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Grafer McVey & Co., P.C.
Certified Public Accountants

INDEPENDENT AUDITOR'S REPORT

To the Board of Directors
Western Pennsylvania Cyber Charter School
652 Midland Avenue
Midland, Pennsylvania 15059

We have audited the accompanying general-purpose financial statements of the Western Pennsylvania Cyber Charter School, as of and for the fiscal year ended June 30, 2003, as listed in the table of contents. These general-purpose financial statements are the responsibility of the Western Pennsylvania Cyber Charter School's management. Our responsibility is to express an opinion on these general-purpose 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 the 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 general-purpose financial statements referred to above present fairly, in all material respects, the financial position of the Western Pennsylvania Cyber Charter School as of June 30, 2003, and the results of its operations for the fiscal 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 November 17, 2003 on our consideration of the Western Pennsylvania Cyber Charter School'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.

Grafer, McVey & Co.

November 17, 2003

WESTERN PENNSYLVANIA CYBER CHARTER SCHOOL
 Combined Balance Sheet - All Fund Types and Account Groups
 June 30, 2003

| | Governmental Fund Type | Account Groups | | Totals (Memorandum Only) |
|---------------------------------|---------------------------|-------------------------|----------------------------|--------------------------------|
| | | General Fixed Assets | General Long- Term Debt | |
| ASSETS | | | | |
| Cash and Equivalents | \$ 1,248,689 | | | \$ 1,248,689 |
| Investments - at cost | | | | - |
| Interfund Receivable | | | | - |
| Due from Other Governments | 2,573,588 | | | 2,573,588 |
| Other Receivables | | | | - |
| Buildings & Improvements | | \$ 392,612 | | 392,612 |
| Machinery & Equipment | | 1,971,967 | | 1,971,967 |
| Amount to be Provided for: | | | | |
| Retirement of Lease Obligations | | | \$ 119,440 | 119,440 |
| Compensated Absences | | | | - |
| Total Assets | <u>\$ 3,822,277</u> | <u>\$ 2,364,579</u> | <u>\$ 119,440</u> | <u>\$ 6,306,296</u> |

EXHIBIT I

WESTERN PENNSYLVANIA CYBER CHARTER SCHOOL
 Combined Balance Sheet - All Fund Types and Account Groups
 June 30, 2003

| | Governmental Fund Type | Account Groups | | Totals (Memorandum Only) |
|------------------------------------|---------------------------|-------------------------|----------------------------|--------------------------------|
| | | General Fixed Assets | General Long- Term Debt | |
| LIABILITIES | | | | |
| Interfund Payable | | | | |
| Due to Other Governments | \$ 131,360 | | | \$ 131,360 |
| Accounts Payable | 136,934 | | | 136,934 |
| Credit Line Payable | 249,900 | | | 249,900 |
| Accrued Salaries & Benefits | 43,481 | | | 43,481 |
| Payroll Deductions & Withholdings | 26,926 | | | 26,926 |
| Lease Obligations | | | \$ 119,440 | 119,440 |
| Accumulated Compensated Absences | | | | - |
| Total Liabilities | 588,601 | | 119,440 | 708,041 |
| FUNDEQUITY | | | | |
| Investment in General Fixed Assets | | \$ 2,364,579 | | 2,364,579 |
| Unreserved Fund Balance | | | | |
| Unreserved - Designated | 3,233,676 | | | 3,233,676 |
| Unreserved - Undesignated | | | | - |
| Total Fund Equity | 3,233,676 | 2,364,579 | | 5,598,255 |
| Total Liabilities and Fund Equity | \$ 3,822,277 | \$ 2,364,579 | \$ 119,440 | \$ 6,306,296 |

WESTERN PENNSYLVANIA CYBER CHARTER SCHOOL
 Combined Statement of Revenues, Expenditures and Changes in Fund Balances
 All Governmental Fund Types and Expendable Trust Funds
 Fiscal Year Ended June 30, 2003

| | <u>Governmental Fund Type</u> |
|--|-----------------------------------|
| | <u>General</u> |
| Revenues and Other Financing Sources | |
| Revenues | |
| Local Sources | \$ 8,817,152 |
| State Sources | 108,410 |
| Federal Sources | |
| Other Financing Sources | |
| Refund Prior Years' Expenditures | |
| | <hr/> |
| Total Revenues and Other Financing Sources | 8,925,562 |
| Expenditures and Other Financing Uses | |
| Expenditures | |
| Instruction | 4,541,203 |
| Support Services | 2,658,689 |
| Operation of Noninstructional Services | 6,016 |
| Facilities Acquisition, Construction and Improvement Services | 342,894 |
| Other Financing Uses | |
| Debt Service | 16,872 |
| Operating Transfers to Other Funds | |
| | <hr/> |
| Total Expenditures and Other Financing Uses | <u>7,565,674</u> |
| Revenues and Other Financing Sources Over (Under) Expenditures and Other Financing Uses | 1,359,888 |
| Fund Equity - July 1, 2002 | <u>1,873,788</u> |
| Fund Equity - June 30, 2003 | <u><u>\$ 3,233,676</u></u> |

