

**MARION CITY SCHOOLS DIGITAL ACADEMY  
MARION COUNTY, OHIO**

**Basic Financial Statements  
and Independent Auditor's Reports**

**For the Year Ended June 30, 2005**







**Auditor of State  
Betty Montgomery**

Board of Directors  
Marion City School District Digital Academy  
910 East Church Street  
Marion, Ohio 43302

We have reviewed the *Independent Auditor's Report* of the Marion City School District Digital Academy, Marion County, prepared by Kennedy, Cottrell + Associates, for the audit period July 1, 2004 through June 30, 2005. Based upon this review, we have accepted these reports in lieu of the audit required by Section 117.11, Revised Code. The Auditor of State did not audit the accompanying financial statements and, accordingly, we are unable to express, and do not express an opinion on them.

Our review was made in reference to the applicable sections of legislative criteria, as reflected by the Ohio Constitution, and the Revised Code, policies, procedures and guidelines of the Auditor of State, regulations and grant requirements. The Marion City School District Digital Academy is responsible for compliance with these laws and regulations.

A handwritten signature in cursive script that reads "Betty Montgomery".

BETTY MONTGOMERY  
Auditor of State

January 23, 2006

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MARION CITY SCHOOLS DIGITAL ACADEMY  
MARION COUNTY, OHIO

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## INDEPENDENT AUDITOR'S REPORT

Board of Directors  
Marion City Schools Digital Academy  
Marion County, Ohio  
910 East Church Street  
Marion, Ohio 43302

We have audited the accompanying basic financial statements of the enterprise fund of the Marion City Schools Digital Academy, Marion, Ohio (the "Academy"), a component unit of the Marion City School District, as of and for the year ended June 30, 2005, which collectively comprise the Academy's basic financial statements as listed in the Table of Contents. These component unit financial statements are the responsibility of the Academy's management. Our responsibility is to express an opinion on these component unit 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 opinion.

In our opinion, the financial statements referred to above present fairly, in all material respects, the financial position of the enterprise fund of the Marion City Schools Digital Academy, Marion, Ohio as of June 30, 2005, and the respective changes in financial position and cash flows, where applicable, 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 December 29, 2005, on our consideration of the Academy's internal control over financial reporting and our tests of its compliance with certain provisions of laws, regulations, contracts, and grant agreements and other matters. The purpose of that report is to describe the scope of our testing of internal control over financial reporting and compliance and the results of that testing and not to provide an opinion on the internal control over financial reporting or on compliance. 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 required by the Governmental Accounting Standards Board. We have applied certain limited procedures, which consist principally of inquiries of management regarding the methods of measurement and presentation of the supplementary information. However, we did not audit the information and express no opinion on it.

*Kennedy, Cottrell + Associates LLC*

Kennedy, Cottrell + Associates  
December 29, 2005

**MARION CITY SCHOOLS DIGITAL ACADEMY  
MARION COUNTY, OHIO**

**Management's Discussion and Analysis  
For the Year Ended June 30, 2005  
(Unaudited)**

The discussion and analysis of Marion City Schools Digital Academy's (the Academy) financial performance provides an overall view of the Academy's financial activities for the fiscal year ended June 30, 2005. The intent of this discussion and analysis is to look at the Academy's financial performance as a whole.

**Financial Highlights**

Key financial highlights for 2005 are as follows:

- Net assets activities increased \$31,769.
- Operating revenues accounted for \$698,012 in revenue or 90.1% of all revenues.
- Capital outlay additions of \$4,080 consisted of furniture and equipment.

**Using this Annual Financial Report**

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 Academy as a financial whole, an entire operating entity. Enterprise accounting uses a flow of economic resources measurement focus. With this measurement focus, all assets and all liabilities are included on the statement of net assets. The *statement of net assets* represents the basic statement of position for the Academy. The Statement of Net Assets and Statement of Revenues, Expenses, and Changes in Net Assets provide information about the activities of the Academy, presenting an aggregate view of the Academy's finances. For the Academy, there is only one fund presented. The statement of cash flows reflects how the Academy finances and meets its cash flow needs. Finally the notes to the basic financial statements provide additional information that is essential to a full understanding of the data provided on the basic financial statements.

