table 1
Net Assets

	2007	2006	Change
Assets:			
Current Assets	$ 236,733	$ 30,527	$ 206,206
Capital Assets	102,747	102,950	(203)
Total Assets	339,480	133,477	206,003
Liabilities:			
Current Liabilities	318,975	236,875	(82,100)
Long-term Liabilities	28,432	65,400	36,968
Total Liabilities	347,407	302,275	(45,132)
Net Assets:			
Invested in Capital Assets, Net of Related Debt	37,347	4,980	32,367
Restricted for Other Purposes	81	-	81
Unrestricted	(45,355)	(173,778)	128,423
Total Net Assets	$ (7,927)	$ (168,798)	$ 160,871

Results of fiscal year 2007 indicate an ending net asset balance of ($7,927), an increase of $160,871 from fiscal 2006. The increase is the result of additional enrollment and availability of substantially higher Federal Grants. We anticipate that the Academy will have an increase in net assets for fiscal year 2008 and this trend is expected to continue through fiscal year 2009. The goal is to grow enrollment to be closer to the capacity of the facility at which point the school would generate surpluses on an annual basis sufficient to eliminate accumulated deficits. The Academy started operations in 2006 and initial loss in the first year of operations is typical for a new Academy due to significant start-up costs.

Table 2 reflects the changes in net assets for the fiscal year 2007 as compared to 2006:

Table 2
Change in Net Assets

	2007	2006	Change
Operating Revenues:			
Community School Foundation	$ 1,047,202	$ 829,451	$ 217,751
Charge for Services	1,246	1,908	(662)
Total Operating Revenues	1,048,448	831,359	217,089
Operating Expenses:			
Building	82,917	113,466	(30,549)
Purchased Services	1,032,776	769,158	263,618
Depreciation	10,323	2,539	7,784
General Supplies	228,007	103,736	124,271
Other Operating Expenses	16,607	61,093	(44,486)
Total Operating Expenses	1,370,630	1,049,992	320,638
Operating Loss	(322,182)	(218,633)	(103,549)
Nonoperating Revenues and Expenses:			
Federal and State Restricted Grants	499,578	54,395	445,183
Interest Expense	(16,525)	(4,560)	(11,965)
Net Nonoperating Revenues and Expenses	483,053	49,835	433,218
Change in Net Assets	160,871	(168,798)	329,669
Net Assets Beginning of Year	(168,798)	-	(168,798)
Net Assets End of Year	$ (7,927)	$ (168,798)	$ 160,871

Management and the board carefully calculate the costs and risks associated with offering a high quality educational program that will be competitive with the educational programs available at the traditional public schools and weighed those costs and risks against the enhanced educational opportunities that will be available to students. Based on that analysis, the board and its management made the decision to make an investment in the future of the children of this community, not based on a plan that was expected to generate large economic profits, but rather on a plan that is economically sustainable and that would generate dividends to the community in the form of enhanced opportunities for children and families. The increase in Net Assets for 2007 is contributed to an increase in Federal and State grants.

BUDGET

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

CAPITAL ASSETS AND DEBT ADMINISTRATION

At the end of FY 2007, the Academy had $102,747 invested in capital assets, net of accumulated depreciation.

Furniture and Equipment	$74,284
Computers	41,325
Less: Accumulated Depreciation	(12,862)
Net Capital Assets:	$102,747

At June 30, 2007, the Academy had $65,400 of capital lease obligations for furniture and technology outstanding. Of that amount $36,968 is due within on year. For further information regarding the Academy's debt, refer to Note 13 to the basic financial statements.

ECONOMIC FACTORS

Management is not currently aware of any facts, decisions or conditions that have occurred that are expected to have a significant effect on the financial position or results of operations.

OPERATIONS

The Academy is a nonprofit corporation established pursuant to Ohio Revised Code Chapter 1702. The Academy offers education for Ohio children in Kindergarten through sixth grade. The Academy is independent of any school district and is nonsectarian in its programs, admission policies, employment practices, and all other operations. The Academy may lease or acquire facilities as needed and contract for any services necessary for the operation of the Academy.

REQUESTS FOR INFORMATION

This financial report is designed to provide our citizens, taxpayers, 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 concerning this report, please contact Robert Schirhart, Controller of the Academy, 3333 Chippewa Drive, Columbus, Ohio 43204.