See Notes to Financial Statements

WESTERN PENNSYLVANIA CYBER CHARTER SCHOOL
Statement of Revenues, Expenditures and Changes in Fund Balance
General Fund - Budget and Actual
Fiscal Year Ended June 30, 2003

| | <u>Budget</u> | <u>Actual</u> | <u>Variance Favorable (Unfavorable)</u> |
|--|-----------------------------|-----------------------------|---|
| Revenues and Other Financing Sources | | | |
| Revenues | | | |
| Local Sources | \$ 7,648,010 | \$8,817,152 | \$ 1,169,142 |
| State Sources | 56,500 | 108,410 | 51,910 |
| Federal Sources | | | - |
| Other Financing Sources | | | |
| Refund of Prior Years' Expenditures | <u> </u> | <u> </u> | <u> </u> |
| Total Revenue and Other Financing Sources | 7,704,510 | 8,925,562 | 1,221,052 |
| Expenditures and Other Financing Uses | | | |
| Expenditures | | | |
| Instruction | | | |
| Regular Programs | 4,256,407 | 4,316,480 | (60,073) |
| Special Education Programs | 382,196 | 107,711 | 274,485 |
| Vocational Education Programs | 8,000 | | 8,000 |
| Other Instructional Programs | 42,900 | | 42,900 |
| Community and Junior College Education Programs | <u>125,000</u> | <u>117,012</u> | <u>7,988</u> |
| Total Instruction | 4,814,503 | 4,541,203 | 273,300 |
| Support Services | | | |
| Pupil Personnel | 56,929 | 39,545 | 17,384 |
| Instructional Staff | 785,690 | 577,439 | 208,251 |
| Administration | 729,787 | 799,314 | (69,527) |
| Pupil Health | 36,735 | 41,771 | (5,036) |
| Business | 62,000 | 605,611 | (543,611) |
| Plant Operation and Maintenance | 636,086 | 330,752 | 305,334 |
| Student Transportation | | | - |
| Central Support | <u> </u> | <u>264,257</u> | <u>(264,257)</u> |
| Total Support Services | 2,307,227 | 2,658,689 | (351,462) |

See Notes to Financial Statements

WESTERN PENNSYLVANIA CYBER CHARTER SCHOOL
Statement of Revenues, Expenditures and Changes in Fund Balance
General Fund - Budget and Actual
Fiscal Year Ended June 30, 2003

| | <u>Budget</u> | <u>Actual</u> | <u>Variance Favorable (Unfavorable)</u> |
|--|-------------------|--------------------|---|
| Expenditures and Other Financing Uses | | | |
| Operation of Noninstructional Services | | | |
| Student Activities | \$ 86,000 | \$ 6,016 | \$ 79,984 |
| Community Services | <u>90,280</u> | <u> </u> | <u>90,280</u> |
| Total Operation of Non-Instructional Services | 176,280 | 6,016 | 170,264 |
| Facilities Acquisition, Construction and Improvement Services | | | |
| | 350,000 | 342,894 | 7,106 |
| Other Financing Uses | | | |
| Debt Service | | 16,872 | (16,872) |
| Operating Transfers to Other Funds | | | - |
| Budgetary Transfers | <u> </u> | <u> </u> | <u> </u> |
| Total Other Financing Uses | <u>-</u> | <u>16,872</u> | <u>(16,872)</u> |
| Total Expenditures and Other Financing Uses | <u>7,648,010</u> | <u>7,565,674</u> | <u>82,336</u> |
| Revenues and Other Financing Sources Over (Under) Expenditures and Other Financing Uses | | | |
| | 56,500 | 1,359,888 | 1,303,388 |
| Fund Equity - July 1, 2002 | <u>-</u> | <u>1,873,788</u> | <u>1,873,788</u> |
| Fund Equity - June 30, 2003 | <u>\$ 56,500</u> | <u>\$3,233,676</u> | <u>\$ 3,177,176</u> |

See Notes to Financial Statements

WESTERN PENNSYLVANIA CYBER CHARTER SCHOOL
Notes To Financial Statements
June 30, 2003

NOTE 1 – REPORTING ENTITY

The Western Pennsylvania Cyber Charter School was formed under the laws of the state of Pennsylvania to provide elementary and secondary education to students through a computer managed learning system designed to meet individual student's needs and styles.