**Reporting the Academy as a Whole**

The view of the Academy as a whole looks at all financial transactions and asks, "How did we do financially during 2005?" The Statement of Net Assets and the Statement of Revenue, Expenses, and Changes in Net Assets answer this Question. These statements include *all assets* and *liabilities* using the *accrual basis of accounting* similar to the accounting used by most private-sector companies. This basis of accounting considers all of the current fiscal year's revenues and expenses regardless of when cash is received or paid.

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

**Financial Analysis**

The Academy is not required to present government-wide financial statements as the Academy is engaged in only business-type activities. Therefore, no condensed financial information derived from government-wide financial statements is included in the discussion and analysis. The following tables represent the Academy's condensed financial information derived from the statement of net assets and the statement of revenues, expenses, and changes in net assets.

**MARION CITY SCHOOLS DIGITAL ACADEMY  
MARION COUNTY, OHIO**

**Management's Discussion and Analysis  
For the Year Ended June 30, 2005  
(Unaudited)**

Table 1 provides a summary of the Academy's net assets for 2005 compared to 2004:

Table 1  
Statement of Net Assets

	<u>2005</u>	<u>2004</u>
<b>Assets</b>		
Current Assets	\$ 100,914	\$ 66,549
Capital Assets, Net of A/D	21,083	23,759
Total Assets	<u>\$ 121,997</u>	<u>\$ 90,308</u>
<b>Liabilities</b>		
Current Liabilities	<u>\$ 48,186</u>	<u>\$ 48,266</u>
Total Liabilities	48,186	48,266
<b>Net Assets</b>		
Invested in Capital Assets, Net of	21,083	23,759
Unrestricted	52,728	18,283
Total Net Assets	<u>\$ 73,811</u>	<u>\$ 42,042</u>

The Academy's net assets increased by \$31,769. An analysis of cash flows for operating activities in 2005 demonstrates cash receipts exceeding unrestricted payments for activities by \$33,177. The net cash provided by non-capital financing activities covers the net cash decrease in operating activities.

***Operating Activities***

Purchased services, made up of mainly professional and technical services, comprise 96.4 percent of operating expenses. The Statement of Revenues, Expenses, and Changes in Net Assets shows the cost of operating expenses and the revenues offsetting those services. Table 2 shows the total amount of operating and non-operating expenses and the revenues associated with those expenses for the fiscal year. That is, it identifies the amount of operating expenses supported by State and other funding.



**MARION CITY SCHOOLS DIGITAL ACADEMY  
MARION COUNTY, OHIO**

**Management's Discussion and Analysis  
For the Year Ended June 30, 2005  
(Unaudited)**

Table 2  
Statement of Revenues, Expenses, and Changes in Net Assets

	2005	2004
<b>Operating Revenue</b>		
Foundation Payments	\$ 630,597	\$ 418,907
Disadvantaged Pupil Impact Aid	166	1,587
Special Education	67,249	40,452
<b>Total Operating Revenues</b>	698,012	460,946
<b>Operating Expenses</b>		
Salaries and Wages	37,061	-
Fringe Benefits	7,783	-
Purchased Services	673,963	495,166
Materials and Supplies	13,802	9,114
Depreciation Expense	6,756	5,940
Other Operating Expense	3,544	3,050
<b>Total Operating Expenses</b>	742,909	513,270
<b>Non-Operating Revenues</b>		
Federal Grants	68,067	-
State Grants	8,034	6,066
Interest Income	565	495
<b>Total Non-Operating Revenue</b>	76,666	6,561
<b>Change in Net Assets</b>	\$ 31,769	\$ (45,763)

The dependence upon state foundation revenues for operating activities is apparent. Foundation payments represented 81.4 percent of revenue of the Academy. The state foundation community, as a whole, is by far the primary support for the district.

**The Academy's Funds**

The Academy had total revenues of \$774,678 and expenses of \$742,909. The change in net assets for the fiscal year was an increase of \$31,769. This increase was due to increased revenues.

