



**Auditor of State
Betty Montgomery**

**ERIE-HURON-OTTAWA EDUCATIONAL SERVICE CENTER
ERIE COUNTY**

TABLE OF CONTENTS

TITLE	PAGE
Independent Accountants' Report.....	1
Management's Discussion and Analysis.....	3
Basic Financial Statements:	
Government-Wide Financial Statements:	
Statement of Net Assets	13
Statement of Activities	14
Fund Financial Statements:	
Balance Sheet - Governmental Funds.....	16
Reconciliation of Total Governmental Fund Balances to Net Assets of Governmental Activities.....	17
Statement of Revenues, Expenditures, and Changes in Fund Balances - Governmental Funds	18
Reconciliation of Statement of Revenues, Expenditures, and Changes in Fund Balances of Governmental Funds to the Statement of Activities	19
Statement of Revenues, Expenditures, and Changes in Fund Balance - Budget (Non-GAAP Basis) and Actual Comparison - General Fund	20
Statement of Net Assets - Fiduciary Funds	21
Statement of Changes in Fiduciary Net Assets - Investment Trust Fund	22
Notes to the Basic Financial Statements	23
Schedule of Federal Awards Expenditures.....	43
Notes to the Schedule of Federal Awards Expenditures	44
Independent Accountants' Report on Compliance and on Internal Control Required by <i>Government Auditing Standards</i>	45
Independent Accountants' Report on Compliance with Requirements Applicable to Major Federal Programs and Internal Control Over Compliance in Accordance with OMB Circular A-133	47
Schedule of Findings.....	49

This page intentionally left blank.



**Auditor of State
Betty Montgomery**

INDEPENDENT ACCOUNTANT'S REPORT

Erie-Huron-Ottawa Educational Service Center
Erie County
2900 Columbus Avenue
Sandusky, Ohio 44870-5569

To the Governing Board:

We have audited the accompanying financial statements of the governmental activities, each major fund, and the aggregate remaining fund information of the Erie-Huron-Ottawa Educational Service Center, Erie County, (the Service Center), as of and for the year ended June 30, 2004, which collectively comprise the Service Center's basic financial statements as listed in the table of contents. These financial statements are the responsibility of the Service Center's management. Our responsibility is to express opinions on these financial statements based on our audit.

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

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

In accordance with *Government Auditing Standards*, we have also issued our report dated March 4, 2005, on our consideration of the Service Center's internal control over financial reporting and our tests of its compliance with certain provisions of laws, regulations, contracts, and grants. That report is an integral part of an audit performed in accordance with *Government Auditing Standards* and should be read in conjunction with this report in considering the results of our audit.

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

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



Betty Montgomery
Auditor of State

March 4, 2005

**ERIE-HURON-OTTAWA EDUCATIONAL SERVICE CENTER
ERIE COUNTY**

**MANAGEMENT'S DISCUSSION AND ANALYSIS
FOR THE FISCAL YEAR ENDED JUNE 30, 2004**

The discussion and analysis of the Erie-Huron-Ottawa Educational Service Center's (the ESC) financial performance provides an overall review of the ESC's financial activities for the fiscal year ended June 30, 2004. The intent of this discussion and analysis is to look at the ESC's financial performance as a whole; readers should also review the basic financial statements and the notes to the basic financial statements to enhance their understanding of the ESC's financial performance.

Financial Highlights

Key financial highlights for 2004 are as follows:

- In total, net assets of governmental activities decreased \$496,296 which represents a 50.83 percent decrease from 2003.
- General revenues accounted for \$3,355,179 in revenue or 19.32 percent of all revenues. Program specific revenues in the form of charges for services and sales, grants and contributions accounted for \$14,007,244 or 80.68 percent of total revenues of \$17,362,423.
- The ESC had \$17,858,719 in expenses related to governmental activities; only \$14,007,244 of these expenses was offset by program specific charges for services, grants, or contributions. General revenues supporting governmental activities (unrestricted grants and entitlements) of \$3,355,179 were not adequate to provide for these programs.
- The ESC's only major governmental fund is the general fund. The general fund had \$14,749,459 in revenues and other financing sources and \$15,383,958 in expenditures and other financing uses. During fiscal 2004, the general fund's fund balance decreased \$634,499 from \$1,056,459 to \$421,960.

Using these Basic Financial Statements (BFS)

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

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

Reporting the ESC as a Whole

Statement of Net Assets and the Statement of Activities

While this document contains the large number of funds used by the ESC to provide programs and activities, the view of the ESC as a whole looks at all financial transactions and asks the question, "How did we do financially during 2004?" The Statement of Net Assets and the Statement of Activities answer this question. These statements include all assets, liabilities, revenues, and expenses using the accrual

**ERIE-HURON-OTTAWA EDUCATIONAL SERVICE CENTER
ERIE COUNTY**

MANAGEMENT'S DISCUSSION AND ANALYSIS
FOR THE FISCAL YEAR ENDED JUNE 30, 2004
(Continued)

basis of accounting similar to the accounting used by most private-sector companies. This basis of accounting will take into account all of the current year's revenues and expenses regardless of when cash is received or paid.

These two statements report the ESC's net assets and changes in those assets. This change in net assets is important because it tells the reader that, for the ESC as a whole, the financial position of the ESC has improved or diminished. The causes of this change may be the result of many factors, some financial, some not. Non-financial factors include increased or decreased services desired by school districts, state budget cuts, required educational programs and other factors.

In the Statement of Net Assets and the Statement of Activities, the Governmental Activities include the ESC's programs and services, including instruction, support services, and other operations.

Reporting the ESC's Most Significant Funds

Fund Financial Statements

Fund financial reports provide detailed information about the ESC's major funds. The ESC uses many funds to account for a multitude of financial transactions. However, these fund financial statements focus on the ESC's most significant funds. The ESC's only major governmental fund is the general fund.

Governmental Funds

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

Reporting the ESC's Fiduciary Responsibilities

The ESC is the fiscal agent of the area A-site, NOECA. This activity is presented as an investment trust fund. The ESC also maintains agency funds to account for monies due to other governments, individuals, or private organizations. All of the ESC's fiduciary activities are reported in a separate Statement of Fiduciary Net Assets. The investment trust funds activities for fiscal 2004 are also reported in a separate Statement of Changes in Fiduciary Net Assets. These activities are excluded from the ESC's other financial statements because the assets cannot be utilized by the ESC to finance its operations.

Notes to the Basic Financial Statements

The notes provide additional information that is essential to a full understanding of the data provided in the government-wide and fund financial statements.

The ESC as a Whole

The Statement of Net Assets provides the perspective of the ESC as a whole.

**ERIE-HURON-OTTAWA EDUCATIONAL SERVICE CENTER
ERIE COUNTY**

MANAGEMENT'S DISCUSSION AND ANALYSIS
FOR THE FISCAL YEAR ENDED JUNE 30, 2004
(Continued)

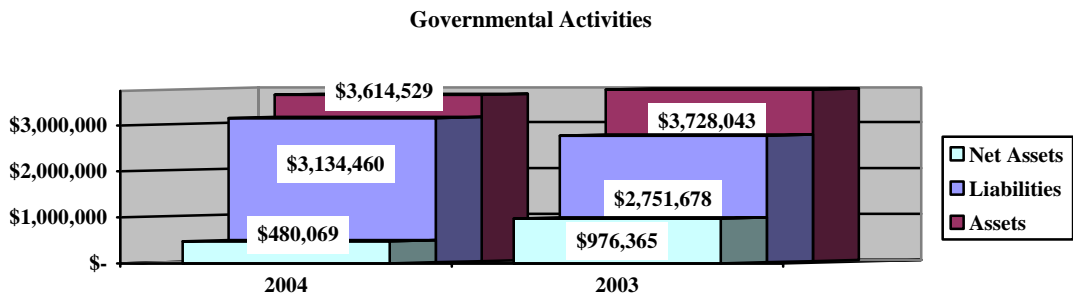
The table below provides a summary of the ESC's net assets for 2004 and 2003.

	Net Assets	
	Governmental Activities 2004	Governmental Activities 2003
Assets		
Current and other assets	\$ 3,182,812	\$ 3,266,714
Capital assets, net	431,717	461,329
<i>Total assets</i>	<u>3,614,529</u>	<u>3,728,043</u>
Liabilities		
Current liabilities	2,091,925	1,911,431
Long-term liabilities	1,042,535	840,247
<i>Total liabilities</i>	<u>3,134,460</u>	<u>2,751,678</u>
Net Assets		
Invested in capital assets	431,717	461,329
Restricted	2,645	9,240
Unrestricted	45,707	505,796
<i>Total net assets</i>	<u>\$ 480,069</u>	<u>\$ 976,365</u>

Over time, net assets can serve as a useful indicator of a government's financial position. At June 30, 2004, the ESC's assets exceeded liabilities by \$480,069. Of this total, \$2,645 is restricted in use.

At year-end, capital assets represented 11.94 percent of total assets. Capital assets include a building, furniture and equipment and vehicles. Capital assets, net of accumulated depreciation at June 30, 2004, were \$431,717. These capital assets are used to provide the ESC's services and are not available for future spending.

A portion of the ESC's net assets, \$2,645, represents resources that are subject to external restriction on how they may be used. The remaining balance of unrestricted net assets of \$45,707 may be used to meet the ESC's ongoing obligations to the students and creditors.



**ERIE-HURON-OTTAWA EDUCATIONAL SERVICE CENTER
ERIE COUNTY**

MANAGEMENT'S DISCUSSION AND ANALYSIS
FOR THE FISCAL YEAR ENDED JUNE 30, 2004
(Continued)

The table below shows the change in net assets for fiscal year 2004 and 2003.