In considering whether there were other entities that should be reported as component units on the School's financial statements, Government Accounting Standards Board Statement No. 14, The Financial Reporting Entity, was used for guidance in determining the activities, organizations and functions of government to be included in the financial statements of the School. The criteria used in determining whether such organizations should be included in the School's financial reporting entity were as follows:

Oversight responsibility
Scope of public service
Other financial relationships

Based upon the above criteria, there are no component units as defined in Government Accounting Standards Board Statement 14 that should be included in the School's reporting entity.

NOTE 2 – SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

The accounting policies of the Western Pennsylvania Cyber Charter School conform to generally accepted accounting principles, as applicable to governmental units.

BASIS OF PRESENTATION

The School's accounting system is organized and operated on a fund basis. A fund is defined as a fiscal and accounting entity with a self-balancing set of accounts that comprise its assets, liabilities, and residual equities or balances, and changes therein, which are segregated for the purpose of carrying on specific activities or attaining certain objectives in accordance with specific regulations restrictions or limitations.

Account groups are used to establish account control and accountability for the School's general fixed assets and long-term debt.

GOVERNMENTAL FUND TYPES

General Fund - The general fund is the general operating fund of the School and accounts for all revenues and expenditures of the School not encompassed within other funds. All revenues and other receipts that are not allocated by law or contractual agreement to some other fund are accounted for in the general fund. General operating expenditures that are not paid through other funds are paid from the general funds.

GENERAL ACCOUNT GROUPS

Fixed Assets used in governmental fund type operations (general fixed assets) are accounted for in the General Fixed Assets Account Group, rather than in governmental funds. General fixed assets are recorded as expenditures through the appropriate funds at the time of purchase.

General Long-Term Debt - Long-term liabilities expected to be financed from governmental funds are accounted for in the general long-term debt account group, not in the Governmental Funds.

WESTERN PENNSYLVANIA CYBER CHARTER SCHOOL
Notes To Financial Statements
June 30, 2003

NOTE 2 – SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

BASIS OF ACCOUNTING

The accounting and financial reporting treatment applied to a fund is determined by its measurement focus. All governmental fund types are accounted for using a current financial resources measurement focus. With this measurement focus, only current assets and current liabilities generally are included on the balance sheet. Operating statements of these funds present increases (i.e., revenues and other financing sources) and decreases (i.e., expenditures and other financing uses) in net current assets.

The modified accrual basis of accounting is followed by the governmental fund types and the agency fund. Under the modified accrual basis of accounting, revenues are recorded when susceptible to accrual, i.e., both measurable and available. Available means collectible within the current period or soon enough thereafter to be used to pay liabilities of the current period. Expenditures, other than interest on long-term debt, are recorded when the related fund liability is incurred, if measurable.

Revenue from local sources consists primarily of tuition payments from other Local Education Agencies and is recorded when earned. Revenues received from the State of Pennsylvania are recognized when susceptible to accrual. Miscellaneous revenues are recorded as revenue when received in cash because they are generally not measurable until actually received. Investment earnings are recorded as earned since they are measurable and available.

Grant funds from federal sources and passed through the Pennsylvania Department of Education or other Local Education Agency are considered to be earned to the extent of expenditures made under the provisions of the grant and, accordingly, when such funds are received they are recorded as deferred revenues until earned.

The general fixed asset group of accounts are recorded at actual cost. Fixed asset purchases are recorded as expenditures in the general fund at the time of purchase. Such assets are to be capitalized at cost in the general fixed asset account group.

The general long-term debt group of accounts are reported at fair value of the outstanding liability. Payments on long-term debts are recorded in the general fund when paid.

Cash and Cash Equivalents - The School's policy is to maintain cash balances in interest-bearing accounts such as money market or flex funds. The market values of the funds approximate cost. All highly liquid investments of three months or less in duration are reported as cash equivalents.

ENCUMBRANCE ACCOUNTING

Encumbrances for goods or purchased services are documented by purchase orders or contracts. Under Pennsylvania Law, appropriations lapse at fiscal year-end, and encumbrances outstanding at year-end would be either cancelled or reappropriated in the subsequent year's budget. A reservation of fund balance equal to outstanding encumbrances at year-end would be provided for at fiscal year-end. Accordingly, no differences exist between actual results and the applicable budgetary data presented in the accompanying general purpose financial statements.

WESTERN PENNSYLVANIA CYBER CHARTER SCHOOL
Notes To Financial Statements
June 30, 2003

NOTE 2 – SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (continued)

BUDGET

The School passed an appropriated budget for the fiscal year ended June 30, 2003 with revenues totaling \$7,704,510 and expenditures totaling \$7,648,010.

The School is required by state law to adopt an annual budget for the General Fund. The budget is presented on the modified accrual basis of accounting which is consistent with generally accepted accounting principles. The following procedures are followed in relation to the adoption of an annual budget reporting of its financial statements.