ACADEMY OF ARTS AND SCIENCE
LORAIN COUNTY

STATEMENT OF NET ASSETS
JUNE 30, 2007

Assets:	
Current Assets:	
Cash and Cash Equivalents	$ 6,293
Intergovernmental Receivable	194,749
Prepaid Expense	35,691
Total Current Assets	236,733
Non-Current Assets:	
Capital Assets, Net of Accumulated Depreciation	102,747
Total Non-Current Assets	102,747
Total Assets	339,480
Liabilities:	
Current Liabilities:	
Accounts Payable, Trade	109,707
Accounts Payable, Related Party	172,300
Current Portion of Long-Term Debt	36,968
Total Current Liabilities	318,975
Non-Current Liabilities:	
Non-Current Portion of Long-Term Debt	28,432
Total Non-Current Liabilities	28,432
Total Liabilities	347,407
Net Assets	
Invested in Capital Assets, Net of Related Debt	37,347
Restricted	81
Unresricted	(45,355)
Total Net Assets	$ (7,927)

See Accompanying Notes to the Basic Financial Statements

ACADEMY OF ARTS AND SCIENCE
LORAIN COUNTY

STATEMENT OF REVENUES, EXPENSES AND CHANGES IN NET ASSETS
FOR THE FISCAL YEAR ENDED JUNE 30, 2007

Operating Revenues:	
Foundation Receipts	$ 1,047,202
Charges for Services	1,246
Total Operating Revenues	1,048,448
Operating Expenses:	
Building	82,917
Purchased Services	1,032,776
Depreciation	10,323
General Supplies	228,007
Other Operating Expenses	16,607
Total Operating Expenses	1,370,630
Operating Loss	(322,182)
Non-Operating Revenues and Expenses:	
Federal Restricted Grants	499,578
Interest Expense	(16,525)
Net Non-Operating Revenues and Expenses	483,053
Change in Net Assets	160,871
Net Asssets Beginning of Year	(168,798)
Net Assets End of Year	$ (7,927)

See Accompanying Notes to the Basic Financial Statements

ACADEMY OF ARTS AND SCIENCE
LORAIN COUNTY

STATEMENT OF CASH FLOWS
FOR THE FISCAL YEAR ENDED JUNE 30, 2007

Increase (Decrease) in Cash and Cash Equivalents	
Cash Flows from Operating Activities:	
Cash Received from State of Ohio	$ 1,030,452
Cash Received from Charges for Services	1,246
Cash Payments for Building	(82,917)
Cash Payments for Goods and Services	(1,211,207)
Cash Payments for Other Operating Expenses	(16,607)
Net Cash used for Operating Activities	(279,033)
CASH FLOWS FROM INVESTMENT ACTIVITIES	
Purchase of Assets	(10,120)
Net Cash Used for Investment Activities	(10,120)
Cash Flows from Noncapital Financing Activities:	
Federal and State Restricted Grants	337,656
Interest Expense	(16,525)
Net Cash Provided by Noncapital Financing Activities	321,131
CASH FLOWS FROM CAPITAL AND RELATED FINANCING ACTIVITIES	
Capital Lease Principal Retirement	(32,570)
Net Decrease in Cash and Cash Equivalents	(592)
Cash and Cash Equivalents at Beginning of Year	6,885
Cash and Cash Equivalents at End of Year	6,293
Reconciliation of Operating Loss to Net Cash Used for Operating Activities:	
Operating Loss	(322,182)
Adjustments to Reconcile Operating Loss to Net Cash Used for Operating Activities:	
Depreciation	10,323
Changes in Assets and Liabilities:	
(Increase)/Decrease in Intergovernmental Receivable	(12,352)
(Increase)/Decrease in Prepaid Expense	(32,524)
Increase/(Decrease) in Accounts Payable	82,100
Increase/(Decrease) in Deferred Revenue	(4,398)
Net cash used for Operating Activities	$ (279,033)

See Accompanying Notes to the Basic Financial Statements

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Note 1 - Description of the School

The Academy of Arts and Sciences (the "Academy") is a nonprofit corporation established pursuant to Ohio Revised Code Chapter 3314. The Academy offers education for Ohio children in kindergarten through sixth grade. The Academy is independent of any school district and is nonsectarian in its programs, admission policies, employment practices, and all other operations. The Academy may lease or acquire facilities as needed and contract for any services necessary for the operation of the Academy.

The Academy was approved for operation under a contract with the St. Aloysius Orphanage (the Sponsor) for a period of five academic years commencing after July 1, 2005 and ending June 30, 2010. The Sponsor is responsible for evaluating the performance of the Academy and has the authority to deny renewal of the contract at its expiration or terminate the contract prior to its expiration.

The Academy operates under the direction of a Governing Board that consists of not less than five individuals who are not owners or employees, or immediate relatives or owners or employees of any for-profit firm that operate or manage the Academy for the Governing Board. The Board is responsible for carrying out the provisions of the contract that include, but are not limited to, state-mandated provisions regarding student population, curriculum, academic goals, performance standards, admission standards, and qualifications of teachers.

The Academy contracts with Mosaica Education, Inc., for management services including management of personnel and human resources, the program of instruction, technology, marketing, data management, purchasing, strategic planning, public relations, financial reporting, recruiting, compliance issues, budgets, contracts, and equipment and facilities. See Note 16.