**Budget**

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

**MARION CITY SCHOOLS DIGITAL ACADEMY  
MARION COUNTY, OHIO**

**Management's Discussion and Analysis  
For the Year Ended June 30, 2005  
(Unaudited)**

**Capital Assets and Debt Administration**

*Capital Assets*

At the end of fiscal year 2005 the Academy had \$21,083 (net of \$12,696 in accumulated depreciation) invested in furniture and equipment. Table 3 shows 2005 balances compared to 2004:

Table 3  
Capital Assets at June 30  
(Net of Depreciation)

	2005	2004
Furniture and Equipment	<u>\$ 21,083</u>	<u>\$ 23,759</u>
Totals	<u>\$ 21,083</u>	<u>\$ 23,759</u>

Depreciation was larger than acquisitions this fiscal year by \$2,676. The increase in the furniture and equipment account is a result of the Academy buying \$4,080 in furniture and equipment.

*Debt*

At June 30, 2005 the Academy had no debt.

**Other Information**

Management is currently unaware of any facts, decisions, or conditions that have occurred that are expected to have a significant effect on financial position or results of operations.

**Contacting the Academy's Financial Management**

This financial report is designed to provide our citizen's, taxpayers, investors and creditors with a general overview of the Academy's finances and to show the Academy's accountability for the money it receives. If you have questions about this report or need additional information contact Mr. Robert Wood, Treasurer of Marion City Schools Digital Academy, 910 East Church Street, Marion, Ohio 43302.

**MARION CITY SCHOOLS DIGITAL ACADEMY  
MARION COUNTY, OHIO**

**Statement of Net Assets  
As of June 30, 2005**

Assets:

Current Assets:

Cash and Cash Equivalents	\$ 99,555
Inventory Held for Resale	<u>1,359</u>
Total Current Assets	100,914

Non-Current Assets:

Capital Assets, Net of Accumulated Depreciation	<u>21,083</u>
Total Non-Current Assets	<u>21,083</u>
Total Assets	<u><u>121,997</u></u>

Liabilities:

Current Liabilities:

Accrued Wages and Benefits	2,642
Due to Other Governments	<u>45,544</u>
Total Current Liabilities	48,186

Net Assets:

Invested in Capital Assets	21,083
Unrestricted	<u>52,728</u>
Total Net Assets	<u><u>\$ 73,811</u></u>

See Accompanying Notes to the Basic Financial Statements

**MARION CITY SCHOOLS DIGITAL ACADEMY  
MARION COUNTY, OHIO**

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

<u>Operating Revenues:</u>	
Foundation Payments	\$ 630,597
Disadvantaged Pupil Impact Aid	166
Special Education	<u>67,249</u>
Total Operating Revenues	698,012
<u>Operating Expenses:</u>	
Salaries and Wages	37,061
Fringe Benefits	7,783
Purchased Services	673,963
Materials and Supplies	13,802
Depreciation	6,756
Other Operating Expenses	<u>3,544</u>
Total Operating Expenses	742,909
Operating Income (Loss)	(44,897)
<u>Non-Operating Revenues and Expenses:</u>	
Federal Grants	68,067
State Grants	8,034
Interest Income	<u>565</u>
Total Non-Operating Revenues and (Expenses)	<u>76,666</u>
Change in Net Assets	31,769
Net Assets at Beginning of Year	<u>42,042</u>
Net Assets at End of Year	<u><u>\$ 73,811</u></u>