	Change in Net Assets	
	Governmental Activities 2004	Governmental Activities 2003
Revenues		
Program revenues:		
Charges for services and sales	\$ 12,067,633	\$ 11,316,927
Operating grants and contributions	1,923,784	2,228,354
Capital grants and contributions	15,827	15,827
General revenues:		
Grants and entitlements	3,322,948	2,831,279
Investment earnings	31,236	50,798
Gain on sale of capital assets	230	-
Other	765	8,116
<i>Total revenues</i>	<u>17,362,423</u>	<u>16,451,301</u>
Expenses		
Program expenses:		
Instruction:		
Regular	111,266	143,866
Special	4,906,527	4,405,296
Support services:		
Pupil	4,140,717	4,025,743
Instructional staff	6,924,671	6,804,537
Board of education	66,659	54,846
Administration	718,432	731,162
Fiscal	338,227	267,565
Business	175,783	176,486
Operations and maintenance	295,940	281,902
Pupil transportation	2,102	33,006
Central	55,923	93,655
Operations of non-instructional services	20,344	17,202
Extracurricular activities	8,816	6,332
Intergovernmental	93,312	75,417
<i>Total expenses</i>	<u>17,858,719</u>	<u>17,117,015</u>
<i>Decrease in net assets</i>	<u>\$ (496,296)</u>	<u>\$ (665,714)</u>

Governmental Activities

Net assets of the ESC's governmental activities decreased \$496,296. Total governmental expenses of \$17,858,719 were not completely offset by program revenues of \$14,007,244 and general revenues of \$3,355,179. Program revenues supported 80.68 percent of the total governmental expenses. The main

**ERIE-HURON-OTTAWA EDUCATIONAL SERVICE CENTER
ERIE COUNTY**

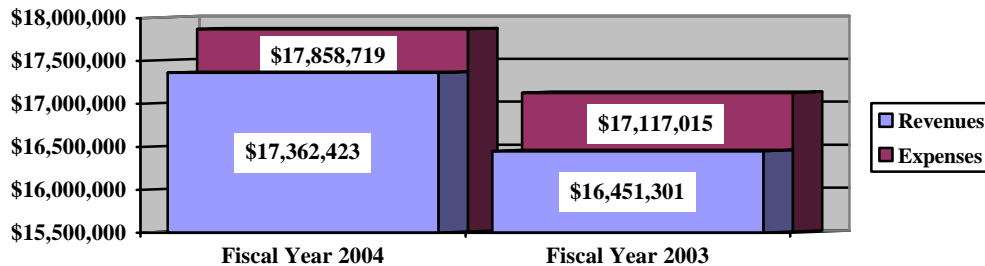
MANAGEMENT'S DISCUSSION AND ANALYSIS
FOR THE FISCAL YEAR ENDED JUNE 30, 2004
(Continued)

reasons for the decrease in net assets can be attributed to a large increase in compensated absences liability, a reduction in capital assets from depreciation, and an increase in current liabilities for accrued wages and benefits. Also, there is less cash and cash equivalents compared to 2003 as expenditures were more than revenues and governmental fund balances were reduced.

The primary sources of revenue for governmental activities are derived from contracted fees for services provided to other entities. This revenue source represents 69.51 percent of total governmental revenue.

The graph below presents the ESC's governmental activities revenue and expenses for fiscal year 2004.

Governmental Activities - Revenues and Expenses



The Statement of Activities shows the cost of program services and the charges for services and grants offsetting those services. The following table shows, for governmental activities, the total cost of services and the net cost of services. That is, it identifies the cost of these services supported by unrestricted State grants and entitlements, and other general revenues not restricted to a specific program.

	Governmental Activities			
	Total Cost of Services 2004	Net Cost of Services 2004	Total Cost of Services 2003	Net Cost of Services 2003
Program expenses				
Instruction:				
Regular	\$ 111,266	\$ 12,673	\$ 143,866	\$ 11,611
Special	4,906,527	787,756	4,405,296	785,508
Support services:				
Pupil	4,140,717	814,250	4,025,743	650,258
Instructional staff	6,924,671	1,243,923	6,804,537	975,886
Board of education	66,659	66,659	54,846	54,846

(Continued)

**ERIE-HURON-OTTAWA EDUCATIONAL SERVICE CENTER
ERIE COUNTY**

MANAGEMENT'S DISCUSSION AND ANALYSIS
FOR THE FISCAL YEAR ENDED JUNE 30, 2004
(Continued)

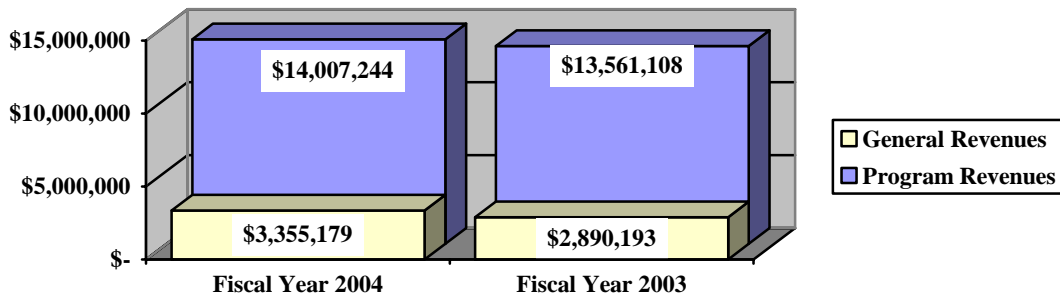
Governmental Activities (Continued)

	Total Cost of Services 2004	Net Cost of Services 2004	Total Cost of Services 2003	Net Cost of Services 2003
Administration	718,432	93,056	731,162	379,345
Fiscal	338,227	287,919	267,565	261,680
Business	175,783	175,783	176,486	176,486
Operations and maintenance	295,940	274,605	281,902	228,070
Pupil transportation	2,102	2,102	33,006	5,929
Central	55,923	55,923	93,655	20,173
Operations of non-instructional services	20,344	(48,739)	17,202	(1,441)
Extracurricular activities	8,816	(2,888)	6,332	(638)
Intergovernmental	93,312	88,453	75,417	8,194
<i>Total expenses</i>	<u>\$ 17,860,723</u>	<u>\$ 3,853,479</u>	<u>\$ 17,119,018</u>	<u>\$ 3,557,910</u>

For all governmental activities, program revenue support is 78.43 percent. The primary support of the ESC is contracted fees for services provided to other districts.

The graph below presents the ESC's governmental activities revenue for fiscal year 2004.

Governmental Activities - General and Program Revenues



The ESC's Funds

The ESC's governmental funds (as presented on the balance sheet) reported a combined fund balance of \$700,957, which is lower than last year's total of \$1,303,562. The schedule below indicates the fund balance and the total change in fund balance as of June 30, 2004 and 2003.

	Fund Balance June 30, 2004	Fund Balance June 30, 2003	Increase (Decrease)
General	\$ 421,960	\$ 1,056,459	\$ (634,499)
Other Governmental	278,997	247,103	31,894
<i>Total</i>	<u>\$ 700,957</u>	<u>\$ 1,303,562</u>	<u>\$ (602,605)</u>

**ERIE-HURON-OTTAWA EDUCATIONAL SERVICE CENTER
ERIE COUNTY**

MANAGEMENT'S DISCUSSION AND ANALYSIS
FOR THE FISCAL YEAR ENDED JUNE 30, 2004
(Continued)

General Fund

The ESC's general fund balance decreased by \$634,499. While the ESC received additional revenues in 2004 from charges to other District's, the decrease in fund balance can be attributed to an increase in costs associated with the additional contract services provided to Districts and increases in Instruction expense for accrued salaries and benefits. The table that follows assists in illustrating the financial activities and fund balance of the general fund.

	2004 Amount	2003 Amount	Percentage Change
Revenues			
Tuition	\$ 21,134	\$ 90,592	(76.67) %
Services provided to other entities	11,696,834	10,782,201	8.48 %
Earnings on investments	31,020	50,423	(38.48) %
Intergovernmental	2,965,287	2,831,279	4.73 %
Other revenues	34,954	26,655	31.13 %
<i>Total</i>	<u>\$ 14,749,229</u>	<u>\$ 13,781,150</u>	7.02 %
Expenditures			
Instruction	\$ 4,105,042	\$ 3,678,348	11.60 %
Support services	11,129,007	10,671,138	4.29 %
Operation of non-instructional services	-	6,581	(100.00) %
Facilities acquisition and construction	140,224	133,439	5.08 %
<i>Total</i>	<u>\$ 15,374,273</u>	<u>\$ 14,489,506</u>	6.11 %

General Fund Budgeting Highlights

The ESC's budget is prepared according to Ohio law and is based on accounting for certain transactions on a basis of cash receipts, disbursements, and encumbrances. The most significant budgeted fund is the general fund.

During the course of fiscal 2004, the ESC did not amend its general fund budgeted revenues. For the general fund, original and final budgeted revenues and other financing sources were \$14,609,221. Actual revenues and other financing sources for fiscal 2004 were \$14,790,417. This represents an \$181,196 increase over the original and final budgeted revenues. Services provided to other entities was \$1,516,241 more than budgeted due the ESC not anticipating providing as much services as occurred in 2004, thus more amounts billed to the Districts. Also, the ESC's General Fund actual revenues from State and Federal sources were \$1,330,753 less than anticipated due to reduced amounts received from the Title XIX (Medicaid) Federal Program due to the ESC being behind in submitting bills for services and a significant reduction in State aid provided to the ESC.

General fund original budgeted expenditures and other financing uses of \$16,902,253 were increased to \$16,983,415 in the final budget. The actual budget basis expenditures and other financing uses for fiscal year 2004 totaled \$15,049,484, which was \$1,933,931 less than the final budget appropriations. The ESC budgeted \$649,675 for contingency purposes as miscellaneous use of funds and never had to use this account. Also, \$994,139 was not spent from the budgets of Support Services Pupil and Support Services Instructional staff. The ESC anticipated more expenditures on the cash basis for salaries and benefits in these areas than actually occurred.

**ERIE-HURON-OTTAWA EDUCATIONAL SERVICE CENTER
ERIE COUNTY**

MANAGEMENT'S DISCUSSION AND ANALYSIS
FOR THE FISCAL YEAR ENDED JUNE 30, 2004
(Continued)

Capital Assets

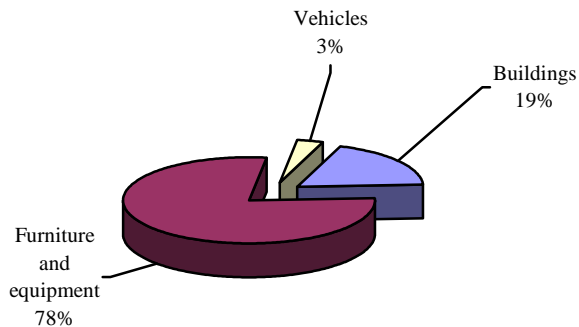
At the end of fiscal 2004, the ESC had \$431,717 invested in buildings, furniture and equipment, and vehicles. This entire amount is reported in governmental activities. The following table shows fiscal 2004 balances compared to 2003:

	Capital Assets at June 30 (Net of Depreciation)	
	Governmental Activities	
	2004	2003
Buildings	\$ 80,700	\$ 82,500
Furniture and equipment	336,826	358,037
Vehicles	14,191	20,792
<i>Total</i>	<u>\$ 431,717</u>	<u>\$ 461,329</u>

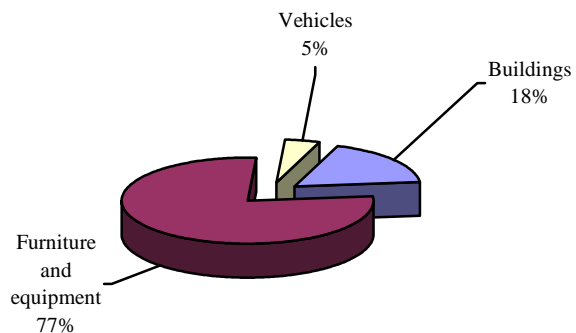
Total additions to capital assets for 2004 were \$67,340. A total of \$96,952 in depreciation expense was recognized for fiscal 2004.