Note 2 - Summary of Significant Accounting Policies

The financial statements of the Academy have been prepared in conformity with generally accepted accounting principals (GAAP) as applied to governmental units. The Governmental Accounting Standards Board (GASB) is the accepted standard-setting body for establishing governmental accounting and financial reporting principles. The Academy also applies Financial Accounting Standards Board (FASB) statements and interpretations issued on or before November 30, 1989, provided they do not conflict with or contradict GASB pronouncements. The entity has elected not to apply FASB pronouncements and interpretations issued after November 30, 1989. 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. The Academy uses a single enterprise presentation for its financial records. Enterprise reporting focuses on the determination of operating income, changes in net assets, financial position, and cash flows.

B. Measurement Focus

The enterprise activity is accounted for using a flow of economic resources measurement focus. All assets and liabilities associated with the operation of the Academy are included on the statement of net assets. The statement of revenues, expenses, and changes in net assets presents increases (e.g. revenues) and decreases (e.g. expenses) in total net assets. The statement of cash flows reflects how the Academy finances meet its cash flow needs.

Note 2 - Summary of Significant Accounting Policies (Continued)

C. Basis of Accounting

Basis of accounting determines when transactions are recorded in the financial records and reported on the financial statements. The Academy's 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. Revenue resulting from nonexchange transactions, in which Academy receives value without directly giving equal value in return, such as grants and entitlements, are recognized in the period in which all eligibility requirements have been satisfied. Eligibility requirements include timing requirements, which specify the period when the resources are required to be used or the period 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. Expenses are recognized at the time they are incurred.

D. Budgetary Process

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

E. Cash and Cash Equivalents

Cash received by the Academy is reflected as "Cash and Cash Equivalents" on the statement of net assets. The Academy had no investments during the fiscal year ended June 30, 2007.

F. Prepaid Items

The Academy records payments made to vendors for services that will benefit periods beyond June 30, 2007, as prepaid items using the consumption method. A current asset for the prepaid amount is recorded at the time of the purchase and an expense is reported in the year in which services are consumed.

G. Capital Assets

The Academy's capital assets during fiscal year 2007 consisted of capital leases for computers and other equipment. All capital assets are capitalized at cost and updated for additions and retirements during the fiscal year. Donated capital assets are recorded at their fair market values as of the date received. The Academy maintains a capitalization threshold of one thousand five hundred dollars. The Academy does not have 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.

Note 2 - Summary of Significant Accounting Policies (Continued)

All capital asset leases are depreciated. Depreciation is computed using the straight-line method over the following useful lives:

Description	Useful Lives
Furniture, Fixtures, and Equipment	5-20 years
Computer Technology	5 years

H. Net Assets

Net assets represent the difference between assets and liabilities. Net assets are reported as restricted when there are limitations imposed on their use either through the enabling legislation adopted by Academy or through external restrictions imposed by creditors, grantors, or laws or regulations of other governments. The Academy applies restricted resources first when an expense is incurred for purposes for which both restricted and unrestricted net assets are available.

The statement of net assets reports $81 in restricted net assets related to certain unspent federal grant receipts and $37,347 invested in capital assets net of related debt.

I. Operating Revenues and Expenses

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

J. Estimates

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

K. Economic Dependency

The Academy receives approximately 99% of its operating revenue from the Ohio Department of Education. Due to the significance of this revenue source, the Academy is considered to be economically dependent on the State of Ohio Department of Education.

Note 3 – Changes in Accounting Principles

There were no changes in accounting principals implemented during 2007 that would have a material effect on the financial statements.

Note 4 - Deposits

Custodial credit risk is the risk that, in the event of a bank failure, the Academy's deposits may not be returned. The Academy does not have a deposit policy for custodial credit risk. At June 30, 2007, the bank balance of Academy's deposits was $10,634. The bank balance was covered by federal depository insurance which covers deposits up to $100,000. There are no significant statutory restrictions regarding the deposit and investment of funds by the nonprofit corporation.

Note 5 – Receivables

At June 30, 2007, the Academy had intergovernmental receivables, in the amount of $194,749. The receivables are expected to be collected within one year.

Grant	Amount
State Community School Grant	$ 40,077
State Foundation Adjustment	12,352
Federal Community School Grant	87,617
Title I	41,567
IDEA B	9,335
Title IIA	3,681
Title V	120
Total Intergovernmental Receivables	$194,749

Note 6 – Capital Assets

The capital asset activity for the fiscal year ended June 30, 2007, was as follows:

	Balance July 1, 2006	Additions (Deletions)	Depreciation Expense	Balance June 30, 2007
Depreciable Capital Assets:				
Furniture & Equipment	$74,284	$0	$0	$74,284
Computer Technology	31,205	10,120	0	41,325
Less Accumulated Depreciation:				
Furniture & Equipment	(978)	0	(3,913)	(4,891)
Computer Technology	(1,561)	0	(6,410)	(7,971)
Capital Assets, Net	$102,950	$10,120	($10,323)	$102,747