See Accompanying Notes to the Basic Financial Statements

**MARION CITY SCHOOLS DIGITAL ACADEMY  
MARION COUNTY, OHIO**

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

**Increase (Decrease) in Cash and Cash Equivalents**

<u>Cash Flows from Operating Activities:</u>	
Cash Received from State of Ohio	\$ 698,012
Cash Payments to Suppliers for Goods and Services	(695,219)
Cash Payments for Employee Salaries, Wages, and Fringe Benefits	<u>(42,202)</u>
Net Cash Used for Operating Activities	<u>(39,409)</u>
<u>Cash Flows from Noncapital Financing Activities:</u>	
Operating Grants Received - Federal	68,067
Operating Grants Received - State	<u>8,034</u>
Net Cash Provided by Noncapital Financing Activities	<u>76,101</u>
<u>Cash Flows from Capital and Related Financing Activities:</u>	
Cash Payments for Capital Acquisitions	<u>(4,080)</u>
Net Cash Used for Capital and Related Financing Activities	<u>(4,080)</u>
<u>Cash Flows from Investing Activities</u>	
Cash Received from Interest on Investments	<u>565</u>
Net Cash Provided by Investing Activities	<u>565</u>
Net Increase (Decrease) in Cash and Cash Equivalents	33,177
Cash and Cash Equivalents at Beginning of Year	<u>66,378</u>
Cash and Cash Equivalents at End of Year	<u><u>99,555</u></u>
<b>Reconciliation of Operating Income to Net Cash Provided by Operating Activities</b>	
Operating Income (Loss)	(44,897)
Adjustments to Reconcile Operating Income (Loss) to Net Cash Used for Operating Activities:	
Depreciation	6,756
Changes in Assets and Liabilities:	
Decrease in Inventory Held for Resale	(1,188)
Decrease in Due to Other Governments	(2,722)
Increase in Accrued Wages and Benefits	<u>2,642</u>
Total Adjustments	<u>5,488</u>
Net Cash Used for by Operating Activities	<u><u>\$ (39,409)</u></u>

See Accompanying Notes to the Basic Financial Statements

**MARION CITY SCHOOLS DIGITAL ACADEMY  
MARION COUNTY, OHIO**

**Notes to the Basic Financial Statements  
For the Year Ended June 30, 2005**

**NOTE 1 - DESCRIPTION OF THE ACADEMY AND REPORTING ENTITY**

Marion City Schools Digital Academy (the Academy) is a nonprofit corporation established pursuant to Ohio Revised Code Chapters 3314 and 1702. The Academy is an approved tax-exempt organization under Section 501(c)(3) of the Internal Revenue Code. Management is not aware of any course of action or series of events that have occurred that might adversely affect the Academy's tax-exempt status. The Academy's objective is to deliver a comprehensive educational program of high quality, tied to state and national standards, which can be delivered to students in the K-12 population entirely through distance learning technologies. It is to be operated in cooperation with the public schools to provide an innovative and cost-effective solution to the special problems of disabled students, students removed from school for disciplinary reasons, students needing advanced or specialized courses which are not available locally, and others, including home-schooled students who are not currently enrolled in any public school and who are not receiving a meaningful, comprehensive, and standards-based educational program. The Academy, which is part of the State's education program, is nonsectarian in its programs, admissions policies, employment practices, and all other operations. The Academy may acquire facilities as needed and contract for any services necessary for the operation of the school.

The Academy was approved for operation under a contract with the Marion City School District (the Sponsor). The Sponsor is responsible for evaluating the performance of the Academy and has the authority to deny renewal of the contract at its expiration.

The Academy operates under the direction of a seven-member (five voting members) Board of Directors made up of:

- (a) Four persons employed and serving in administrator positions within the Sponsor's District, which positions have been identified by the Sponsor's Board of Education. Each of the foregoing administrators serves on the Board of Directors in his/her official capacity as a representative of the Sponsor's Board of Education and its interests.
- (b) One person who is neither an officer nor employee of the Sponsor's District who shall be a public educator or other public official representing a governmental entity that desires to further the establishment and operation of the Academy. Such person has been elected by the Sponsor's Board of Education.
- (c) One person who is neither an officer nor employee of the Sponsor who is a representative initially appointed by the Tri-Rivers Educational Computer Association (TRECA), and who serves on the Board in his official capacity as a representative of TRECA and TRECA's interests. However, the TRECA representative shall within one year following the incorporation of the Academy, be replaced by a person appointed to represent the interests of parents and students served by the conversion school to be operated by the Academy. Such person must be the parent or legal guardian of a student who is enrolled in the conversion school. Such person shall be elected by the Sponsor's Board of Education.
- (d) The Academy's Treasurer as a non-voting ex officio member who is also the Sponsor's Treasurer and serves the Board of Directors in his official capacity as a representative of the Sponsor's Board of Education and its interests.

Therefore, the Academy is a component unit of the Sponsor. Additionally, the Academy entered into a two-year contract in June 2004, with Tri-Rivers Educational Computer Association (TRECA) for management consulting services (See Note 8).