The graphs below present the District's capital assets for fiscal 2004 and fiscal 2003.

**Capital Assets - Governmental Activities
2003**



**Capital Assets - Governmental Activities
2004**



See Note 6 to the basic financial statements for additional information on the ESC's capital assets.

Current Financial Related Activities

The Erie-Huron-Ottawa Educational Service Center relies heavily on contracts with local, city and exempted village school districts in the three-county area, state foundation revenue, and grants. Contracts with participating districts are expected to increase in fiscal year 2005 and beyond due to additional service requests from districts. The ESC also looks to expand providing fiscal, administrative,

**ERIE-HURON-OTTAWA EDUCATIONAL SERVICE CENTER
ERIE COUNTY**

MANAGEMENT'S DISCUSSION AND ANALYSIS
FOR THE FISCAL YEAR ENDED JUNE 30, 2004
(Continued)

and other services to entities. Currently some of those entities are the Northern Ohio Educational Computer Association, Bay Area Gas Consortium, and Ohio Effective Schools. These new contracts and expanded services along with the ESC's cash balance will provide the necessary funds to meet operating expenses in the future.

One challenge that is being faced by Educational Service Centers is the legislation regarding Ohio's Regional Education Delivery System and the implementation of that system by the Ohio Department of Education. This system will directly affect the Educational Service Centers and their funding mechanism. The Ohio Department of Education has submitted a report to the legislature. What effect this legislation will have on future state funding and on ESC financial operations is uncertain at this time.

Under state law, the County Commissioners are no longer required to provide rent-free space to ESC's. The Erie-Huron-Ottawa ESC Governing Board has negotiated a four-year rental agreement, however beyond that there may be a need to acquire new space or to pay a much higher rent for our current space.

Another challenge facing the Erie-Huron-Ottawa Educational Service Center is the declining enrollment in Erie, Huron, and Ottawa Counties over the past several years and the projected decline in the future. State foundation funding is based on the ADM of the school districts in the counties, so the continued decline will directly impact state funding.

Contacting the ESC's Financial Management

This financial report is designed to provide the citizen's supported by the districts, and investors and creditors with a general overview of the ESC's finances and to show the ESC's accountability for the money it receives. If you have questions about this report or need additional financial information contact Ms. Betty Schwiefert, Treasurer, Erie-Huron-Ottawa Educational Service Center, 2900 S. Columbus Avenue, Sandusky, Ohio 44870-5569 or by calling (419) 625-6274.

This page intentionally left blank.

**ERIE-HURON-OTTAWA EDUCATIONAL SERVICE CENTER
ERIE COUNTY**

STATEMENT OF NET ASSETS
JUNE 30, 2004

	Governmental Activities
Assets:	
Equity in pooled cash and cash equivalents	\$ 2,314,801
Receivables:	
Accounts	3,178
Intergovernmental	850,226
Prepayments	14,607
Depreciable capital assets, net	431,717
<i>Total assets</i>	3,614,529
Liabilities:	
Accounts payable	70,154
Accrued wages and benefits	1,700,174
Pension obligation payable	263,279
Intergovernmental payable	57,968
Deferred revenue	350
Long-term liabilities:	
Due within one year	167,279
Due within more than one year	875,256
<i>Total liabilities</i>	3,134,460
Net Assets:	
Invested in capital assets	431,717
Restricted for:	
Permanent endowment	2,645
Unrestricted (deficit)	45,707
<i>Total net assets</i>	\$ 480,069

SEE ACCOMPANYING NOTES TO THE BASIC FINANCIAL STATEMENTS

**ERIE-HURON-OTTAWA EDUCATIONAL SERVICE CENTER
ERIE COUNTY**

STATEMENT OF ACTIVITIES
FOR THE FISCAL YEAR ENDED JUNE 30, 2004

	Expenses
Governmental activities:	
Instruction:	
Regular	\$ 111,266
Special	4,906,527
Support services:	
Pupil	4,140,717
Instructional staff	6,924,671
Board of education	66,659
Administration	718,432
Fiscal	338,227
Business	175,783
Operations and maintenance	295,940
Pupil transportation	2,102
Central	55,923
Operation of non-instructional services	20,344
Extracurricular activities	8,816
Intergovernmental	93,312
<i>Total governmental activities</i>	\$ 17,858,719

SEE ACCOMPANYING NOTES TO THE BASIC FINANCIAL STATEMENTS

<u>Charges for Services and Sales</u>	<u>Program Revenues</u>		<u>Net (Expense) Revenue and Changes in Net Assets</u>
	<u>Operating Grants and Contributions</u>	<u>Capital Grants and Contributions</u>	
\$ 70,453	\$ 28,140	\$ -	\$ (12,673)
3,349,636	769,135	-	(787,756)
3,259,621	33,944	-	(847,152)
4,917,613	728,657	-	(1,278,401)
-	-	-	(66,659)
386,693	238,683	-	(93,056)
1,088	49,220	-	(287,919)
-	-	-	(175,783)
5,508	-	15,827	(274,605)
-	-	-	(2,102)
-	-	-	(55,923)
60,458	8,625	-	48,739
11,704	-	-	2,888
4,859	67,380	-	(21,073)
<u>\$ 12,067,633</u>	<u>\$ 1,923,784</u>	<u>\$ 15,827</u>	<u>(3,851,475)</u>

General Revenues:

Grants and entitlements not restricted to specific programs	3,322,948
Investment earnings	31,236
Gain on sale of capital assets	230
Miscellaneous	765
<i>Total general revenues</i>	<u>3,355,179</u>
<i>Change in net assets</i>	(496,296)
Net assets at beginning of year	976,365
<i>Net assets at end of year</i>	<u>\$ 480,069</u>

**ERIE-HURON-OTTAWA EDUCATIONAL SERVICE CENTER
ERIE COUNTY**

BALANCE SHEET
GOVERNMENTAL FUNDS
JUNE 30, 2004

	General	Other Governmental Funds	Total Governmental Funds
Assets:			
Equity in pooled cash and cash equivalents	\$ 1,914,318	\$ 400,483	\$ 2,314,801
Receivables:			
Accounts	3,178	-	3,178
Intergovernmental	848,094	2,132	850,226
Prepayments	14,249	358	14,607
<i>Total assets</i>	<u>\$ 2,779,839</u>	<u>\$ 402,973</u>	<u>\$ 3,182,812</u>
Liabilities:			
Accounts payable	\$ 11,655	\$ 58,499	\$ 70,154
Accrued wages and benefits	1,647,227	52,947	1,700,174
Compensated absences payable	45,229	-	45,229
Pension obligation payable	198,470	6,601	205,071
Intergovernmental payable	53,571	4,397	57,968
Deferred revenue	401,727	1,532	403,259
<i>Total liabilities</i>	<u>2,357,879</u>	<u>123,976</u>	<u>2,481,855</u>
Fund Balances:			
Reserved for encumbrances	68,237	59,165	127,402
Reserved for prepayments	14,249	358	14,607
Reserved for principal endowment	-	2,645	2,645
Unreserved, undesignated, reported in:			
General fund	339,474	-	339,474
Special revenue funds	-	216,829	216,829
<i>Total fund balances</i>	<u>421,960</u>	<u>278,997</u>	<u>700,957</u>
<i>Total liabilities and fund balances</i>	<u>\$ 2,779,839</u>	<u>\$ 402,973</u>	<u>\$ 3,182,812</u>

SEE ACCOMPANYING NOTES TO THE BASIC FINANCIAL STATEMENTS

**ERIE-HURON-OTTAWA EDUCATIONAL SERVICE CENTER
ERIE COUNTY**

RECONCILIATION OF TOTAL GOVERNMENTAL FUND BALANCES TO
NET ASSETS OF GOVERNMENTAL ACTIVITIES
JUNE 30, 2004

Total governmental fund balances		\$ 700,957
Amounts reported for governmental activities in the statement of net assets are different because:		
Capital assets used in governmental activities are not financial resources and therefore are not reported in the funds.		431,717
Other long-term assets are not available to pay for current-period expenditures and therefore are deferred in the funds.		
Accounts	\$ 45,248	
Intergovernmental	357,661	
<i>Total</i>	402,909	402,909
Long-term liabilities are not due and payable in the current period and therefore are not reported in the funds.		
Compensated absences	997,306	
Pension obligation	58,208	
<i>Total</i>	(1,055,514)	(1,055,514)
<i>Net assets of governmental activities</i>		\$ 480,069

SEE ACCOMPANYING NOTES TO THE BASIC FINANCIAL STATEMENTS

**ERIE-HURON-OTTAWA EDUCATIONAL SERVICE CENTER
ERIE COUNTY**

STATEMENT OF REVENUES, EXPENDITURES, AND CHANGES IN FUND BALANCES
GOVERNMENTAL FUNDS
FOR THE FISCAL YEAR ENDED JUNE 30, 2004

	<u>General</u>	<u>Other Governmental Funds</u>	<u>Total Governmental Funds</u>
Revenues:			
From local sources:			
Services provided to other entities	\$ 11,696,834	\$ 296,616	\$ 11,993,450
Tuition	21,134	-	21,134
Earnings on investments	31,020	216	31,236
Extracurricular	-	14,272	14,272
Contributions and donations	-	9,625	9,625
Other local revenues	34,954	90	35,044
Intergovernmental - intermediate sources	4,576	556,893	561,469
Intergovernmental - state	2,322,866	1,188,892	3,511,758
Intergovernmental - federal	637,845	203,318	841,163
<i>Total revenue</i>	<u>14,749,229</u>	<u>2,269,922</u>	<u>17,019,151</u>
Expenditures:			
Current:			
Instruction:			
Regular	-	107,881	107,881
Special	4,105,042	797,470	4,902,512
Support Services:			
Pupil	4,021,459	42,501	4,063,960
Instructional staff	5,911,949	786,350	6,698,299
Board of education	66,659	-	66,659
Administration	435,208	245,255	680,463
Fiscal	284,802	51,075	335,877
Business	159,908	-	159,908
Operations and maintenance	241,582	45,292	286,874
Pupil transportation	-	52	52
Central	7,440	49,365	56,805
Operation of non-instructional services	-	20,344	20,344
Extracurricular activities	-	8,816	8,816
Facilities acquisition and construction	140,224	-	140,224
Intergovernmental pass through	-	93,312	93,312
<i>Total expenditures</i>	<u>15,374,273</u>	<u>2,247,713</u>	<u>17,621,986</u>
<i>Excess of revenues over (under) expenditures</i>	<u>(625,044)</u>	<u>22,209</u>	<u>(602,835)</u>
Other financing sources (uses):			
Transfers in	-	9,685	9,685
Transfers out	(9,685)	-	(9,685)
Proceeds from sale of capital assets	230	-	230
<i>Total other financing sources (uses)</i>	<u>(9,455)</u>	<u>9,685</u>	<u>230</u>
<i>Net change in fund balances</i>	<u>(634,499)</u>	<u>31,894</u>	<u>(602,605)</u>
Fund balances at beginning of year	1,056,459	247,103	1,303,562
<i>Fund balances at end of year</i>	<u>\$ 421,960</u>	<u>\$ 278,997</u>	<u>\$ 700,957</u>