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 2007, the Academy contracted with the Hartford Casualty Insurance Company. The types and amounts of coverage provided are as follows:

Note 7 – Risk Management (continued)

General Liability:	
Each Occurrence	$1,000,000
Aggregate Limit	2,000,000
Products - Completed Operations Aggregate Limit	2,000,000
Medical Expense Limit - Any One Person/Occurrence	10,000
Damage to Rented Premises - Each Occurrence	300,000
Personal and Advertising Injury	1,000,000
Business Personal Property	425,700
Automobile Liability:	
Combined Single Limit	1,000,000
Excess/Umbrella	
Each Occurrence	3,000,000
Aggregate Limit	3,000,000

Settled claims have not exceeded this commercial coverage in any prior years and there have been no significant reductions in insurance coverage during the year.

Note 8 – Purchased Services

For the year ending June 30, 2007, purchased service expenses were for the following services:

Service	Amount
Personnel Services	$600,300
Management Fee	193,493
Food Service	108,072
IT / Telephone	46,766
Professional Contractors	20,256
Advertising	4,729
Professional Development	15,347
Building Maintenance	12,565
Sponsor Fee	9,341
Nursing Services	6,584
Other Services	6,471
Professional Fees	5,716
Postage	3,136
Total	$1,032,776

Note 9 – Defined Benefit Pension Plans

The Academy has contracted with Mosaica Education, Inc. to provide employee services. However, these contracted services do not relieve the Academy of the obligation for remitting pension contributions. The retirement systems consider the School as the Employer-of-Record and the Academy is ultimately responsible for remitting retirement contributions to each of the systems.

<u>Note 9 – Defined Benefit Pension Plans</u> (continued)

A. School Employees Retirement System

The Academy contributes to the School Employees Retirement System (SERS), a cost-sharing multiple-employer defined benefit pension plan. SERS provides retirement and disability benefits, annual cost-of-living adjustments, and death benefits to plan members and beneficiaries. Authority to establish and amend benefits is provided by Chapter 3309 of the Ohio Revised Code. SERS issues a publicly available, stand-alone financial report that includes financial statements and required supplementary information. That report may be obtained by writing to the School Employees Retirement System, 300 East Broad Street, Suite 100, Columbus, Ohio 43215-3746, by calling (800) 878-5853 or by visiting the SERS website at: ohsers.org.

Plan members are required to contribute 10 percent of their annual covered salary and the Academy is required to contribute at an actuarially determined rate. The current Academy rate is 14 percent of annual covered payroll. A portion of the Academy's contribution is used to fund pension obligations with the remainder being used to fund health care benefits; for fiscal year 2007, 10.68 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 a statutory maximum amount, by the SERS' Retirement Board. The Academy's required contributions for pension obligations to SERS for the fiscal years ended June 30, 2007 and 2006 were $9,479 and $7,457 respectively; 47 percent of this amount has been contributed for fiscal year 2007 and 100 percent for fiscal year 2006.

B. State Teachers Retirement System

The Academy participates in the State Teachers Retirement System of Ohio (STRS Ohio), a cost-sharing, multiple-employer public employee retirement system. STRS Ohio provides retirement and disability benefits to members and death and survivor benefits to beneficiaries. STRS Ohio issues a stand-alone financial report that may be obtained by writing to STRS Ohio, 275 E. Broad St., Columbus, OH 43215-3371, by calling (614) 227-4090, or by visiting the STRS Ohio web site at www.strsoh.org.

New members have a choice of three retirement plans, 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 divided by an actuarially determined annuity factor. The DC Plan allows members to place all their member contributions and employer contributions equal to 10.5 percent of earned compensation into an investment account. Investment decisions are made by the member. A member is eligible to receive a retirement benefit at age 50 and termination of employment. The Combined Plan offers features of both 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. Benefits are established by Chapter 3307 of the Ohio Revised Code.

Note 9 – Defined Benefit Pension Plans (continued)

A DB or Combined Plan member with five or more years of 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, 2007, plan members were required to contribute 10 percent of their annual covered salaries. The Academy was required to contribute 14 percent; 13 percent was the portion used to fund pension obligations. For fiscal year 2006, the portion used to fund pension obligations was also 13 percent. Contribution rates are established by the State Teachers Retirement Board, upon recommendations 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 Academy's required contribution for pension obligations for the STRS Ohio for the fiscal years ended June 30, 2007 and 2006 were $49,305 and $45,500 respectively; 100 percent has been contributed for fiscal year 2007 and 100 percent has been contributed for fiscal year 2006. No employees contribute to the DCP and CP Plans.

Note 10 – Postemployment Benefits

The Academy 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-certified employees and their dependents through the School Employees Retirement System (SERS). Benefits include hospitalization, physicians' fees, prescription drugs and partial reimbursement of monthly Medicare premiums. Benefit provisions and the obligations to contribute are established by the Systems based on authority granted by State statute. Both systems are on a pay-as-you-go basis.