1. Prior to June 1 of the preceding fiscal year, the School prepares a budget for the next succeeding fiscal year beginning July 1. The operating budget includes proposed expenditures and the means of financing them.
2. A meeting of the School Board is then called for the purpose of adopting the proposed budget, after ten days' public notice of the meeting has been given.
3. Prior to July 1, the budget is legally enacted through passage of a resolution by the School Board.
4. The budget for the general fund must be file with the Office of the Department of Public Instruction within fifteen (15) days after the adoption of the budget.

Once the budget is approved, it can be amended at the function and fund level only by approval of a majority of the members of the School Board. Amendments are presented to the School Board at their regular meetings. Each amendment must have School Board approval. Such amendments are made before the fact and are reflected in the official minutes of the School Board, and are not made after fiscal year-end as dictated by law.

Each budget is prepared and controlled by the budget coordinator at the revenue and expenditure function/object level. Budgeted amounts are as amended by the School Board. All budget appropriations lapse at year-end.

Estimates - The preparation of financial statements in conformity with generally accepted accounting principles requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities and disclosure of contingent assets and liabilities at the date of the financial statements and the reported amounts of revenues and expenditures during the reporting period. Actual results could differ from those estimates.

Total Columns on Combined Statements - The total columns presented in the combined financial statements are captioned "Memorandum Only" to indicate that they are presented only to facilitate financial analysis. No consolidating entries or other eliminations were made in the aggregation of the totals; thus, they do not present consolidated information and do not purport to present financial position, results of operations or changes in financial position in conformity with generally accepted accounting principles.

WESTERN PENNSYLVANIA CYBER CHARTER SCHOOL
Notes To Financial Statements
June 30, 2003

NOTE 3 – COMPLIANCE AND ACCOUNTABILITY

The School's General Fund has an unreserved-undesignated fund balance of \$3,233,676 as of June 30, 2003. The unreserved-undesignated fund balance is appropriable for expenditure or not legally or otherwise segregated for a specific to tentative future use. Revenues exceed expenditures by \$1,359,888 in the general fund.

NOTE 4 – CASH AND INVESTMENTS

Pennsylvania statutes provide for investment of governmental funds into certain authorized investment types including U.S. Treasury Bills, other short-term U.S. and Pennsylvania government obligations, and insured or collateralized time deposits and certificates of deposit. The statutes do not prescribe regulations related to demand deposits; however, they do allow the pooling of governmental funds for investment purposes.

DEPOSITS

At June 30, 2003, the deposits of the School can be categorized to indicate the level of risk assumed. Category 1 - Includes insured deposits and deposits collateralized with securities held by the entity or by its agent in the entity's name and investments which are insured or registered and held by the entity or its agent in the entity's name. Category 2 - Includes uninsured deposits collateralized with securities held by the pledging financial institution's trust department or agent in the entity's name and uninsured, unregistered investments held by the counterparty's trust department or agent in the entity's name. Category 3 - Includes uninsured deposits collateralized with securities held by the pledging financial institution's trust department or agent not in the entity's name and uninsured, unregistered investments held by the counterparty's trust department or agent not in the entity's name. Pennsylvania statutes require banks to pledge collateral for School deposits in excess of \$100,000.

| | <u>Carrying Amount</u> | <u>Bank Balance</u> | <u>Category 1</u> | <u>Category 2</u> | <u>Category 3</u> |
|--------------------|----------------------------|-------------------------|-----------------------|-----------------------|-----------------------|
| General Fund: Cash | \$ <u>1,235,301</u> | \$ <u>1,428,013</u> | \$ <u>100,000</u> | | \$ <u>1,328,013</u> |

CASH EQUIVALENTS AND INVESTMENTS

The investments of the School as of June 30 2003 have been categorized to indicate the level of risk assumed by the School. Category 1 includes investments that are insured or registered and are held by the School's agent in the School's name. Category 2 includes uninsured and unregistered investments held by the financial institution's trust department or agent in the School's name. Category 3 includes uninsured and unregistered investments by the financial institution's trust department or agent, but not in the School's name.

| | <u>Category 1</u> | <u>Category 2</u> | <u>Category 3</u> | <u>Bank Balance</u> | <u>Carrying Value</u> |
|---------------|-----------------------|-----------------------|-----------------------|-------------------------|---------------------------|
| General Fund: | | | | | |
| Merrill Lynch | | \$ <u>13,388</u> | | \$ <u>13,388</u> | \$ <u>13,388</u> |

WESTERN PENNSYLVANIA CYBER CHARTER SCHOOL
Notes To Financial Statements
June 30, 2003