SEE ACCOMPANYING NOTES TO THE BASIC FINANCIAL STATEMENTS

**ERIE-HURON-OTTAWA EDUCATIONAL SERVICE CENTER
ERIE COUNTY**

RECONCILIATION OF THE STATEMENT OF REVENUES, EXPENDITURES,
AND CHANGES IN FUND BALANCES OF GOVERNMENTAL FUNDS
TO THE STATEMENT OF ACTIVITIES
FOR THE FISCAL YEAR ENDED JUNE 30, 2004

Net change in fund balances - total governmental funds \$ (602,605)

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

Governmental funds report capital outlays as expenditures. However, in the statement of activities, the cost of those assets is allocated over their estimated useful lives as depreciation expense. This is the amount by which depreciation expenses (\$96,952) exceeds capital outlays (\$67,340) in the current period. (29,612)

Revenues in the statement of activities that do not provide current financial resources are not reported as revenues in the funds. 351,188

Some expenses reported in the statement of activities, such as compensated absences and pension obligations, do not require the use of current financial resources and therefore are not reported as expenditures in governmental funds. (215,267)

Change in net assets of governmental activities \$ (496,296)

SEE ACCOMPANYING NOTES TO THE BASIC FINANCIAL STATEMENTS

**ERIE-HURON-OTTAWA EDUCATIONAL SERVICE CENTER
ERIE COUNTY**

STATEMENT OF REVENUES, EXPENDITURES, AND CHANGES IN FUND BALANCE
BUDGET AND ACTUAL COMPARISON (NON-GAAP BUDGETARY BASIS)
GENERAL FUND
FOR THE FISCAL YEAR ENDED JUNE 30, 2004

	<u>Budgeted Amounts</u>			Variance with Final Budget Positive (Negative)
	<u>Original</u>	<u>Final</u>	<u>Actual</u>	
Revenues:				
From local sources:				
Services provided to other entities	\$ 10,280,000	\$ 10,280,000	\$ 11,796,241	\$ 1,516,241
Tuition	18,000	18,000	21,685	3,685
Earnings on investments	46,020	46,020	31,020	(15,000)
Other local revenues	42,500	42,500	34,954	(7,546)
Intergovernmental - intermediate sources	-	-	4,576	4,576
Intergovernmental - state	3,312,701	3,312,701	2,322,866	(989,835)
Intergovernmental - federal	900,000	900,000	559,082	(340,918)
<i>Total revenue</i>	<u>14,599,221</u>	<u>14,599,221</u>	<u>14,770,424</u>	<u>171,203</u>
Expenditures:				
Current:				
Instruction:				
Special	4,089,530	4,116,974	4,060,552	56,422
Support Services:				
Pupil	4,152,220	4,180,334	3,891,068	289,266
Instructional staff	6,419,995	6,450,306	5,745,433	704,873
Board of education	76,600	86,671	67,770	18,901
Administration	435,750	436,101	408,947	27,154
Fiscal	311,400	325,279	291,177	34,102
Business	227,550	202,456	157,337	45,119
Operations and maintenance	300,955	329,426	262,708	66,718
Central	11,000	11,000	8,680	2,320
Facilities acquisition and construction	211,578	177,990	140,224	37,766
<i>Total expenditures</i>	<u>16,236,578</u>	<u>16,316,537</u>	<u>15,033,896</u>	<u>1,282,641</u>
<i>Excess of revenues under expenditures</i>	<u>(1,637,357)</u>	<u>(1,717,316)</u>	<u>(263,472)</u>	<u>1,453,844</u>
Other financing sources (uses):				
Refund of prior year expenditure	10,000	10,000	19,763	9,763
Refund of prior year receipts	(3,000)	(5,903)	(5,903)	-
Transfers out	(10,000)	(10,000)	(9,685)	315
Advances out	(3,000)	(1,300)	-	1,300
Other miscellaneous use of funds	(649,675)	(649,675)	-	649,675
Proceeds from sale of capital assets	-	-	230	230
<i>Total other financing sources (uses)</i>	<u>(655,675)</u>	<u>(656,878)</u>	<u>4,405</u>	<u>661,283</u>
<i>Net change in fund balance</i>	<u>(2,293,032)</u>	<u>(2,374,194)</u>	<u>(259,067)</u>	<u>2,115,127</u>
Fund balance at beginning of year	2,018,033	2,018,033	2,018,033	-
Prior year encumbrances appropriated	81,161	81,161	81,161	-
<i>Fund balance at end of year</i>	<u>\$ (193,838)</u>	<u>\$ (275,000)</u>	<u>\$ 1,840,127</u>	<u>\$ 2,115,127</u>

SEE ACCOMPANYING NOTES TO THE BASIC FINANCIAL STATEMENTS

**ERIE-HURON-OTTAWA EDUCATIONAL SERVICE CENTER
ERIE COUNTY**

STATEMENT OF NET ASSETS
FIDUCIARY FUNDS
JUNE 30, 2004

	Investment Trust	Agency
Assets:		
Equity in pooled cash and cash equivalents	\$ 1,024,968	\$ 1,145,125
Receivables:		
Accounts	-	48
Intergovernmental	-	4,760
<i>Total assets</i>	1,024,968	\$ 1,149,933
 Liabilities:		
Deposits held and due to others	-	\$ 1,082,974
Due to other governments	-	66,959
<i>Total liabilities</i>	-	\$ 1,149,933
 Net Assets:		
Net assets available for pool participants	1,024,968	
<i>Total net assets</i>	\$ 1,024,968	

SEE ACCOMPANYING NOTES TO THE BASIC FINANCIAL STATEMENTS

**ERIE-HURON-OTTAWA EDUCATIONAL SERVICE CENTER
ERIE COUNTY**

STATEMENT OF CHANGES IN FIDUCIARY NET ASSETS
INVESTMENT TRUST FUND
FOR THE FISCAL YEAR ENDED JUNE 30, 2004

	<u>Investment Trust</u>
Net increase in net assets resulting from operations	\$ 12,333
Distributions paid to participants	(12,333)
Share transactions:	
Purchase of units	2,887,015
Redemptions of units	<u>(2,831,953)</u>
Net increase in net assets and shares resulting from share transactions	<u>55,062</u>
<i>Change in net assets</i>	55,062
Net assets at beginning of year	<u>969,906</u>
<i>Net assets at end of year</i>	<u><u>\$ 1,024,968</u></u>

SEE ACCOMPANYING NOTES TO THE BASIC FINANCIAL STATEMENTS

**ERIE-HURON-OTTAWA EDUCATIONAL SERVICE CENTER
ERIE COUNTY**

**NOTES TO THE BASIC FINANCIAL STATEMENTS
FOR THE FISCAL YEAR ENDED JUNE 30, 2004**

1. DESCRIPTION OF THE ESC

The Erie-Huron-Ottawa Educational Service Center (the ESC) is a body politic and corporate established for the purpose of exercising the rights and privileges conveyed to it by the Constitution and laws of the State of Ohio. The ESC is an Educational Service Center as defined by § 3311.05 of the Ohio Revised Code. The ESC operates under an elected Governing Board of Education (eleven members) and is responsible for the provision of public education to residents of the local school districts that it services.

The ESC is the result of the July 1, 1997, merger of the Erie County Educational Service Center and the Ottawa County Educational Service Center, and the July 1, 1999, merger of the Erie-Ottawa Educational Service Center and the Huron County Educational Service Center, under the authority of the Ohio Revised Code Section 3311.053 and 3311.054 and resolutions made by the Governing Boards.

The ESC is staffed by 198 certified employees, 193 classified employees and 39 administrators.

2. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

The basic financial statements of the ESC have been prepared in conformity with accounting principles generally accepted in the United States of America (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 ESC also applies Financial Accounting Standards Board (FASB) Statements and Interpretations issued on or before November 30, 1989, to its governmental activities provided they do not conflict with or contradict GASB pronouncements. The ESC's significant accounting policies are described below.

A. Reporting Entity

The reporting entity has been defined in accordance with GASB Statement No. 14, "*The Financial Reporting Entity*". The reporting entity is composed of the primary government, component units and other organization that are included to ensure that the basic financial statements of the ESC are not misleading. The primary government consists of all funds, departments, boards, and agencies that are not legally separate from the ESC. For the ESC, this includes general operations and student related activities of the ESC.

Component units are legally separate organizations for which the ESC is financially accountable. The ESC is financially accountable for an organization if the ESC appoints a voting majority of the organizations' government board and (1) the ESC is able to significantly influence the programs or services performed or provided by the organization; or (2) the ESC is legally entitled to or can otherwise have access to organizations resources; or (3) the ESC is legally obligated or has otherwise assumed the responsibility to finance the deficits of, or provide financial support to, the organization; or (4) the ESC is obligated for the debt of the organization. Component units may also include organizations that are fiscally dependent on the ESC in that the ESC approves the budget, the issuance of debt or the levying of taxes. Based upon the application of these criteria, the ESC has no component units. The basic financial statements of the reporting entity include only those of the ESC (the primary government). The following organizations are described due to their relationship to the ESC:

**ERIE-HURON-OTTAWA EDUCATIONAL SERVICE CENTER
ERIE COUNTY**

NOTES TO THE BASIC FINANCIAL STATEMENTS
FOR THE FISCAL YEAR ENDED JUNE 30, 2004
(Continued)

JOINTLY GOVERNED ORGANIZATIONS

Bay Area Council of Governments

The Bay Area Council of Governments (BACG) is a jointly governed organization. Members of the BACG consist of 26 school districts representing 7 counties (Ottawa, Sandusky, Seneca, Erie, Huron, Wood, and Crawford). The BACG was formed for the purpose of purchasing goods and services at a lower cost. The items currently being purchased through the council of governments are natural gas and insurance. The only cost to the ESC is an administrative charge if it participates in purchasing through the BACG. The membership of BACG consists of the superintendent of each participating school district. The Board of Directors of the BACG consists of one elected representative of each county, the superintendent of the fiscal agent and two non-voting members (administrator and fiscal agent). Members of the Board serve staggered two-year terms. The ESC serves as fiscal agent for the BACG. Financial activity for fiscal 2004 is reported in the basic financial statements as an agency fund.