All STRS Ohio retirees who participated in the DB or Combined Plans and their dependents are eligible for health care coverage. 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 funds is included in the employer contribution rate, currently 14 percent of covered payroll. For the fiscal years ended June 30, 2007 and 2006, the STRS Ohio Board allocated employer contributions equal to one percent of covered payroll to the Health Care Stabilization Fund. For the Academy, this amount equaled $3,791 for fiscal year 2007.

STRS Ohio pays health care benefits from the Health Care Stabilization Fund. At June 30, 2006, (the latest information available) the balance in the Fund was $3.5 billion. For the fiscal year ended June 30, 2006, net health care costs paid by STRS Ohio were $282,743,000 and STRS Ohio had 119,184 eligible benefit recipients.

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. 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.

<u>Note 10 – Postemployment Benefits</u> (continued)

After the allocation for basic benefits, the remainder of the employer's 14 percent contribution is allocated to providing health care benefits. For the fiscal year ended June 30, 2007, employer contributions to fund health care benefits were 3.32 percent of covered payroll, compared to 3.42 percent of covered payroll for fiscal year 2006. 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 2007, the minimum pay was established at $35,800. However, the surcharge is capped at two percent of each employer's SERS salaries. For the Academy, the amount contributed to fund health care benefits, including the surcharge, during the fiscal year 2007 equaled $2,946.

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. The target level for the health care reserve is 150 percent of the projected claims less premium contributions for the next fiscal year. Expenses for health care for the fiscal year ended June 30, 2006 (the latest information available) were $158,751,207. At June 30, 2006, SERS had net assets available for payment of health care benefits of $295.6 million. SERS has 59,492 participants eligible to receive health care benefits.

<u>Note 11 - Contingencies</u>

A. Grants

The Academy received financial assistance from federal and state agencies in the form of grants. The disbursement of funds received under these programs generally requires compliance with terms and conditions specified in the grant agreements and 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 such disallowed claims will not have a material adverse effect on the overall financial position of the Academy at June 30, 2007.

B. Full Time Equivalency

The Ohio Department of Education conducts reviews of enrollment data and full-time equivalency (FTE) calculations made by community schools. These reviews are conducted to ensure the schools are reporting accurate student enrollment data to the State, upon which state foundation funding is calculated. The conclusions of this review could result in state funding being adjusted. A review conducted by the Ohio Department of Education reflected the Academy is owed $12,352 by the Ohio Department of Education. This is reported as an intergovernmental receivable on the June 30, 2007 Statement of Net Assets.

<u>Note 12 – Building Leases</u>

The Academy leases its premises on a month to month basis and may elect to terminate the lease with 180 days written notice. The base rent is $10,500 per month. In January 2007, Lorain Preparatory Academy assumed one half of the Academy's lease payments. The Lorain Preparatory Academy relocated in September 2007 and the Academy resumed full payment of the base rent. Base rent expense for the fiscal year ended 2007 was $82,917.

Note 13 – Long-Term Obligations

Changes in the Academy's long-term obligations during fiscal year 2007 were as follows:

	Balance 6/30/2006	Additions	Reductions	Balance 6/30/2007	Amount Due Within One Year
Capital Leases Payable	$ 97,970	$ -	$ (32,570)	$ 65,400	$ 36,968

Note 14 – Capital Lease-Lessee Disclosure

The Academy entered into three lease agreements in fiscal year 2006 with Relational LLC for technology equipment (computers) and furniture. The Academy's lease obligations met the criteria of a capital lease as defined by Statement of Financial Accounting Standards No. 13 "Accounting for Leases". The technology equipment and furniture have been capitalized in the amounts of $31,205 and $74,283 respectively, the present value of the minimum lease payments at the inception of the lease. The following is a schedule of the future long-term minimum lease payments required under the capital leases and the present value of the minimum lease payments are as follows:

Year Ending June 30	Technology	Furniture
2008	$12,780	$30,421
2009	9,585	20,281
Total future minimum lease payments	22,365	50,702
Less: amount representing interest	(2,613)	(5,054)
Present value of future minimum lease payments	$19,752	$45,648

A liability for capital lease obligations in the amount of $65,400 is reported on the Statement of Net Assets. Of this amount, $36,968 is a current liability due within one year and $28,432 is a long-term liability due in more than one year.

Note 15 –Tax Exempt Status.

The Academy has applied for tax-exempt status under Section 501(c)(3) of the Internal Revenue Code. The Academy has made no provision for any potential tax liability resulting from not obtaining the Section 501(c)(3) tax-exempt status.

Note 16 – Related Party Transactions/Management Company

The Academy contracts with Mosaica Education, Inc. for a variety of services including management of personnel and human resources, board relations, financial management, marketing, the program of instruction, purchasing, strategic planning, public relations, financial reporting, recruiting, compliance issues, budgets, contracts, and equipment and facilities. Financial management services include, but are not limited to, financial statement and budget preparation and accounts payable and payroll preparation.