NOTE 5 – GENERAL FIXED ASSETS

A summary of fixed assets recorded in the general fixed asset account group is as follows:

| | <u>Buildings & Improvements</u> | <u>Equipment & Furniture</u> | <u>Total</u> |
|----------------------------------|---|--------------------------------------|---------------------|
| Balance, July 1, 2002 | \$ 49,717 | \$ 1,323,874 | \$ 1,373,591 |
| Additions | | | |
| Building Improvements | 342,895 | | 342,895 |
| Technology Equipment & Furniture | <u> </u> | <u>648,093</u> | <u>648,093</u> |
| Balance, June 30, 2003 | \$ <u>392,612</u> | \$ <u>1,971,967</u> | \$ <u>2,364,579</u> |

NOTE 6 – CREDIT LINE PAYABLE

The School currently has a credit line with Sky Bank for short-term financing needs. The maximum borrowing amount of the credit line is \$500,000. The credit line is payable upon demand, and is renewed annually. Interest is charged at the Bank's going prime rate plus two percent, 2.00%. At June 30, 2003 the rate charges amounted to 4.30%. During the fiscal year ended June 30, 2003, the School had borrowed \$150,000 on the line and repaid \$100.00. Interest paid on the line for the fiscal year ended June 30, 2003 totaled \$10,917. As of June 30, 2003 the outstanding obligation on the credit line in the amount of \$249,900. Due to the short-term nature of the credit line, this obligation has been recorded as a current liability of the general fund.

NOTE 7 – LEASE OBLIGATIONS

The School has entered into various leases for facilities and equipment. The leases require fixed monthly payments, inclusive of interest, through May 2006. The following is a summarization of lease purchase obligations capitalized and currently being serviced by the general fund of the school.

| <u>Lease Description</u> | <u>Lease Date</u> | <u>Expiration Date</u> | <u>Obligation Amount</u> |
|--|-----------------------|----------------------------|------------------------------|
| Sky Bank – Ford Expedition Wagon Payable in 36 monthly installments of \$1,191.03 | Jan 2003 | Jan 2006 | \$ 34,452 |
| Sky Bank – Chrysler Mini Van Payable in 36 monthly installments of \$1,444.00 | May 2003 | May 2006 | 46,768 |
| Xerox Corp – Photocopier Payable in 36 monthly installments of \$346.97 | July 2001 | June 2004 | 4,164 |
| Xerox Corp – Photocopier Payable in 36 monthly installments of \$338.03 | July 2001 | June 2004 | 4,056 |

WESTERN PENNSYLVANIA CYBER CHARTER SCHOOL
Notes To Financial Statements
June 30, 2003

NOTE 7 – LEASE OBLIGATIONS (continued)

| <u>Lease Description</u> | <u>Lease Date</u> | <u>Expiration Date</u> | <u>Obligation Amount</u> |
|---|-------------------|------------------------|--------------------------|
| Midland Boro School District - Building Payable in 15 monthly installments of \$10,000 | June 2002 | Sept 2003 | <u>30,000</u> |
| Total Obligation | | | \$ <u>119,440</u> |

Future minimum lease payments on the lease obligation are as follows:

| <u>Fiscal Year</u> | <u>Amount</u> |
|--------------------|-------------------|
| 2003-2004 | \$ 69,840 |
| 2004-2005 | 31,620 |
| 2005-2006 | <u>17,980</u> |
| | \$ <u>119,440</u> |

During the fiscal year ended June 30, 2003, the School was obligated to the Midland Boro School District for operating leases dated July 1, 2002 for the use of facilities, vehicles and technology equipment. The lease term runs twelve (12) months and expires June 30, 2003. Lease payments for the fiscal year ended June 30, 2003 amounted to \$51,000.

NOTE 8 – RETIREMENT PLAN

All eligible employees of the School participate in the Pennsylvania Public School Employees' Retirement System (PSERS), as established by authority of the Public School Employees' Retirement Code (Act No. 96 of October 2, 1975, as amended). PSERS is a statewide Governmental cost sharing multiple employer retirement system covering all employees of local school districts within the state of Pennsylvania. PSERS provides retirement and disability, legislatively mandated ad hoc cost-of-living adjustments, and healthcare insurance. The Public School Employees' Retirement System issues a publicly available financial report that may be obtained by writing to Public Employees' Retirement System of Pennsylvania, P. O. Box 125, Harrisburg, PA 17108, or at the PSERS website at www.psers.state.pa.us.