**MARION CITY SCHOOLS DIGITAL ACADEMY  
MARION COUNTY, OHIO**

**Notes to the Basic Financial Statements  
For the Year Ended June 30, 2005**

**NOTE 2 - SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES**

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

**A. Basis of Presentation**

**Enterprise Accounting**

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

The Academy uses enterprise accounting to track and report on its financial activities. Enterprise accounting is used to account for operations that are financed and operated in a manner similar to private business enterprises where the intent is that the costs of providing goods or services to the general public on a continuing basis be financed or recovered primarily through user charges, or where it has been decided that periodic determination of revenues earned, expenses incurred, and/or changes in net assets is appropriate for public policy, management control, accountability or other purposes.

**B. Measurement Focus and Basis of Accounting**

Enterprise accounting uses a flow of economic resources measurement focus. With this measurement focus, all assets and all liabilities are included on the statement of net assets. The statement of revenues, expenses, and changes in net assets presents increases (e.g., revenues) and decreases (e.g., expenses) in net total assets. The statement of cash flows reflects how the Academy finances and meets its cash flow needs.

Basis of accounting determines when transactions are recorded in the financial records and reported on the financial statements. The Academy's financial statements are prepared using the accrual basis of accounting. Revenues resulting from exchange transactions, in which each party gives and receives essentially equal value, is recorded when the exchange takes place. Revenues resulting from nonexchange transactions, in which the Academy receives value without directly giving equal value in return, such as grants and entitlements, are recognized in the year in which all eligibility requirements have been satisfied. Eligibility requirements include timing requirements, which specify the year when the resources are required to be used or the year when use is first permitted; matching requirements, in which the Academy must provide local resources to be used for a specified purpose; and expenditure requirements, in which the resources are provided to the Academy on a reimbursement basis. Expenses are recognized at the time they are incurred.

**C. Budgetary Process**

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

**D. Cash and Cash Equivalents**

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

**MARION CITY SCHOOLS DIGITAL ACADEMY  
MARION COUNTY, OHIO**

**Notes to the Basic Financial Statements  
For the Year Ended June 30, 2005**

**E. Intergovernmental Revenues**

The Academy currently participates in the State Foundation Program, the State Disadvantaged Pupil Impact Aid (DPIA) Program, and the State Special Education Program. Revenues received from these programs are recognized as operating revenues (foundation payments) in the accounting period in which they are earned and become measurable.

Grants are recognized as non-operating revenues in the accounting period in which all eligibility requirements have been met. Eligibility requirements include timing requirements, which specify the year when the resources are required to be used or the year when use is first permitted, matching requirements, in which the Academy must provide local resources to be used for a specified purpose, and expenditure requirements, in which the resources are provided to the Academy on a reimbursement basis.

**F. Capital Assets and Depreciation**

All capital assets are capitalized at cost (or estimated historical cost) and updated for additions and retirements during the fiscal year. Donated capital assets are recorded at their fair market values as of the date received. The Academy maintains a capitalization threshold of \$500 dollars. The Academy 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. Interest incurred during the construction of capital assets is also capitalized.

All reported capital assets are depreciated. Improvements are depreciated over the remaining useful live of the related capital assets. Depreciation is computed using the straight-line method over an estimated useful life of five years.

A summary of changes in capital assets for the year ended June 30, 2005 follows:

	<b>Beginning of Year</b>	<b>Additions</b>	<b>Deletions</b>	<b>End of Year</b>
Furniture & Equipment	\$ 29,699	\$ 4,080	\$ -	\$ 33,779
Accumulated Depreciation	(5,940)	(6,756)	-	(12,696)
Capital Assets, Net	<u>\$ 23,759</u>			<u>\$ 21,083</u>

**G. Net Assets**

Net assets represent the difference between assets and liabilities. Net assets are reported as restricted when there are limitations imposed on their use either through the enabling legislation adopted by the Academy or through external restrictions imposed by creditors, grantors, or laws or regulations of other governments. The Academy did not have any restricted net assets at fiscal year end.

**H. Operating Revenues and Expenses**

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



**MARION CITY SCHOOLS DIGITAL ACADEMY  
MARION COUNTY, OHIO**

**Notes to the Basic Financial Statements  
For the Year Ended June 30, 2005**

**I. Estimates**

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

**NOTE 3 – DEPOSITS**

For the fiscal year ending June 30, 2005, the carrying amount of the School's deposits was \$99,555 and the bank balance was \$148,863. Of the bank balance, \$100,000 was covered by federal depository insurance. \$48,863 was covered by eligible securities pledged by the financial institution as security for repayment, by surety company bonds deposited with the treasurer by the financial institution or by a single collateral pool established by the financial institution to secure the repayment of all public money deposited with the institution.