Note 16 – Related Party Transactions/Management Company (continued)

Per the management agreement with the Academy, Mosaica Education is entitled to a management fee that is equivalent to 12.5% of the Academy's revenues. The management fee for fiscal year 2007 was $193,493. In addition, upon termination of the agreement due to nonperformance by either party, or in the event of nonrenewal upon expiration of the agreement, the Academy must pay Mosaica Education, Inc. $100,000 per year for three year consecutive years.

Also, per the management agreement there are expenses that will be billed to the Academy based on the actual costs incurred for the Academy by Mosaica Education, Inc. These expenses include rent, salaries of Mosaica Education, Inc. employees working at the Academy, and other costs related to providing educational and administrative services.

At June 30, 2007, the Academy had payables to Mosaica Education in the amount of $172,300. The following is a schedule of payables to Mosaica Education, Inc.

	Amount
Payroll	$164,768
Management Fee	2,500
Interest/Finance Charges	1,303
Miscellaneous	3,729
Total June 30, 2007	$172,300

Note 17 – Sponsor

The Academy was approved for operation under a contract with the St. Aloysius Orphanage (the Sponsor) for a period of five academic years commencing July 18, 2005. As part of this contract, the Sponsor is entitled to a maximum of 1% of the total state funds. Total amount due and paid for fiscal year 2007 was $9,341.

Note 18 – Management's Plan

For fiscal year 2007, the Academy had an increase in net assets of $160,871, a cumulative net asset deficit of ($7,927). Although the Academy saw a sizeable increase in its enrollment of 11.5% during 2008, the Academy expects a similar net asset balance thru fiscal year 2008. Management is projecting an increase in net assets for 2009 as a result of continued enrollment growth. Over time, management believes that continued enrollment growth should allow the school to continue its recovery from any deficits.

The unaudited financial statements at 6/30/2008 present a ($346,022) operating loss and a net assets deficit of ($102,996). At November 30, 2008, the Academy had a cash balance of $81,814.

Management plans to increase enrollment through active advertising via print, radio, mailings and through referrals of current parents which may increase enrollment, reduce future deficits and may lead to no operating losses in future years. Management has been successful in increasing enrollment at its other community schools in Ohio.

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

Academy of Arts and Sciences
Lorain County
201 West Erie Street
Lorain, Ohio 44052

To the Board of Directors:

We have audited the financial statements of the Academy of Arts and Sciences, Lorain County, Ohio (the Academy), as of and for the year ended June 30, 2007, and have issued our report thereon dated December 8, 2008, wherein we noted the Academy experienced certain financial difficulties. 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 as a basis for designing our audit procedures for expressing our opinion on the financial statements, but not to opine on the effectiveness of the Academy's internal control over financial reporting. Accordingly, we have not opined on the effectiveness of the Academy's internal control over financial reporting.

Our consideration of internal control over financial reporting was for the limited purpose described in the preceding paragraph and would not necessarily identify all deficiencies in internal control over financial reporting that might be significant deficiencies or material weaknesses. However, as discussed below, we identified certain deficiencies in internal control over financial reporting that we consider significant deficiencies.

A control deficiency exists when the design or operation of a control does not allow management or employees, in performing their assigned functions, to prevent or detect misstatements on a timely basis. A significant deficiency is a control deficiency, or combination of control deficiencies, that adversely affects the Academy's ability to initiate, authorize, record, process, or report financial data reliably in accordance with its applicable accounting basis, such that there is more than a remote likelihood that the Academy's internal control will not prevent or detect a more-than-inconsequential financial statement misstatement.

We consider the following deficiencies described in the accompanying schedule of findings to be significant deficiencies in internal control over financial reporting: 2007-001 and 2007-002.

A material weakness is a significant deficiency, or combination of significant deficiencies resulting in more than a remote likelihood that the Academy's internal control will not prevent or detect a material financial statement misstatement.

Our consideration of the internal control over financial reporting was for the limited purpose described in the first paragraph of this section and would not necessarily identify all deficiencies in the internal control that might be significant deficiencies and accordingly, would not necessarily disclose all significant deficiencies that are also material weaknesses. However, we believe the significant deficiencies described above are also material weaknesses.

We also noted a certain internal control matter that we reported to the Academy's management in a separate letter dated December 08, 2008.

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*.

We did note a certain noncompliance or other matter not requiring inclusion in this report that we reported to the Academy's management in a separate letter dated December 8, 2008.

The Academy's responses to the findings identified in our audit are described in the accompanying schedule of findings. We did not audit the Academy's responses and, accordingly, we express no opinion on them.

We intend this report solely for the information and use of management, Board of Directors, and the Community School's sponsor. We intend it for no one other than these specified parties.

