

Management Report

for

Independent School District No. 199
Inver Grove Heights, Minnesota
June 30, 2014

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To the School Board of
Independent School District No. 199
Inver Grove Heights, Minnesota

We have prepared this management report in conjunction with our audit of Independent School District No. 199, Inver Grove Heights, Minnesota's (the District) financial statements for the year ended June 30, 2014. The purpose of this report is to communicate information relevant to the financing of public education in Minnesota and to provide comments resulting from our audit process. We have organized this report into the following sections:

- Audit Summary
- Funding Public Education in Minnesota
- Financial Trends of Your District
- Legislative Summary
- Accounting and Auditing Updates

We would be pleased to further discuss any of the information contained in this report or any other concerns that you would like us to address. We would also like to express our thanks for the courtesy and assistance extended to us during the course of our audit.

The purpose of this report is solely to provide those charged with governance of the District, management, and those who have responsibility for oversight of the financial reporting process comments resulting from our audit process and information relevant to school district financing in Minnesota. Accordingly, this report is not suitable for any other purpose.

Malloy, Montague, Karnowski, Radosevich & Co., P.A.

Minneapolis, Minnesota
December 1, 2014

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AUDIT SUMMARY

The following is a summary of our audit work, key conclusions, and other information that we consider important or that is required to be communicated to the School Board, administration, or those charged with governance of the District.

OUR RESPONSIBILITY UNDER AUDITING STANDARDS GENERALLY ACCEPTED IN THE UNITED STATES OF AMERICA, *GOVERNMENT AUDITING STANDARDS*, AND THE U.S. OFFICE OF MANAGEMENT AND BUDGET (OMB) CIRCULAR A-133

We have audited the financial statements of the governmental activities, each major fund, and the aggregate remaining fund information of the District as of and for the year ended June 30, 2014, and the related notes to the financial statements. Professional standards require that we provide you with information about our responsibilities under auditing standards generally accepted in the United States of America, *Government Auditing Standards*, and OMB Circular A-133, as well as certain information related to the planned scope and timing of our audit. We have communicated such information to you verbally and in our audit engagement letter. Professional standards also require that we communicate to you the following information related to our audit.

PLANNED SCOPE AND TIMING OF THE AUDIT

We performed the audit according to the planned scope and timing previously discussed and coordinated in order to obtain sufficient audit evidence and complete an effective audit.

AUDIT OPINION AND FINDINGS

Based on our audit of the District's financial statements for the year ended June 30, 2014:

- We have issued an unmodified opinion on the District's annual financial statements.
- We reported two deficiencies involving the District's internal control over financial reporting that we considered to be material weaknesses:
 - Due to the limited size of the District's business office staff, the District has limited segregation of duties in several areas.
 - Due to the turnover of district personnel, the District's monthly cash reconciliation process and the recording of cash receipts to the general ledger were not being completed in a timely manner at times during the year.
- The results of our testing disclosed no instances of noncompliance that are required to be reported under *Government Auditing Standards*.
- We reported that the Schedule of Expenditures of Federal Awards is fairly stated, in all material respects, in relation to the basic financial statements.
- The results of our tests indicate that the District has complied, in all material respects, with the requirements that could have a direct and material effect on each major federal program.
- We reported one matter involving the internal control over compliance and its operation that we consider to be a significant deficiency in our testing of major federal programs:
 - For the child nutrition cluster of federal programs, the District did not have adequate controls in place to assure that it was not contracting for goods or services with parties that are suspended or debarred, or whose principals are suspended or debarred.
- We reported no findings based on our testing of the District's compliance with Minnesota laws and regulations.

EXTRACURRICULAR STUDENT ACTIVITY ACCOUNTS

In accordance with Minnesota Statutes, the District's School Board has elected not to exercise control over the transactions of the extracurricular student activity accounts maintained at various district sites. Consequently, the cash receipts and disbursements of the District's extracurricular student activity accounts are reported in a separate set of financial statements, rather than being reported within the District's General Fund. We have issued an opinion on these separate financial statements, stating that they fairly present the cash balances and cash receipts and disbursements of these accounts as of and for the year ended June 30, 2014 on the cash basis of accounting. Our opinion was qualified for a limitation related to the completeness of cash receipts reported.