Active members who joined the system prior July 22, 1983 contribute at 5.25 percent (membership class TC) or at 6.50 percent (membership class TD) of the member's qualifying compensation. Members who joined the system on or after July 22, 1983 contribute at 6.25 percent (membership class TC) or at 7.50 percent (membership class TD) of the member's qualifying compensation. Members who joined the system after June 30, 2001 contribute 7.50 percent (automatic membership class T-D). For all new hires and for members who elected Class T-D membership, the higher contribution rates began with service rendered on or after January 1, 2002. The Western Pennsylvania Cyber Charter School is required to contribute at an actuarially determined rate. The rates applied to covered payroll were 1.15 percent at June 30, 2003 and 1.09 percent at June 30, 2002. The 1.15 percent at June 30, 2003 is entirely attributed to actuarial requirement for healthcare insurance premiums.

The Western Pennsylvania Cyber Charter School's contribution to PSERS for the years ended June 30, 2003 and 2002 amounted to \$20,961 and \$9,450, respectively.

WESTERN PENNSYLVANIA CYBER CHARTER SCHOOL
Notes To Financial Statements
June 30, 2003

NOTE 9 – COMMITMENTS AND CONTINGENCIES

Litigation – The western Pennsylvania Cyber Charter School is involved in two litigation concerning payments from Pennsylvania School Districts to cyber charter schools. The Western Pennsylvania Cyber Charter School is defending its position as a legitimate charter school under Pennsylvania law. As of the date of these financial statements, none of the cases the School is party to have been settled.

Grant Programs - The School participates in various state and federal grant programs that are governed by various rules and regulations of the grantor agencies. Costs charged to the respective programs are subject to audit and adjustments by the grantor agencies; therefore, to the extent that the School has not complied with the rules and regulations applicable to the grant programs, refunds of and grant funds received may be required and the collectibility of any related receivable may be impaired. In the opinion of the School, there are no significant contingent liabilities relating to compliance with the rules and regulations applicable to the state and federal grants; therefore, no provision has been recorded in the accompanying general-purpose financial statements for such contingencies.

NOTE 10 – GOVERNMENT ACCOUNTING STANDARDS NO. 34

Government Accounting Standards No. 34 establishes financial reporting standards for state and local governments, including school districts. It establishes that the basic financial statements and required supplemental information (RSI) for general-purpose governments should consist of:

1. Management's discussion and analysis (MD&A). MD&A should introduce the basic financial statements and provide an analytical overview of the governments financial activity.
2. Government-wide financial statements using the economic measurement focus, which will include all capital assets, depreciation and outstand debt.
3. Required supplementary information (RSI) to include whether resources were obtained and used in accordance with the legally adopted budget (i.e. original budget before transfers).

This statement will require changes in reporting, general ledger accounting, and significant research to accomplish the conversion. The Western Pennsylvania Cyber Charter School is required to report in accordance with FASB No. 34 starting with the fiscal year 2003-2004.

NOTE 11 – RELATED PARTY TRANSACTIONS

The Chief Administrative Officer of the Western Pennsylvania Cyber Charter School is also the Superintendent of the Midland Borough School District. The Chief Administrative Officer of the Western Pennsylvania is compensated for services rendered to the School. The following financial transactions took place between the Midland Borough School District and the Western Pennsylvania Cyber Charter School:

WESTERN PENNSYLVANIA CYBER CHARTER SCHOOL

Notes To Financial Statements

June 30, 2003

NOTE 11 – RELATED PARTY TRANSACTIONS (continued)

1. An intergovernmental payable to the Midland Borough School District in the amount of \$131,360 has been reported on the balance sheet at June 30, 2003. This amount represents use by the School of property owned by the Midland Borough School District, and for compensation of the School's Chief Administrative Officer. The following is a breakdown of the related party payable:

| | |
|---|-------------------|
| Lease of data-server and e-mail services | \$ 12,000 |
| Lease of vehicle use | 24,000 |
| Lease of building at 652 Midland Avenue | 15,000 |
| Services of the Midland Borough School District Superintendent | <u>80,360</u> |
| Total | \$ <u>131,360</u> |

The entire amount was realized as an expense during the fiscal year ended June 30, 2003, and is shown as Support Services expense and Instruction expense on the Combined Statement of Revenues, Expenditures and Changes in Fund Balance at June 30, 2003.

2. During the fiscal year ended June 30, 2003, the Western Pennsylvania Cyber Charter School leased the building at 652 Midland Avenue, Midland, PA, for its operations from the Midland Borough School District for a monthly lease cost of \$10,000. Rent expense realized for the fiscal year ended June 30, 2003 amounted to \$120,000.

NOTE 12 – SUBSEQUENT EVENTS

As of July 1, 2003 the Western Pennsylvania Cyber Charter School entered into the following leases with the Lincoln Park Performing Arts Center:

1. Lease to rent the building at 900 Midland Avenue (i.e. Ruth Building) for \$20,000 per month for office space. The lease is a month to month lease. During the fiscal year ended June 30, 2003 the School expended \$228,402 for improvements to the building.
2. Lease to rent the building at 935 Ohio Avenue (i.e. Boston House) for an annual payment of \$1.00 for office space. The lease is an annual lease. During the fiscal year ended June 30, 2003 the School expended \$106,157 for improvements to the building.