Mary Taylor

Mary Taylor, CPA
Auditor of State

December 8, 2008

ACADEMY OF ARTS AND SCIENCES
LORAIN COUNTY

SCHEDULE OF FINDINGS
JUNE 30, 2007

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

FINDING NUMBER 2007-001

Board Monitoring—Significant Deficiency and Material Weakness

Mosaica Education, Inc., the Academy's management company, prepares monthly bank reconciliation and year-to-date and month-to-date budget versus actual financial reports that are presented to the Board of Directors. However, the Academy reports on a full accrual basis of accounting throughout the year and the revenue and expenditures reported on the budget versus actual reports include receivable and payable amounts outstanding. A Statement of Net Assets is not presented to the Board of Directors. Therefore, the Board of Directors can not monitor the Academy's assets, liabilities, and net assets throughout the year.

In addition, the management agreement entered into with Mosaica Education, Inc. states that the following services would be provided: management of personnel and human resources, board relations, financial management, marketing, the program of instruction, purchasing, strategic planning, public relation, financial reporting, recruiting, compliance issues, budgets, contracts, and equipment and facilities. Currently the Board does not have procedures in place to monitor the services being provided by Mosaica Education, Inc.

Monitoring comprises of regular management activities established to oversee whether management's financial objectives are being achieved. Data from financial reports provided by Mosaica Education, Inc may indirectly provide assurance as to the reliability of financial reporting information if it conforms to the users' expectation. Lack of effective legislative monitoring may lead to errors, irregularities, or misappropriation of the Academy's funds.

We recommend that the following items be reviewed and approved by the Board of Directors at the monthly meetings.

1. A Statement of Net Assets that reports the assets, liabilities, and net assets as of the last day of each month.
2. All invoices from Mosaica Education, Inc. and the supporting documentation of the expenses incurred by Mosaica Education, Inc. on behalf of the Academy. Supporting documentation should include payroll reports, the calculation of the management fee charged, rental agreements, and invoices of any other miscellaneous expenses billed to the Academy.

These items should be reviewed by the Board of Directors for any unusual or unexpected financial activity and for discrepancies between the Academy's Management Agreement and the actual services provided and billed by Mosaica Education, Inc. Appropriate follow-up should be made regarding any unusual balances or transactions.

Officials' Response:

Management submits monthly financial reports to the Board of the Academy. Until spring of 2008, those financial reports were just the statement of revenues and expenses comparing budget to actual, the bank reconciliations and a schedule of receipts and disbursements. In the spring of 2008, management expanded the monthly financial reporting package to include the following items: a balance sheet, statement of revenues and expenses comparing budget to actual, a detailed payables listing, bank reconciliations, check registers and management company invoices. In the past, the added reports were available to the Board upon request.

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

FINDING NUMBER 2007-001 (continued)

Board Monitoring—Significant Deficiency and Material Weakness (continued)

Officials' Response: (continued)

In addition to the monthly financial reporting package, the Board is provided a monthly report from management and the site administration regarding operational activities to provide the Board with the information it deems necessary to monitor the services and the outcomes of the services provided by management. Other monitoring of compliance from the Academy's sponsor is reported directly to the Academy's Board.

FINDING NUMBER 2007-002

Development and Implementation of Payroll Processing Procedures – Significant Deficiency and Material Weakness

Mosaica Education Incorporated developed payroll policies and procedures to be followed during the payroll process at the Academy. Based on a review of these policies we noted the following:

- Approval signatures of the Regional Vice President, (RVP), Chief Administrative Officer, (CAO), or their designees were type written on the Excel spreadsheet used to record the time worked by the school employees. We were unable to verify the validity of who approved the payroll;
- Personnel Action Forms (PAF's) were not always signed by the RVP, CAO, and employee as required by the payroll policies and procedures. Consequently; changes were made to the payroll master file without the required authorizations;
- Payroll records provided by the controller were incomplete;
- The Automated Data Processing (ADP) reports of payroll changes, by pay period and authorizing PAF's were not signed by the Assistant Controller as required;
- We were unable to locate evidence the Assistant Controller signed the payroll register to authenticate the reconciliation of the payroll to the general ledger;
- The Academy was not able to locate the sign in sheets/time sheets used for reporting payroll for the hourly employees;
- Payrolls for the audit period were processed and approved by the same individual;
- Payroll Policies and Procedures, under the school procedures section, require the CAO and RVP approve the time sheets before they are submitted. We could not locate the approval of the RVP; and
- Employees were allowed to work at additional positions prior to the approval and filing of the PAF's. When these documents were filed the employees received compensation for all additional hours worked.

Without the timely filing of properly completed forms, as outlined in the payroll policies and procedures, errors and omissions could occur and not be detected.