**NOTE 4 - RECEIVABLES**

There were no receivables at June 30, 2005.

**NOTE 5 – FISCAL AGENT**

The sponsorship agreement states the Treasurer of the Sponsor shall serve as the Chief Financial Officer (Treasurer) of the Academy.

The Treasurer of Sponsor shall perform the following functions while serving as the Treasurer of the Academy:

- A. Maintain the financial records of the Academy in the same manner as are financial records of school districts, pursuant to rules of the Auditor of State;
- B. Comply with the policies and procedures regarding internal financial control of the Academy;
- C. Comply with the requirements and procedures for financial audits by the Auditor of the State.

**NOTE 6 - 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 Academy is currently unable to determine what effect, if any, this decision will have on its future State funding and its financial operations.

**MARION CITY SCHOOLS DIGITAL ACADEMY  
MARION COUNTY, OHIO**

**Notes to the Basic Financial Statements  
For the Year Ended June 30, 2005**

**NOTE 7 - RELATED PARTY TRANSACTION**

The Academy is a component unit of the Sponsor. The Academy and the Sponsor entered into a 5-year sponsorship agreement on August 26, 2002 whereby terms of the sponsorship were established. Pursuant to this agreement, the Sponsor's treasurer serves as the Academy's fiscal officer. Also, the Academy is required annually to pay to the Sponsor, from funding provided to the Academy by the Ohio Department of Education pursuant to Section 3314.08 of the Ohio Revised Code, \$150 per student per year. This amounted to \$31,800 for fiscal year 2005 and is recognized as a liability in the accompanying financial statements due to the payment not being made as of June 30, 2005.

In 2005, payments made by the Academy to the Sponsor totaled \$192,662. These represent payments for administrative services and other related services provided by the Sponsor to the Academy.

The Executive Director of TRECA serves as a member of the Academy's Board of Directors. Payments made by the Academy to TRECA in fiscal year 2005 totaled \$468,873.

**NOTE 8 - MANAGEMENT CONSULTING CONTRACT**

The Academy entered into a two-year contract on June 14, 2004, with Tri-Rivers Educational Computer Association (TRECA) for management consulting services. Under the contract, the following terms were agreed upon:

1. TRECA shall provide instructional, supervisory/administrative, and technical services sufficient to effectively implement the Academy's educational plan and the Academy's assessment and accountability plan.
2. All personnel providing services to the Academy on behalf of TRECA under the agreement shall be employees or contractors of TRECA and TRECA shall be solely responsible for all payroll functions, including retirement system contributions and all other legal withholding and/or payroll taxes, with respect to such personnel. All shall possess any certification or licensure, which may be required by law.
3. The technical services provided by TRECA to the Academy shall include access to, and the use of, computer software, computer hardware, networking hardware, network services, and the services of technical support personnel necessary to implement the plan of operation.
4. In exchange for the services and support (including equipment) provided by TRECA, the Academy shall pay to TRECA a fee of \$25,000 for 2005.
5. The Academy shall pay to TRECA \$3,550 per full-time high school student and \$2,550 per full-time K – 8 student enrolled in the Academy per fiscal year. Additionally, the Academy shall pay amounts ranging from \$500 to \$21,000 per student enrolled in the Academy for special education services provided (based on the state special education multiplier). These amounted to \$336,789 for 2005 with June's accrual payment of \$12,000 recognized as a liability. Part-time students may be enrolled on such terms as are agreed to by the parties.

**MARION CITY SCHOOLS DIGITAL ACADEMY  
MARION COUNTY, OHIO**

**Notes to the Basic Financial Statements  
For the Year Ended June 30, 2005**

**NOTE 9 - CONTINGENCIES**

**A. Grants**

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

**B. Litigation**

A suit was filed in Franklin County common Pleas Court on May 14, 2001 alleging Ohio's Community (i.e., Charter) Schools program violates the state Constitution and state laws. On April 21, 2003 the court dismissed the counts containing constitutional claims and stayed the other counts pending appeal of the constitutional issues. The plaintiffs appealed to the Court of Appeals, the issues have been briefed, and the case was heard on November 18th, 2003. On August 24, 2004, the Court of Appeals rendered a decision that Community Schools are part of the state public educational system and this matter was sent to the Ohio Supreme Court. The Ohio Supreme Court accepted the appeal from the Court of Appeals for review on February 16, 2005. No oral argument date has been set. The effect of this suit, if any, on the Academy is not presently determinable.