Northern Ohio Educational Computer Association

The Northern Ohio Educational Computer Association (NOECA) is a jointly governed organization, which is a computer consortium. NOECA is an association of 41 public school districts formed for the purpose of applying modern technology (with the aid of computers and other electronic equipment) to administrative and instructional functions among member school district. The NOECA Board of Directors consists of two representatives from each county in which participating school districts are located, the chairman of each of the operating committees, and a representative from the fiscal agent. The ESC serves as fiscal agent for NOECA. Financial activity for 2004 is reported in the basic financial statements as an investment trust fund.

PUBLIC ENTITY RISK POOLS

Ohio Association of School Business Officials Workers' Compensation Group Rating Plan

The ESC participates in a group rating plan for workers' compensation as established under § 4123.29 of the Ohio Revised Code. The Ohio Association of School Business Officials Workers' Compensation Group Rating Plan (the Plan) was established through the Ohio Association of School Business Officials (OASBO) as a group purchasing pool.

The Executive Director of the OASBA, or his designee, serves as coordinator of the Plan. Each year, the participating school district pays an enrollment fee to the Plan to cover the costs of administering the program

Huron-Erie School Employees Insurance Association

The Huron-Erie School Employees Insurance Association (Association) is a public entity risk pool comprised of 14 districts. The Association assembly consists of a superintendent or designated representative from each participating district and the program administrator. The Association is governed by a board of directors chosen from the general membership. The degree of control exercised by any participating district is limited to its representation on the board. Financial information can be obtained by contacting the program administrator at the

**ERIE-HURON-OTTAWA EDUCATIONAL SERVICE CENTER
ERIE COUNTY**

NOTES TO THE BASIC FINANCIAL STATEMENTS
FOR THE FISCAL YEAR ENDED JUNE 30, 2004
(Continued)

Huron-Erie School Employees Insurance Association, located at 2900 Columbus Avenue, Sandusky, Ohio 44870.

The San-Ott School Employees Welfare Benefit Association (Consortium)

The ESC participates in a shared risk pool, with participants from Sandusky and Ottawa counties. The Consortium is governed by an assembly which consists of one representative from each participant (usually the superintendent or designee). The assembly exercises control over the operation of the consortium. All consortium revenues are generated from charges for services. Financial information can be obtained by writing to San-Ott Consortium, Jay Valasek, Treasurer of Vanguard-Sentinel Vocational Schools, at 1306 Cedar Street, Fremont, Ohio 43420.

B. Fund Accounting

The ESC uses funds to maintain its financial records during the year. A fund is defined as a fiscal and accounting entity with a self balancing set of accounts. There are three categories of funds: governmental, proprietary and fiduciary. The ESC does not have any proprietary funds.

GOVERNMENTAL FUNDS

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

General Fund - The general fund is used to account for all financial resources except those required to be accounted for in another fund. The general fund balance is available for any purpose provided it is expended or transferred according to the general laws of Ohio.

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

FIDUCIARY FUNDS

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

**ERIE-HURON-OTTAWA EDUCATIONAL SERVICE CENTER
ERIE COUNTY**

NOTES TO THE BASIC FINANCIAL STATEMENTS
FOR THE FISCAL YEAR ENDED JUNE 30, 2004
(Continued)

C. Basis of Presentation and Measurement Focus

Government-wide Financial Statements - The statement of net assets and the statement of activities display information about the ESC as a whole. These statements include the financial activities of the primary government, except for fiduciary funds.

The government-wide statement of activities presents a comparison between direct expenses and program revenues for each function or program of the governmental activities of the ESC. Direct expenses are those that are specifically associated with a service, program, or department and therefore clearly identifiable to a particular function. Program revenues include amounts paid by the recipient of goods or services offered by the program and grants and contributions that are restricted to meeting the operational or capital requirements of a particular program. Revenues not classified as program revenues are presented as general revenues of the ESC.

The government-wide financial statements are prepared using the economic resources measurement focus. All assets and all liabilities associated with the operation of the ESC are included on the statement of net assets.

Fund Financial Statements - Fund financial statements report detailed information about the ESC. The focus of governmental fund financial statements is on major funds rather than reporting funds by type. Each major fund is presented in a separate column, and all nonmajor funds are aggregated into one column. Fiduciary funds are reported by fund type.

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

Fiduciary funds are reported using the economic resources measurement focus. Agency funds do not report a measurement focus as they do not report operations.

D. Basis of Accounting

Basis of accounting determines when transactions are recorded in the financial records and reported on the financial statements. Government-wide financial statements are prepared using the accrual basis of accounting. Governmental funds use the modified accrual basis of accounting. Fiduciary funds also use the accrual basis of accounting.

Revenues - Exchange and Non-exchange Transactions - Revenue resulting from exchange transactions, in which each party gives and receives essentially equal value, are recorded on the accrual basis when the exchange takes place. On a modified accrual basis, revenue is recorded in the fiscal year in which the resources are measurable and become available. Available means that the resources will be collected within the current fiscal year or are expected to be collected soon enough thereafter to be used to pay liabilities of the current

**ERIE-HURON-OTTAWA EDUCATIONAL SERVICE CENTER
ERIE COUNTY**

NOTES TO THE BASIC FINANCIAL STATEMENTS
FOR THE FISCAL YEAR ENDED JUNE 30, 2004
(Continued)

fiscal year. For the ESC, available means expected to be received within sixty days of fiscal year-end.

Nonexchange transactions, in which the ESC receives value without directly giving equal value in return, include grants, entitlements, and donations.

Revenue from grants, entitlements, and donations is recognized in the fiscal year in which all eligibility requirements have been satisfied. Eligibility requirements include timing requirements, which specify the year when the resources are required to be used or the fiscal year when use is first permitted, matching requirements, in which the ESC must provide local resources to be used for a specified purpose, and expenditure requirements, in which the resources are provided to the ESC on a reimbursement basis. On a modified accrual basis, revenue from nonexchange transactions must also be available before it can be recognized.

Under the modified accrual basis, the following revenue sources are considered to be both measurable and available at fiscal year-end: tuition, grants, and contract services.

Deferred Revenue - Deferred revenue arises when assets are recognized before revenue recognition criteria have been satisfied. Contractual services provided by the ESC during the fiscal year for which payment is not received in the available period. Grants and entitlements received before the eligibility requirements are met are also recorded as deferred revenue.

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

Expenses/Expenditures - On the accrual basis of accounting, expenses are recognized at the time they are incurred.

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

E. Budgets

The ESC adopts its budget on or before the start of the new fiscal year. Included in the budget are the estimated resources and expenditures for each fund. Upon review by the ESC's Governing Board, the annual appropriation resolution is adopted. After the start of the fiscal year, the estimated resources are revised and accepted by the Board to include any unencumbered cash balances from the preceding year. Both the estimated resources and appropriations may be amended or supplemented throughout the year as circumstances warrant.

In the first quarter of each fiscal year, the ESC summarizes and certifies its budget on forms furnished by the State Department of Education, together with such other information as the State Department of Education may require. The summarized budget document consists of three parts. Part (A) includes entitlement funding from the state for the cost of salaries, employer's retirement contributions, and travel expenses of supervisory teachers approved by the State Department of Education. Part (B) includes the cost of all other lawful expenditures of the ESC. Part (C) includes the adopted appropriation resolution of the ESC. The State

**ERIE-HURON-OTTAWA EDUCATIONAL SERVICE CENTER
ERIE COUNTY**

NOTES TO THE BASIC FINANCIAL STATEMENTS
FOR THE FISCAL YEAR ENDED JUNE 30, 2004
(Continued)

Board of Education reviews the budget and certifies to each local board of education under the supervision of the ESC the amount from part (B) that is to be apportioned to their district.

The ESC is funded by the State Department of Education for the cost of Part (A) of their budget. This funding is provided from state resources.

Part (B) of the budget is provided by the school districts served by the ESC, and by the State Department of Education. Each school district's portion is determined by multiplying the average daily membership of the school district (the total number of students enrolled) by \$6.50. This amount is deducted by the State Department of Education from that school district's resources provided under the State's Foundation Program. The Department of Education's portion is determined by multiplying the sum of the average daily memberships of all of the school district's served by the ESC by \$40.52. This amount is provided from state Resources.

If additional funding is needed for the ESC, and if a majority of the Boards of Education of the school districts served by the ESC approve, the cost of Part (B) of the budget can be increased. The portion that is in excess of the original funding calculation is shared by all of the school districts served by the ESC through additional reductions in their resources provided through the State Foundation Program. The State Board of Education initiates and supervises the procedure under which the school districts approve or disapprove the additional apportionment. The districts in Erie County to which the ESC provides service have agreed to pay \$9.50 per pupil, or an additional \$3.00 per pupil, to provide additional funding for services provided by the ESC.

APPROPRIATIONS

The annual appropriation resolution is legally enacted by the ESC's Governing Board at the fund level of expenditures, which is the legal level of budgetary control. Prior to the passage of the annual appropriation measure, the ESC may pass a temporary appropriation measure to meet the ordinary expenses of the ESC. The appropriation resolution, by fund, must be within the estimated resources, and the total of expenditures and encumbrances may not exceed the appropriation totals at any level of control. Any revisions that alter the total of any fund appropriation must be approved by the ESC's Governing Board.

The ESC's Governing Board may pass supplemental fund appropriations so long as the total appropriations by fund do not exceed the amounts set forth in the budget approved by the state Department of Education. The budget figures which appear in the statements of budgetary comparisons represent the final appropriation amounts, including all supplemental appropriations. Formal budgetary integration is employed as a management control device during the year for all funds, consistent with statutory provisions. All supplemental appropriations were legally enacted by the Governing Board during fiscal 2004.

Encumbrance accounting, under which purchase orders, contracts, and other commitments for the expenditure of monies are recorded in order to reserve that portion of the applicable appropriation, is employed as an extension of formal budgetary control in the appropriated governmental funds. Encumbrances outstanding at year-end are reported as reservations of fund balance for subsequent year expenditures on the modified accrual basis of accounting compared to encumbrances outstanding at year-end reported as expenditures on the budget

**ERIE-HURON-OTTAWA EDUCATIONAL SERVICE CENTER
ERIE COUNTY**

NOTES TO THE BASIC FINANCIAL STATEMENTS
FOR THE FISCAL YEAR ENDED JUNE 30, 2004
(Continued)

basis of accounting. Note 11 provides a reconciliation of the budgetary and GAAP basis of accounting.

F. Cash and Investments

To improve cash management, cash received by the ESC is pooled in a central bank account. Monies for all funds are maintained in this pool. Individual fund integrity is maintained through the ESC's records. Each fund's interest in the pool is presented as "Equity in Pooled Cash and Cash Equivalents" on the financial statements.

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

Under existing Ohio statutes all investment earning are assigned to the general fund unless statutorily required to be credited to a specific fund. The Board of Education has, by resolution, specified the funds to receive an allocation of interest earnings. Interest revenue credited to the general fund during fiscal year 2004 amounted to \$31,020, which includes \$12,591 assigned from other ESC funds.