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

FINDING NUMBER 2007-002 (continued)

Development and Implementation of Payroll Processing Procedures - Significant Deficiency and Material Weakness (continued)

We recommend the following:

- Digital signatures be used to record approval signatures to payroll spreadsheets;
- A designated individual be responsible for ensuring all required signatures are on the Personnel Action Forms. Changes to the payroll standing data, based on the provisions of the policy and procedures for payroll, should not be made until all required signatures are on the form;
- To authenticate the payroll charges of hourly employees all sign in sheets should be filed and safeguarded. When completed the sign in sheets should be signed and dated by the responsible individual and secured as evidence of the accuracy of the payroll spreadsheets prepared;
- Complete payroll records should be maintained by the controller. Based on inquiry of the payroll officer all PAF's are forwarded to the controller when complete. Without a complete set of PAF forms the controller cannot attest to the accuracy of the semi-monthly payroll;
- ADP payroll reports and PAF's should be signed by the assistant controller to verify the accuracy of the posting to the payroll files;
- The CAO or the RVP of the Academy should institute procedures to help ensure the same individual is not preparing the payroll and approving the payroll;
- Prior to processing the payroll, the employees in the payroll department should ensure the appropriate signatures are affixed to the spreadsheets; and
- Employees should only be allowed to work additional or extra hours after the necessary approvals have been received.

Although the Board contracted with Mosaica Education, Inc. for the management of the Academy, the Board should review the payroll process and the final payroll amount to help verify the accuracy of the amount paid. In addition, the Board should participate in setting annual salaries and hourly wages of the employees.

Officials' Response:

- Management has been having the Chief Administrative Officer forward the payroll spreadsheets with their approval of the information being submitted prior to payroll being processed. Since the payroll spreadsheets are excel files that are used for uploading pay information to ADP, management cannot use paper copies with manual signatures and digital signatures can be copied and pasted. In order for someone to e-mail approval from the CAO's e-mail account without the CAO's knowledge, they would need to be able to log-in to the CAO's computer, which is unlikely because of policies prohibiting sharing of passwords.

- The payroll accountant monitors PAFs to ensure that the required signatures are obtained prior to processing for entry into the payroll system. PAFs no longer get processed without the CAO's signature or e-mail approving them.

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

FINDING NUMBER 2007-002 (continued)

Development and Implementation of Payroll Processing Procedures - Significant Deficiency and Material Weakness (continued)

Officials' Response: (continued)

- In the past, PAFs were submitted to the accounting office immediately upon receipt. Management has changed that procedure and payroll is submitting PAFs to accounting after the necessary salary proration calculations have been completed. That way, instead of having PAFs being released prior to accuracy verification and approval verification, the PAFs maintained in accounting match the final PAFs that are processed in payroll. This will ensure that all payroll records are available upon request by auditor.

- It would appear that the procedures that the Auditor of State reviewed were procedures for processing Mosaica corporate staff payroll, not school payrolls. Sign off of the ADP report of payroll changes is not a step required for school payrolls as those payrolls are processed at a different site than the Mosaica corporate staff payroll.

- The original journal postings maintained in accounting include the name of the accountant that posted the payroll to the accounting records. As part of the posting process the accountant does each pay period, a reconciliation is generated and attached to the Journal Entry support.

- Sign in sheets that were unable to be located from the first and part of the second year of operations are still missing. Site personnel are now maintaining hourly personnel time sheets and salary personnel sign in logs in the administrative office.

- The procedures that have been in place from the start of the Academy do not permit access to ADP software for anyone outside the payroll department. Accordingly, it is not possible for the site staff that prepare the payroll spreadsheets to also process payroll in ADP. This segregation of duties provides a layer of controls ensuring checks or direct deposits are not being generated for non-existent staff.

- As noted in the first recommendation response, prior to the payroll department processing payroll, they receive an e-mail verification that the Chief Administrative Officer has reviewed and approves the payroll spreadsheets as submitted.

- Management agrees that PAFs should be approved and submitted to the payroll department in a timely manner so that personnel are not performing extra duty services with the expectation of compensation without a written agreement clearly communicating the agreed upon pay and approved hours.

ACADEMY OF ARTS AND SCIENCES
LORAIN COUNTY

SCHEDULE OF PRIOR AUDIT FINDINGS
JUNE 30, 2007

Finding Number	Finding Summary	Fully Corrected?	Not Corrected, Partially Corrected; Significantly Different Corrective Action Taken; or Finding No Longer Valid; ***Explain***
2006-001	Ohio Rev. Code Section 117.38 – Financial Report Filing	Yes	
2006-002	Ohio Rev. Code Section 1702.15 – Books, Records of Accounts, and Minutes	Yes	
2006-003	Ohio Rev. Code Section 3314.02(E) – Governing Board Membership	Yes	
2006-004	Development and Implementation of Payroll Processing Procedures	No	Not corrected, reissued as 2007-002

Mary Taylor, CPA
Auditor of State

ACADEMY OF ARTS AND SCIENCES

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
JANUARY 13, 2009