On September 4, 2003 the School entered into a lease with Sky Bank for the purchase of computer equipment used for educational and instructional purposes. The lease is payable in quarterly installments of \$124,863.85 including interest, beginning November 23, 2003 and maturing on August 23, 2005. Total payments to Sky Bank over the lease term amounts to \$998,911.

WESTERN PENNSYLVANIA CYBER CHARTER SCHOOL

OTHER FINANCIAL INFORMATION

FISCAL YEAR ENDED JUNE 30, 2003

Grafer McVey & Co., P.C.
Certified Public Accountants

REPORT ON COMPLIANCE AND ON INTERNAL CONTROL OVER FINANCIAL
REPORTING BASED ON AN AUDIT OF FINANCIAL STATEMENTS PERFORMED
IN ACCORDANCE WITH GOVERNMENT AUDITING STANDARDS

To The Board of Directors
Western Pennsylvania Cyber Charter School
652 Midland Avenue
Midland, Pennsylvania 15059

We have audited the general-purpose financial statements of Western Pennsylvania Cyber Charter School for the year ended June 30, 2003, and have issued our report thereon dated November 17, 2003. 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 Western Pennsylvania Cyber Charter School's general-purpose 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 that are required to be reported under Government Auditing Standards. However, we noted certain immaterial instances of noncompliance that we have reported to management of the Western Pennsylvania Cyber Charter School in a separate letter dated November 17, 2003.

Internal Control Over Financial Reporting

In planning and performing our audit, we considered the Western Pennsylvania Cyber Charter School's internal control over financial reporting in order to determine our auditing procedures for the purpose of expressing our opinion on the general-purpose 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 would 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 general-purpose 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 other matters involving the internal control over financial reporting that we have reported to management of the Western Pennsylvania Cyber Charter School in a separate letter dated November 17, 2003.

This report is intended solely for the use of management of the Western Pennsylvania Cyber Charter School, U.S. Department of Education, Pennsylvania Department of Education and other pass-through entities, and is not intended to be and should not be used by anyone other than these specified parties.

Truex M Vg + Co

November 17, 2003

Grafer McVey & Co., P.C.
Certified Public Accountants

To The Board of Directors
Western Pennsylvania Cyber Charter School
625 Midland Avenue
Midland, Pennsylvania 15059

We have audited the general-purpose financial statements of the Western Pennsylvania Cyber Charter School for the year ended June 30, 2003. As part of our audit we made a study and evaluation of the School's system of internal accounting control to the extent we considered necessary to evaluate the system as required by generally accepted accounting auditing standards. Under those standards, the purpose of such evaluation is to establish a basis for reliance on the system of internal accounting control to determine the nature, timing and extent of other auditing procedures that are necessary for expressing an opinion on the general-purpose financial statements and to assist the auditors in planning and performing the audit of the general-purpose financial statements.

The objective of internal accounting control is to provide reasonable, but not absolute, assurance as to the safeguarding of assets against loss from unauthorized use or disposition, and the reliability of financial records for preparing financial statements and maintaining accountability for assets. The concept of reasonable assurance recognizes that the cost of a system of internal accounting control should not exceed the benefits derived and also recognizes that the evaluation of these factors necessarily requires estimates and judgments by management.

There are inherent limitations that should be recognized in considering the potential effectiveness of any system of internal accounting control. In the performance of most control procedures, errors can result from misunderstanding of instructions, mistakes of judgments, carelessness or other personal factors. Control procedures whose effectiveness depends upon the segregation of duties can be circumvented by collusion. Similarly, control procedures can be circumvented intentionally by management either with respect to the execution and recording of transactions or with respect to the estimates and judgments required in the preparation of financial statements. Further, projection of any evaluation of internal accounting control to future periods is subject to the risk that the procedures may become inadequate because changes in conditions that the degree of compliance with the procedures may deteriorate.

Our audit of the general-purpose financial statements made in accordance with generally accepted auditing standards, including the study and evaluation of the School's internal accounting control for the year ended June 30, 2003 that was made for the purpose set forth in the first paragraph of this report, would not necessarily disclose all weaknesses in the system because it was based on selective tests of accounting records and data. However, such study and evaluation disclosed the following.

SEGREGATION OF DUTIES

The School has limited staff responsible for or with access to receipts, check writing, bank reconciliation, account coding, and general ledger posting.

Due to limited staff, segregation of the above duties is not practical, if not impossible. The responsibility of management is greatly increased because the Board must rely on their knowledge of the everyday operations to discover any material changes in the School's financial position. Management should take a greater role in the review and approval of accounting transactions and financial reports. All material changes in monthly reports and/or accounting transactions and data should be thoroughly investigated.