For presentation on the basic financial statements, investments of the cash management pool and investments with original maturities of three months or less at the time they are purchased by the ESC are considered to be cash equivalents. Investments with an initial maturity of more than three months are reported as investments.

An analysis of the ESC's investment account at fiscal year-end is provided in Note 4.

G. Capital Assets

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

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 ESC maintains a capitalization threshold of five hundred dollars. The ESC does not possess any infrastructure. Improvements are capitalized; the costs of normal maintenance and repairs that do not add to the value of the asset or materially extend an asset's life are not.

All reported capital assets are depreciated. Improvements are depreciated over the remaining useful lives of the related capital assets. Depreciation is computed using the straight-line method over the following useful lives:

**ERIE-HURON-OTTAWA EDUCATIONAL SERVICE CENTER
ERIE COUNTY**

NOTES TO THE BASIC FINANCIAL STATEMENTS
FOR THE FISCAL YEAR ENDED JUNE 30, 2004
(Continued)

Description	Governmental Activities Estimated Lives
Building/improvements	30 - 50 years
Furniture and equipment	5 - 20 years
Vehicles	6 - 10 years

H. Compensated Absences

Compensated absences of the ESC consist of vacation leave and sick leave to the extent that payment to the employee for these absences are attributable to services already rendered and are not contingent on a specific event that is outside the control of the ESC and the employee.

In accordance with the provisions of GASB Statement No. 16, "*Accounting for Compensated Absences*", a liability for vacation leave is accrued if (a) the employees' rights to payment are attributable to services already rendered; and (b) it is probable that the employer will compensate the employees for the benefits through paid time off or other means, such as cash payment at termination or retirement. A liability for severance is accrued using the vesting method; i.e., the liability is based on the sick leave accumulated at June 30, 2004, by those employees who are currently eligible to receive termination (severance) payments, as well as those employees expected to become eligible in the future. For purposes of establishing a liability for severance on employees expected to become eligible to retire in the future, all employees at least 50 years of age with 10 years of service or any age with at least 20 years of service were considered expected to become eligible to retire in accordance with GASB Statement No. 16.

The total liability for vacation and severance payments has been calculated using pay rates in effect at June 30, 2004, and reduced to the maximum payment allowed by labor contract and/or statute, plus any applicable additional salary related payments.

The entire compensated absence liability is reported on the government-wide financial statements.

For governmental fund financial statements, compensated absences are recognized as liabilities and expenditures as payments come due each period upon the occurrence of employee resignations and retirements.

I. Accrued Liabilities and Long-Term Obligations

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

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

**ERIE-HURON-OTTAWA EDUCATIONAL SERVICE CENTER
ERIE COUNTY**

NOTES TO THE BASIC FINANCIAL STATEMENTS
FOR THE FISCAL YEAR ENDED JUNE 30, 2004
(Continued)

J. Fund Balance Reserves

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

K. Net Assets

Net assets represent the difference between assets and liabilities. Net assets invested in capital assets consist of capital assets, net of accumulated depreciation. Net assets are reported as restricted when there are limitations imposed on their use either through the enabling legislation or through external restrictions imposed by creditors, grantors or laws or regulations of other governments.

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

L. Prepayments

Certain payments to vendors reflect the costs applicable to future accounting periods and are recorded as prepaid items in both government-wide and fund financial statements. These items are reported as assets on the balance sheet using the consumption method. A current asset for the prepaid amounts is recorded at the time of the purchase and the expenditure/expense is reported in the year in which services are consumed. At fiscal year-end, because prepayments are not available to finance future governmental fund expenditures, the funds balance is reserved on the fund financial statements by an amount equal to the carrying amount of the asset.

M. Estimates

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

N. Interfund Activity

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

O. Extraordinary and Special Items

Extraordinary items are transactions or events that are both unusual in nature and infrequent in occurrence. Special items are transactions or events that are within the control of the Board of

**ERIE-HURON-OTTAWA EDUCATIONAL SERVICE CENTER
ERIE COUNTY**

NOTES TO THE BASIC FINANCIAL STATEMENTS
FOR THE FISCAL YEAR ENDED JUNE 30, 2004
(Continued)

Education and that are either unusual in nature or infrequent in occurrence. Neither type of transaction occurred during fiscal 2004.

3. ACCOUNTABILITY AND COMPLIANCE

Deficit Fund Balances

Fund balances at June 30, 2004 included the following individual fund deficits:

	<u>Deficit</u>
Nonmajor Funds	
Preschool Grant (State)	\$ 1,452
Management Information Systems	60
Title I	24,765
Alternative Learning	53
Miscellaneous State Grants	21,186
Preschool Grant (Federal)	205

These funds complied with Ohio state law, which does not permit a cash basis deficit at year-end. The general fund is liable for any deficits in these funds and provides transfers when cash is required, not when accruals occur. The deficit fund balances results from adjustments for accrued liabilities.

4. EQUITY IN POOLED CASH AND CASH EQUIVALENTS

The ESC maintains a cash and investment pool used by all funds. Each fund type's portion of this pool is displayed on the financial statements as "Equity in Pooled Cash and Cash Equivalents". Statutes require the classification of monies held by the ESC into three categories.

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

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

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

Protection of the ESC's deposits is provided by the Federal Deposit Insurance Corporation (FDIC), by eligible securities pledged by the finance institution as security for repayment, by surety company bonds deposited with the Treasurer by the financial institution or by a single collateral

**ERIE-HURON-OTTAWA EDUCATIONAL SERVICE CENTER
ERIE COUNTY**

NOTES TO THE BASIC FINANCIAL STATEMENTS
FOR THE FISCAL YEAR ENDED JUNE 30, 2004
(Continued)

pool established by the financial institution to secure the repayment of all public monies deposited with the institution.

Interim monies may be deposited or invested in the following securities:

1. United States Treasury Notes, Bills, Bonds, or any other obligation or security issued by the United States Treasury or any other obligation guaranteed as to principal or interest by the United States;
2. Bonds, notes, debentures, or any other obligations or securities issued by any federal government agency or instrumentality, including but not limited to, the Federal National Mortgage Association, Federal Home Loan Bank, Federal Farm Credit Bank, Federal Home Loan Mortgage Corporation, Government National Mortgage Association, and Student Loan Marketing Association. All federal agency securities shall be direct issuances of federal government agencies or instrumentalities;
3. Written repurchase agreements in the securities listed above provided that the market value of the securities subject to the repurchase agreement must exceed the principal value of the agreement by at least 2 percent and be marked to market daily, and that the term of the agreement must not exceed thirty days;
4. Bonds and other obligations of the State of Ohio;
5. No-load money market mutual funds consisting exclusively of obligations described in division (1) or (2) of this section and repurchase agreements secured by such obligations, provided that investments in securities described in this division are made only through eligible institutions;
6. The State Treasury Asset Reserve of Ohio (STAR Ohio);
7. Certain bankers' acceptances and commercial paper notes for a period not to exceed 180 days in an amount not to exceed 25 percent of the interim monies available for investment at any one time; and
8. Under limited circumstances, corporate debt instrument rated in either of the two highest rating classifications by at least two nationally recognized rating agencies.

Investments in stripped principal or interest obligations, reverse repurchase agreements, and derivatives are prohibited. The issuance of taxable notes for the purpose of arbitrage, the use of leverage and short selling are also prohibited. An investment must mature within five years from the date of purchase unless matched to a specific obligation or debt of the ESC, and must be purchased with the expectation that it will be held to maturity. Investments may only be made through specified dealers and institutions. Payment for investments may be made only upon delivery of the securities representing the investments to the Treasurer or qualified trustee or, if the securities are not represented by a certificate, upon receipt of confirmation of transfer from the custodian.

Cash on Hand: At fiscal year-end, the ESC had \$43 in undeposited cash on hand which is included on the financial statements of the ESC as part of "Equity in Pooled Cash and Cash Equivalents".

**ERIE-HURON-OTTAWA EDUCATIONAL SERVICE CENTER
ERIE COUNTY**

NOTES TO THE BASIC FINANCIAL STATEMENTS
FOR THE FISCAL YEAR ENDED JUNE 30, 2004
(Continued)

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

Deposits: At year-end, the carrying amount of the ESC's deposits was \$152,462 and the bank balance was \$290,504. Of the bank balance:

1. \$100,000 was covered by federal depository insurance; and
2. \$190,504 was covered by collateral held by a qualified third party in the name of the Service Center.

Investments: The ESC's investments are categorized below to give an indication of the level of custodial credit risk assumed by the entity at fiscal year-end. Category 1 includes investments that are insured or registered or securities held by the ESC. Category 2 includes uninsured and unregistered investments for which the securities are held by the counterparty's trust department or agent in the ESC's name. Category 3 includes uninsured and unregistered investments for which the securities are held by the counterparty or by its trust department, but not in the ESC's name.

The ESC had investments of \$4,332,389 in STAR Ohio at June 30, 2004. STAR Ohio is not categorized because it is not evidenced by securities that exist in physical or book entry form.

The classification of cash and cash equivalents and investments on the financial statements is based on criteria set forth in GASB Statement No. 9. A reconciliation between the classifications of cash and investments on the basic financial statements and the classification per GASB Statement No. 3 is as follows:

	Cash and Cash Equivalents/ Deposits	Investments
GASB Statement No. 9	\$ 4,484,894	\$ -
Investments of the cash management pool:		
Investment in STAR Ohio	(4,332,389)	4,332,389
Cash on hand	(43)	-
GASB Statement No. 3	\$ 152,462	\$ 4,332,389

5. RECEIVABLES

Receivables at June 30, 2004 consisted of intergovernmental (billings to School Districts for user charged services) and accounts (charges for individual tuition on other services). All receivables are considered collectible in full. A summary of the principal items of receivables reported on the statement of net assets follows:

Governmental Activities:	
Intergovernmental	\$ 850,226
Accounts	3,178

Receivables have been disaggregated on the face of the basic finance statements. All receivables are expected to be collected within the subsequent year.