**C. Full Time Equivalency**

The Ohio Department of Education conducts reviews of enrollment data and full-time equivalency (FTE) calculations made by the schools. These reviews are conducted to ensure the schools are reporting accurate student enrollment data to the State, upon which state foundation funding is calculated. The conclusions of this review could result in state funding being adjusted. This information was not available as of the date of this report. The Academy does not anticipate any material adjustments to state funding for 2005 as a result of such review.

**NOTE 10 – PURCHASED SERVICES**

For the period July 1, 2004 through June 30, 2005, purchased services expenses were mainly payments for professional and technical services to TRECA and the Sponsor in the amount of \$684,365. The following is a breakdown of the total purchase services for fiscal year June 30, 2005:

Salaries Reimbursed	\$ 148,997
Fringe Benefits Reimbursed	42,799
Professional and Technical Services	471,741
Travel Mileage/Meeting Expense	10,426
Total Purchased Services	<u>\$ 673,963</u>

**MARION CITY SCHOOLS DIGITAL ACADEMY  
MARION COUNTY, OHIO**

**Notes to the Basic Financial Statements  
For the Year Ended June 30, 2005**

**NOTE 11 - DEFINED BENEFIT PENSION PLANS**

**School Employees Retirement System**

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

**Funding Policy.** Plan members are required to contribute 10 percent of their annual covered salary and the District is required to contribute at an actuarially determined rate. The current Academy rate is 14 percent of annual covered payroll. The contribution requirements of plan members and employers are established and may be amended, up to a statutory maximum amounts, by the SERS' Retirement Board. The Academy's contributions for pension obligations to SERS for the fiscal year ended June 30, 2005 was \$3,597, respectively.

**State Teachers Retirement System**

The Academy contributes to the State Teachers Retirement System of Ohio (STRS), a cost-sharing multiple employer public employee retirement system. STRS Ohio is a statewide retirement plan for licensed teachers and other faculty members employed in the public schools of Ohio or any school, college, university, institution or other agency controlled, managed and supported, in whole or in part, by the state or any political subdivision thereof. STRS Ohio issues a stand-alone financial report. Additional information or copies of STRS Ohio's Comprehensive Annual Financial Report can be requested in writing to STRS Ohio, 275 E. Broad St., Columbus, OH 43215-3371, or by calling (614) 227-4090

**Plan Options** – Effective July 1, 2001, two new plan options were offered to selected members. New members have a choice of three retirement plan options. In addition to the Defined Benefit (DB) Plan, new members are offered a Defined Contribution (DC) Plan and a Combined Plan. The DC Plan allows members to invest all their member contributions and employer contributions equal to 10.5% of earned compensation. The Combined Plan offers features of the DC Plan and the DB Plan. In the Combined Plan, member contributions are invested by the member, and employer contributions are used to fund the defined benefit payment at a reduced level from the regular DB Plan. Contributions into the DC Plan and the Combined Plan are credited to member accounts as employers submit their payroll information to STRS Ohio, generally on a biweekly basis. DC and Combined Plan members will transfer to the Defined Benefit Plan during their fifth year of membership unless they permanently select the DC or Combined Plan.

Chapter 3307 of the Revised Code provides the statutory authority for member and employer contributions. Contribution rates are established by the State Teachers Retirement Board, upon recommendations of its consulting actuary, not to exceed statutory maximum rates of 10% for members and 14% for employers.

Contribution requirements and the contributions actually made for the fiscal year ended June 30, 2004, were 9.3 percent of covered payroll for members and 14 percent for employers. The Academy's contributions for pension obligations to STRS for the fiscal year ended June 30, 2005 was \$5,141, respectively.