RELATED PARTY TRANSACTIONS

During the audit, it was noted the Western Pennsylvania Cyber Charter School engaged in several related party transactions with the Midland Borough School District. These transactions were considered to be related party transactions because the Superintendent of the Midland Borough School District is also the Chief Administrative Officer of the Western Pennsylvania Cyber Charter School.

The School needs to establish policy to define the criteria and documentation requirement for related party transactions to ensure that related party transactions are properly recorded, and that the transactions are consummated on terms equivalent to those that prevail in an "arm's-length" transaction.

POLICIES AND PROCEDURES

The foundation of any sound system of internal accounting controls requires the establishment of written policies and procedures governing the flow of financial transactions and data as well as the School's compliance with certain provisions of laws, regulations, contracts, and grants.

The School needs to establish written policies and implement written procedures governing school finances, purchasing, budgetary accounting, and student activities. As part of this process, the policies and procedures should clearly outline the job responsibility of each employee or class of employees. In addition, relevant policies and procedures as well as job responsibilities should be disseminated to all applicable employees.

BUDGETARY PROCESS

State law and governmental accounting standards require the periodic transfer of budgeted amounts from one budgetary line item to another budgetary line item when the actual expenditures for that particular budgetary line exceed the amount budgeted for that line item. Transfers should be made at the time actual expenditures exceed the amount budgeted, and should be approved by the Board.

The formation of policies and procedures should include the establishment and implementation of proper budgetary guidelines in accordance with state law and governmental accounting standards. Budget transfers should be made at the time actual expenditures for a budgeted line item exceeds the actual budget for that line item. At the minimum, transfers are required to be made at the function and major object level. All transfers should be presented in writing to the Board and approved by the Board through Board resolution.

PURCHASING

State law requires the use of quotes and written bids when a single purchase, or a series of similar purchases to one vendor made in short time period, exceeds a specific dollar amount. Purchase orders should be reviewed and approved by a responsible school official to ensure compliance.

The development of policies and implementation of procedures should require the appropriate use of purchasing guidelines established by state law. Procedures should be disseminated to all applicable individuals charged with purchasing responsibilities to ensure purchasing guidelines are followed. Management responsible for approving purchase orders should review purchase orders to ensure quotes and or written bids are obtained when applicable.

DISBURSEMENTS / EXPENDITURES

The development of policies and implementation of procedures needs to address the use of employer owned credit cards and vehicles.

Credit cards

Policies and procedures need to be established that requires complete and accurate documentation of all expenses charged on School owned credit cards. Policy should discourage the charging of personal expenses and provide for the reimbursement of any undocumented or personal expense charged to the School's credit card.

Proper review of credit card charges should be made to ensure adherence with policy. All credit card purchases should be approved by management prior to payment.

Vehicles

Policies and procedures need to be implemented as to when and what employees are eligible to use vehicles owned or leased by the School. Policies should be designed to discourage personal use. Implemented procedures should require the documentation of when vehicles are used, who uses the vehicle and the purpose for which the vehicle was used.

Policy should require vehicles to be returned and to reside on the School's property at all times when not in use. Policy should require the reimbursement of personal use from the applicable employee.

STUDENT BILLINGS AND TUITION ACCOUNTS

Policies regarding student tuition billings should require tuition billing be made using the most current or recent expenditure per ADM figure. The School should use either the expenditure per ADM figure provided by the school district in which the student resides or the figure supplied by the PA Dept of Education for that school district. Previous billings should be adjusted to reflect any changes made in the expenditures per ADM figure.

Final tuition billings should be reviewed for accuracy and compared to monthly billing statements for each school district. In addition, a comparison should be performed to student billing activity in the general ledger to ensure final billings are complete and accurate.

The preceding comments and recommendations are submitted to assist you in your efforts for the continued improvements and development of policies, procedures and controls. Our comments are not intended to be critical of individual persons, but rather constructive suggestions to assist you in these efforts. We would be happy to discuss these matters with you at any time and to furnish any additional information you may require.

Gregory M. W. + C.

November 17, 2003

WESTERN PENNSYLVANIA CYBER CHARTER SCHOOL
LIST OF REPORT DISTRIBUTION
JUNE 30, 2003

1. Commonwealth of Pennsylvania
Office of the Budget
Bureau of Audits
303 Walnut Street
Bell Tower - Strawberry Square
6th Floor
Harrisburg, PA 17101
2. Beaver Valley Intermediate Unit
225 Center Grange Road
Aliquippa, PA 15001
3. Beaver County Court House
Clerk of Courts
810 Third Street
Beaver, PA 15009