**ERIE-HURON-OTTAWA EDUCATIONAL SERVICE CENTER
ERIE COUNTY**

NOTES TO THE BASIC FINANCIAL STATEMENTS
FOR THE FISCAL YEAR ENDED JUNE 30, 2004
(Continued)

6. CAPITAL ASSETS

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

	Balance 06/30/03	Additions	Deductions	Balance 06/30/04
Capital assets, being depreciated:				
Buildings	\$ 90,000	\$ -	\$ -	\$ 90,000
Furniture and equipment	828,461	67,430	(9,886)	886,005
Vehicles	58,439	-	-	58,439
<i>Total capital assets, being depreciated</i>	<u>976,900</u>	<u>67,430</u>	<u>(9,886)</u>	<u>1,034,444</u>
Less: accumulated depreciation				
Buildings	(7,500)	(1,800)	-	(9,300)
Furniture and equipment	(470,424)	(88,551)	9,886	(549,089)
Vehicles	(37,647)	(6,601)	-	(44,248)
<i>Total accumulated depreciation</i>	<u>(515,571)</u>	<u>(96,952)</u>	<u>9,886</u>	<u>(602,637)</u>
<i>Governmental activities capital assets, net</i>	<u>\$ 461,329</u>	<u>\$ (29,522)</u>	<u>\$ -</u>	<u>\$ 431,807</u>

Depreciation expense was charged to governmental functions as follows:

Instruction:	
Regular	\$ 3,915
Special	21,356
Support Services:	
Pupil	7,557
Instructional staff	35,547
Administration	8,172
Fiscal	1,255
Business	14,056
Operations and maintenance	3,936
Pupil Transportation	1,158
<i>Total depreciation expense</i>	<u>\$ 96,952</u>

7. LONG-TERM OBLIGATIONS

The ESC's long-term obligations at fiscal year-end consist of the following:

	Balance Outstanding 06/30/03	Additions	Reductions	Balance Outstanding 06/30/04	Amounts Due in One Year
Compensated absences	<u>\$ 840,247</u>	<u>\$ 379,945</u>	<u>\$ (177,657)</u>	<u>\$ 1,042,535</u>	<u>\$ 167,279</u>

**ERIE-HURON-OTTAWA EDUCATIONAL SERVICE CENTER
ERIE COUNTY**

NOTES TO THE BASIC FINANCIAL STATEMENTS
FOR THE FISCAL YEAR ENDED JUNE 30, 2004
(Continued)

Compensated absences will be paid from the fund from which the employee's salaries are paid.

8. RISK MANAGEMENT

A. The ESC is exposed to various risks of loss related to torts, theft of, damage to, and destruction of assets, errors, and omissions, injuries to employees and natural disasters. During fiscal year 2004, the ESC has contracted with various insurance commercial carriers to provide insurance coverage for the following risks:

- Commercial property.
- Inland marine.
- Business liability.
- Business personal property.
- Business auto.
- Education liability.

Settled claims have not exceeded this commercial coverage in any of the past three years. There has been no significant reduction in coverage from the prior year.

B. Employee Health Benefits

The ESC provides employee health care benefits through the Huron-Erie School Employees Insurance Association. However, employees originally employed by the former Ottawa County Educational Service Center have benefits provided through the San-Ott School Employees Welfare Benefit Association.

The ESC has contracted with the Huron-Erie School Employees Insurance Association (Association) to provide medical/surgical, dental, vision, and life insurance benefits for its employees and their covered dependents. The Association is a shared risk pool comprised of 14 school districts that provide public education within Erie and Huron Counties. The ESC's pay monthly contributions that are placed in a common fund from which eligible claims and expenses are paid for employees of participating school districts and their covered dependents. Claims are paid for all participants regardless of claims flow.

In the event of withdrawal, the ESC shall assume and be responsible for payment of all claims of its eligible employees, families, and dependents from the effective date of withdrawal, regardless of when such claims were incurred, processed, or presented to the Association, insurance provider, insurance consultant, or any other appropriate or authorized person or representative; provided further, any such claims, which are paid after the effective date of withdrawal by the Association insurance provider or insurance consultant, or charged to such parties, shall be reimbursed in full by any withdrawing member upon demand of the Association.

The ESC has contracted the San-Ott Schools Employee Welfare Benefit Association (the Association), to provide medical/surgical, dental, and life insurance benefits for the eligible employees employed by the former Ottawa County Educational Service Center and their dependents. The ESC pays premiums to the Association based upon the benefits structure selected. The Association Trust Agreement provides that the Association will be self-sustaining through member premiums and will reinsure through commercial companies for

**ERIE-HURON-OTTAWA EDUCATIONAL SERVICE CENTER
ERIE COUNTY**

NOTES TO THE BASIC FINANCIAL STATEMENTS
FOR THE FISCAL YEAR ENDED JUNE 30, 2004
(Continued)

specific claims in excess of \$100,000 and aggregate claims in excess of 120 percent of expected claims.

C. Workers' Compensation Rating Program

The ESC participates in the Ohio Association of School Business Officials Workers' Compensation Group Rating Plan (GRP), an insurance purchasing pool (Note 2.A.). The intent of the GRP is to achieve the benefit of a reduced premium for the ESC by virtue of its grouping and representation with other participants in the GRP. Participants in the GRP are placed on tiers according to their loss history. Participants with low loss histories are rewarded with greater savings than participants with higher loss histories. Each participant pays its workers' compensation premium to the state based on the rate for its GRP tier rather than its individual rate. Participation in the GRP is limited to school districts that can meet the GRP's selection criteria. The firm of Sheakley UniService, Inc. provides administrative, cost control, assistance with safety programs, and actuarial services to the GRP.

9. DEFINED BENEFIT PENSION PLANS

A. School Employees Retirement System

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

Plan members are required to contribute 10 percent of their annual covered salary and the ESC is required to contribute at an actuarially determined rate of 14 percent for 2004, 9.09 percent was the portion 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 adequacy of the contribution rates is determined annually. The ESC's contributions for pension obligations to SERS for the fiscal years ended June 30, 2004, 2003, and 2002 were \$345,812, \$332,117, and \$196,617, respectively; 82 percent has been contributed for 2004 and 100 percent for 2003 and 2002.

B. State Teachers Retirement System

The ESC contributes to the State Teachers Retirement System of Ohio (STRS), a cost-sharing, multiple-employer public employee retirement system administered by the State Teachers Retirement Board. STRS provides retirement and disability benefits, annual cost-of-living adjustments, and death and survivor benefits to plan members and beneficiaries. Authority to establish and amend benefits is provided by Chapter 3307 of the Ohio Revised Code. STRS issues a publicly available, stand-alone financial report that includes financial statements and required supplementary information. The report may be obtained by writing to the State Teachers Retirement System, 275 East Broad Street, Columbus, Ohio 43215-3371, or by calling (614) 227-4090.

**ERIE-HURON-OTTAWA EDUCATIONAL SERVICE CENTER
ERIE COUNTY**

NOTES TO THE BASIC FINANCIAL STATEMENTS
FOR THE FISCAL YEAR ENDED JUNE 30, 2004
(Continued)

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 times 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.

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.

Plan members are required to contribute 10 percent of their annual covered salary and the ESC is required to contribute 14 percent; 13 percent was the portion used to fund pension obligations. Contribution rates are established by the State Teachers Retirement Board, 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 employee contributions. The ESC's contributions for pension obligations to STRS for the fiscal years ended June 2004, 2003, and 2002 were \$1,106,440, \$1,168,322, \$768,613, respectively; 82 percent has been contributed for 2004 and 100 percent for 2003 and 2002.

C. Social Security System

Effective July 1, 1991, all employees not otherwise covered by the SERS or the STRS have an option to choose Social Security or the SERS/STRS. As of June 30, 2004, certain members of the Governing Board have elected Social Security. The ESC's liability is 6.2 percent of wages paid.

10. POSTEMPLOYMENT BENEFITS

The ESC provides comprehensive health care benefits to retired teachers and their dependents through STRS, and to retired non-certified employees and their dependents through SERS. Benefits include hospitalization, physicians' fees, prescription drugs, and partial reimbursement of monthly Medicare Part B premiums. Benefit provisions and the obligations to contribute are established by STRS and SERS based on authority granted by state statute. Both STRS and SERS are funded on a pay-as-you-go-basis.

**ERIE-HURON-OTTAWA EDUCATIONAL SERVICE CENTER
ERIE COUNTY**

**NOTES TO THE BASIC FINANCIAL STATEMENTS
FOR THE FISCAL YEAR ENDED JUNE 30, 2004
(Continued)**

The State Teachers Retirement Board has statutory authority over how much, if any, of the health care costs will be absorbed by STRS. Most benefit recipients pay a portion of the health care cost in the form of a monthly premium. By Ohio law, the cost of coverage paid from STRS funds shall be included in the employer contribution rate, currently 14 percent of covered payroll. For this fiscal year, the State Teachers Retirement Board allocated employer contributions equal to 1 percent of covered payroll to the Health Care Reserve fund. For the ESC, this amount equaled \$85,111 during fiscal 2004.

STRS pays health care benefits from the Health Care Reserve fund. The balance in the Health Care Reserve fund was \$3.1 billion at June 30, 2004. For the fiscal year ended June 30, 2004, net health care costs paid by STRS were \$268.739 million and STRS had 111,853 eligible benefit recipients.

For SERS, coverage is made available to service retirees with 10 or more years of qualifying service credit, and disability and survivor benefit recipients. Effective January 1, 2004, all retirees and beneficiaries are required to pay a portion of their health care premiums. 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.

For this fiscal year, employer contributions to fund health care benefits were 4.91 percent of covered payroll. 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 2004, the minimum pay has been established at \$25,400. 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.

The target level for the health care reserve is 150 percent of annual health care expenses. Expenses for health care at June 30, 2004 were \$223.444 million and the target level was \$335.2 million. At June 30, 2004, SERS had net assets available for payment of health care benefits of \$300.8 million and SERS had approximately 62,000 participants receiving health care benefits. For the ESC, the amount to fund health care benefits, including surcharge, equaled \$199,892 during the 2004 fiscal year.

11. BUDGETARY BASIS OF ACCOUNTING

While reporting financial position, results of operations, and changes in fund balance on the basis of generally accepted accounting principles (GAAP), the budgetary basis as provided by law is based upon accounting for certain transactions on a basis of cash receipts and disbursements.

The Statement of Revenue, Expenditures, and Changes in Fund Balance - Budget and Actual (Non-GAAP Budgetary Basis) presented for the general fund is presented on the budgetary basis to provide a meaningful comparison of actual results with the budget. The major differences between the budget basis and the GAAP basis are that:

- (a) Revenues and other financing sources are recorded when received in cash (budget basis) as opposed to when susceptible to accrual (GAAP basis);
- (b) Expenditures and other financing uses are recorded when paid in cash (budget basis) as opposed to when the liability is incurred (GAAP basis);

**ERIE-HURON-OTTAWA EDUCATIONAL SERVICE CENTER
ERIE COUNTY**

NOTES TO THE BASIC FINANCIAL STATEMENTS
FOR THE FISCAL YEAR ENDED JUNE 30, 2004
(Continued)

- (c) In order to determine compliance with Ohio law, and to reserve that portion of the applicable appropriation, total outstanding encumbrances (budget basis) are recorded as the equivalent of an expenditure, as opposed to a reservation of fund balance for that portion of outstanding encumbrances not already recognized as an account payable (GAAP basis).