**MARION CITY SCHOOLS DIGITAL ACADEMY  
MARION COUNTY, OHIO**

**Notes to the Basic Financial Statements  
For the Year Ended June 30, 2005**

**NOTE 12 - POSTEMPLOYMENT BENEFITS**

**School Employees Retirement System**

The Ohio Revised Code gives SERS the discretionary authority to provide postretirement health care to retirees and their dependents. Coverage is made available to service retirees with ten or more years of qualifying service credit, and disability and survivor benefit recipients. Members retiring on or after August 1, 1989 with less than twenty-five years of service credit must pay a portion of their premium for health care. The portion is based on years of service up to a maximum of 75% of the premium.

After the allocation for basic benefits, the remainder of the employer's 14% contribution is allocated to providing health care benefits. At June 30, 2003, the healthcare allocation was 4.91%. In addition, SERS levies a surcharge to fund health care benefits equal to 14% of the difference between a minimum pay and the member's pay, prorated for partial service credit. For fiscal year 2004, the minimum pay was \$25,400. The surcharge, added to the unallocated portion of the 14% employer contribution rate, provides for maintenance of the asset target level for the health care fund.

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

The number of recipients currently receiving health care benefits is approximately 62,000. For the Academy, the amount contributed to fund post-employment benefits during fiscal year 2005 was \$177.

**State Teachers Retirement System**

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

The Revised Code grants authority to STRS Ohio to provide health care coverage to eligible benefit recipients, spouses and dependents. By Ohio law, the cost of coverage paid from STRS Ohio funds shall be included in the employer contribution rate, currently 14 percent of covered payroll.

The Retirement Board allocates employer contributions equal to the Health Care Stabilization Fund from which health care benefits are paid. Effective July 1, 2002, 1% of covered payroll was allocated by the board to post-employment health care. For the District, the amount contributed to fund post-employment benefits during fiscal year 2005 was \$51.

**NOTE 13 – RISK MANAGEMENT**

The Academy is exposed to various risks of loss related to torts; theft of, damage to, and destruction of assets; errors and omissions; injuries to employees; and natural disasters. The Academy assets are covered on the Sponsor's insurance policy. During fiscal year 2005, the Sponsor purchased insurance from Nationwide Insurance Company (through the Ohio School Plan).



**INDEPENDENT AUDITOR'S REPORT ON INTERNAL CONTROL OVER FINANCIAL  
REPORTING AND ON COMPLIANCE AND OTHER MATTERS BASED UPON THE AUDIT PERFORMED IN  
ACCORDANCE WITH GOVERNMENT AUDITING STANDARDS**

Board of Directors  
Marion City Schools Digital Academy  
Marion County, Ohio  
910 East Church Street  
Marion, Ohio 43302

We have audited the financial statements of the enterprise fund of the Marion City Schools Digital Academy, Marion, Ohio (the "Academy"), a component unit of the Marion City School District, as of and for the year ended June 30, 2005, and have issued our report thereon dated December 29, 2005. We conducted our audit in accordance with auditing standards generally accepted in the United States of America and the standards applicable to financial audits contained in *Government Auditing Standards*, issued by the Comptroller General of the United States.

**Internal Control Over Financial Reporting**

In planning and performing our audit, we considered the Academy's internal control over financial reporting in order to determine our auditing procedures for the purpose of expressing our opinions on the financial statements and not to provide an opinion 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 reportable condition in which the design or operation of one or more of the internal control components does not reduce to a relatively low level the risk that misstatements caused by error or fraud in amounts 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.

**Compliance and Other Matters**

As part of obtaining reasonable assurance about whether the Academy's financial statements are free of material misstatement, we performed tests of its compliance with certain provisions of laws, regulations, contracts, and grants, noncompliance with which could have a direct and material effect on 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 or other matters that are required to be reported under *Government Auditing Standards*.

However, we noted other matters that do not require inclusion in this report, that we have reported to management of the Academy in a separate letter dated December 29, 2005.

This report is intended solely for the information and use of the Board of Directors, management of the Academy, and is not intended to be and should not be used by anyone other than these specified parties.

*Kennedy, Cottrell + Associates LLC*

Kennedy, Cottrell + Associates  
December 29, 2005



**Auditor of State  
Betty Montgomery**

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**MARION CITY SCHOOL DISTRICT DIGITAL ACADEMY**

**MARION 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  
FEBRUARY 9, 2006**