The adjustments necessary to convert the results of operations for the year on the budget basis to the GAAP basis for the general fund is as follows:

Net Change in Fund Balance	
	General Fund
Budget basis	\$ (259,067)
Net adjustment for revenue accruals	(21,195)
Net adjustment for expenditure accruals	(414,568)
Net adjustment for other sources/uses	(13,860)
Adjustment for encumbrances	74,191
GAAP basis	\$ (634,499)

12. CONTINGENCIES

A. Grants

The ESC receives significant financial assistance from numerous federal, state, and local 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 ESC. However in the opinion of management, any such disallowed claims will not have a material effect on the financial position of the ESC.

B. Litigation

The ESC is not a party to legal proceedings that would have a material effect, if any, on the financial condition of the ESC.

C. State School Funding Decision

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

The Supreme Court relinquished jurisdiction over the case and directed "...the Ohio General Assembly to enact a school funding scheme that is thorough and efficient..." The ESC is currently unable to determine what effect, if any, this decision will have on its future state funding and its financial operations.

**ERIE-HURON-OTTAWA EDUCATIONAL SERVICE CENTER
ERIE COUNTY**

NOTES TO THE BASIC FINANCIAL STATEMENTS
FOR THE FISCAL YEAR ENDED JUNE 30, 2004
(Continued)

13. INTERFUND TRANSACTIONS

Interfund transfers for the year ended June 30, 2004, consisted of the following, as reported on the fund financial statements:

Transfers to Nonmajor Governmental funds from:	
General fund	<u>\$ 9,685</u>

Transfers are used to (1) move revenues from the fund that statute or budget requires to collect them to the fund that statute or budget requires to expend them, and (2) use unrestricted revenues collected in the general fund to finance various programs accounted for in other funds in accordance with budgetary authorizations.

Interfund transfers between governmental funds are eliminated for reporting in the statement of activities.

14. EXTERNAL INVESTMENT POOL

The ESC serves as fiscal agent for Northern Ohio Educational Association (NOECA) which is a legally separate entity. The ESC pools the monies of NOECA with the ESC's for investment purposes. Investments are not specifically purchased in the name of NOECA. The investment pool is not registered with the SEC as an investment company. The fair value of investments is determined annually. NOECA is allocated a pro rata share of each investment at fair value along with a pro rata share of the interest that it earns based upon its fund balance to the entire ESC's fund balance.

During fiscal 2004, investments of the ESC were limited to investments in STAR Ohio. The investment in STAR Ohio is valued at amounts reported by the State Treasurer and is an unclassified investment since it is not evidenced by securities that exist in physical or book entry form.

The statement of net assets and statement of changes in net assets for the external investment trust fund has been reported in the basic financial statements. Condensed financial information for the ESC's investment pool follows:

Statement of Net Assets	
June 30, 2004	
<hr/>	
Assets	
Equity in Pooled Cash and Cash Equivalents	<u>\$ 4,484,894</u>
Net Assets Held in Trust for Pool Participants	
Internal Portion	\$ 3,459,926
External Portion	<u>1,024,968</u>
Total Net Assets Held in Trust for Pool Participants	<u>\$ 4,484,894</u>

**ERIE-HURON-OTTAWA EDUCATIONAL SERVICE CENTER
ERIE COUNTY**

NOTES TO THE BASIC FINANCIAL STATEMENTS
FOR THE FISCAL YEAR ENDED JUNE 30, 2004
(Continued)

Statement of Changes in Net Assets
For Fiscal Year Ended June 30, 2004

Additions	
Interest	\$ 43,569
Net Capital Transactions	<u>254,302</u>
<i>Total Additions</i>	297,871
Deductions	
Distributions to Participants	<u>43,569</u>
<i>Change in Net Assets</i>	254,302
Net Assets, Beginning of Year	<u>4,230,592</u>
<i>Net Assets, End of Year</i>	<u><u>\$ 4,484,894</u></u>

**ERIE-HURON-OTTAWA EDUCATIONAL SERVICE CENTER
ERIE COUNTY**

**SCHEDULE OF FEDERAL AWARDS EXPENDITURES
FOR THE YEAR ENDED JUNE 30, 2004**

FEDERAL GRANTOR Pass Through Grantor Program Title	Pass Through Entity Number	Federal CFDA Number	Receipts	Disbursements
UNITED STATES DEPARTMENT OF EDUCATION				
<i>Passed through the Ohio Department of Education</i>				
Pre-school Grant	125690-PGS1-04	84.173	\$ 67,380	\$ 67,380
<i>Total - Pre-school Grant</i>			67,380	67,380
Grants to Local Educational Agencies (ESEA Title I)	125690-C1ST-03P 125690-C1SD-2004	84.010	- 19,173	53,411 19,173
<i>Total - Grants to Local Educational Agencies</i>			19,173	72,584
Even Start	125690-EVS1-03 125690-EVS1-04	84.213	19,127 97,184	62,859 95,568
<i>Total - Even Start</i>			116,311	158,427
State and Drug-Free Schools and Communities	125690-T4S1-2004	84.184c	454	-
<i>Total - State and Drug-Free Schools and Communities</i>			454	-
Total Department of Education			203,318	298,391
UNITED STATES DEPARTMENT OF HEALTH AND HUMAN SERVICES				
<i>Passed through the Ohio Department of Mental Retardation and Developmental Disabilities</i>				
Title XIX (Medicaid)		93.778	559,082	559,082
Totals			\$ 762,400	\$ 857,473

THE ACCOMPANYING NOTES ARE AN INTEGRAL PART OF THIS SCHEDULE.

**ERIE-HURON-OTTAWA EDUCATIONAL SERVICE CENTER
ERIE COUNTY**

**NOTES TO THE SCHEDULE OF FEDERAL AWARDS EXPENDITURES
FISCAL YEAR ENDED JUNE 30, 2004**

NOTE A - SIGNIFICANT ACCOUNTING POLICIES

The accompanying Schedule of Federal Awards Expenditures (the Schedule) summarizes activity of the Service Center's federal award programs. The schedule has been prepared on the cash basis of accounting.

NOTE B - MATCHING REQUIREMENTS

Certain Federal programs require that the Service Center contribute non-Federal funds (matching funds) to support the Federally-funded programs. The Service Center has complied with the matching requirements. The expenditure of non-Federal matching funds is not included on the Schedule.



**Auditor of State
Betty Montgomery**

**INDEPENDENT ACCOUNTANTS' REPORT ON COMPLIANCE AND ON INTERNAL
CONTROL REQUIRED BY *GOVERNMENT AUDITING STANDARDS***

Erie-Huron-Ottawa Educational Service Center
Erie County
2900 Columbus Avenue
Sandusky, Ohio 44870-5569

To the Governing Board:

We have audited the financial statements of the governmental activities, the major fund, and the aggregate remaining fund information of the Erie-Huron-Ottawa Educational Service Center, Erie County, (the Service Center) as of and for the year ended June 30, 2004, which collectively comprise the Service Center's basic financial statements and have issued our report thereon dated March 4, 2005. We conducted our audit in accordance with auditing standards generally accepted in the United States of America and the standards applicable to financial audits contained in *Government Auditing Standards*, issued by the Comptroller General of the United States.

Compliance

As part of obtaining reasonable assurance about whether the Service Center's financial statements are free of material misstatement, we tested its compliance with certain provisions of laws, regulations, contracts, and grants, 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 such an opinion. The results of our tests disclosed no instances of noncompliance we must report under *Government Auditing Standards*.

Internal Control Over Financial Reporting

In planning and performing our audit, we considered the Service Center's internal control over financial reporting to determine our auditing procedures for the purpose of expressing our opinions on the financial statements and not to provide assurance on the internal control over financial reporting. Our consideration of the internal control over financial reporting would not necessarily disclose all matters in the internal control over financial reporting that might be material weaknesses. A material weakness is a condition in which the design or operation of one or more of the internal control components does not reduce to a relatively low level the risk that misstatements in amounts that would be material in relation to the financial statements being audited may occur and not be detected within a timely period by employees in the normal course of performing their assigned functions. We noted no matters involving the internal control over financial reporting and its operation that we consider to be material weaknesses. However, we noted a matter involving the internal control over financial reporting that does not require inclusion in the report, that we have reported to management of the Service Center in a separate letter dated March 4, 2005.

One Government Center / Room 1420 / Toledo, OH 43604-2246
Telephone: (419) 245-2811 (800) 443-9276 Fax: (419) 245-2484
www.auditor.state.oh.us

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

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

Betty Montgomery
Auditor of State

March 4, 2005



Auditor of State Betty Montgomery

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

Erie-Huron-Ottawa Educational Service Center
Erie County
2900 Columbus Avenue
Sandusky, Ohio 44870-5569

To the Governing Board:

Compliance

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

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

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

Internal Control Over Compliance

The management of the Service Center is responsible for establishing and maintaining effective internal control over compliance with requirements of laws, regulations, contracts, and grants applicable to federal programs. In planning and performing our audit, we considered the Service Center's internal control over

compliance with requirements that could have a direct and material effect on a major federal program in order to determine our auditing procedures for the purpose of expressing our opinion on compliance and to test and report on internal control over compliance in accordance with OMB Circular A-133.

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

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



Betty Montgomery
Auditor of State

March 4, 2005

**ERIE-HURON-OTTAWA EDUCATIONAL SERVICE CENTER
ERIE COUNTY**

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

1. SUMMARY OF AUDITOR'S RESULTS

(d)(1)(i)	Type of Financial Statement Opinion	Unqualified
(d)(1)(ii)	Were there any material control weakness conditions reported at the financial statement level (GAGAS)?	No
(d)(1)(ii)	Were there any other reportable control weakness conditions reported at the financial statement level (GAGAS)?	No
(d)(1)(iii)	Was there any reported material noncompliance at the financial statement level (GAGAS)?	No
(d)(1)(iv)	Were there any material internal control weakness conditions reported for major federal programs?	No
(d)(1)(iv)	Were there any other reportable internal control weakness conditions reported for major federal programs?	No
(d)(1)(v)	Type of Major Programs' Compliance Opinion	Unqualified
(d)(1)(vi)	Are there any reportable findings under § .510?	No
(d)(1)(vii)	Major Programs (list):	Title XX Medical Assistance (CFDA #93.778)
(d)(1)(viii)	Dollar Threshold: Type A\B Programs	Type A: > \$ 300,000 Type B: all others
(d)(1)(ix)	Low Risk Auditee?	Yes

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

None.

3. FINDINGS AND QUESTIONED COSTS FOR FEDERAL AWARDS

None.



**Auditor of State
Betty Montgomery**

88 East Broad Street
P.O. Box 1140
Columbus, Ohio 43216-1140

Telephone 614-466-4514
800-282-0370

Facsimile 614-466-4490

ERIE-HURON-OTTAWA EDUCATIONAL SERVICE CENTER

ERIE 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
APRIL 12, 2005**