We reported one deficiency involving internal control over financial reporting for the District's extracurricular student activities that we consider to be a material weakness. The District reports student activities on a cash basis, and has not established procedures to assure that all cash collections are recorded in the accounting records. Procedures such as the use and reconciliation of prenumbered receipts, prenumbered admission tickets for events, and inventory controls over items sold for fundraisers would help strengthen the controls in this area.

We also issued a report on compliance with the Minnesota Department of Education's (MDE) *Manual for Activity Fund Accounting*, in which we reported no findings.

SIGNIFICANT ACCOUNTING POLICIES

Management is responsible for the selection and use of appropriate accounting policies. The significant accounting policies used by the District are described in Note 1 of the notes to basic financial statements. No new accounting policies were adopted and the application of existing policies was not changed during the fiscal year ended June 30, 2014.

We noted no transactions entered into by the District during the year for which there is a lack of authoritative guidance or consensus. All significant transactions have been recognized in the financial statements in the proper period.

CORRECTED AND UNCORRECTED MISSTATEMENTS

Professional standards require us to accumulate all known and likely misstatements identified during the audit, other than those that are trivial, and communicate them to the appropriate level of management. Where applicable, management has corrected all such misstatements. In addition, none of the misstatements detected as a result of audit procedures and corrected by management, when applicable, were material, either individually or in the aggregate, to each opinion unit's financial statements taken as a whole.

DIFFICULTIES ENCOUNTERED IN PERFORMING THE AUDIT

We encountered no significant difficulties in dealing with management in performing and completing our audit.

DISAGREEMENTS WITH MANAGEMENT

For purposes of this letter, professional standards define a disagreement with management as a financial accounting, reporting, or auditing matter, whether or not resolved to our satisfaction, that could be significant to the financial statements or the auditor's report. We are pleased to report that no such disagreements arose during the course of our audit.

ACCOUNTING ESTIMATES AND MANAGEMENT JUDGMENTS

Accounting estimates are an integral part of the financial statements prepared by management and are based on management's knowledge and experience about past and current events and assumptions about future events. Certain accounting estimates are particularly sensitive because of their significance to the financial statements and because of the possibility that future events affecting them may differ significantly from those expected. The most sensitive estimates affecting the financial statements were:

General education revenue and certain other revenues are computed by applying an allowance per student to the number of students served by the District. Student attendance is accumulated in a state-wide database—MARSS. Because of the complexity of student accounting and because of certain enrollment options, student information is input by other school districts and the MARSS data for the current fiscal year is not finalized until after the District has closed its financial records. General education revenue and certain other revenues are computed using preliminary information on the number of students served in the resident district and also utilizing some estimates, particularly in the area of enrollment options.

Special education state aid includes an adjustment related to tuition billings to and from other school districts for special education services which are computed using formulas derived by the MDE. Because of the timing of the calculations, this adjustment for the current fiscal year is not finalized until after the District has closed its financial records. The impact of this adjustment on the receivable and revenue recorded for state special education aid is calculated using preliminary information available to the District.

The District has recorded a liability in the Statement of Net Position for severance benefits payable for which it is probable employees will be compensated. The "vesting method" used by the District to calculate this liability is based on assumptions involving the probability of employees becoming eligible to receive the benefits (vesting), the potential use of accumulated sick leave prior to termination, and the age at which such employees are likely to retire.

The District has recorded activity for other post-employment benefits (OPEB) and pension benefits. These obligations are calculated using actuarial methodologies described in Governmental Accounting Standards Board (GASB) Statement Nos. 27 and 45. These actuarial calculations include significant assumptions, including projected changes, healthcare insurance costs, investment returns, retirement ages, and employee turnover.

The depreciation of capital assets involves estimates pertaining to useful lives.

We evaluated the key factors and assumptions used by management to develop the estimates discussed above in determining that they are reasonable in relation to the financial statements taken as a whole.

The financial statement disclosures are neutral, consistent, and clear.

MANAGEMENT CONSULTATIONS WITH OTHER INDEPENDENT ACCOUNTANTS

In some cases, management may decide to consult with other accountants about auditing and accounting matters, similar to obtaining a "second opinion" on certain situations. If a consultation involves application of an accounting principle to the District's financial statements or a determination of the type of auditor's opinion that may be expressed on those statements, our professional standards require the consulting accountant to check with us to determine that the consultant has all the relevant facts. To our knowledge, there were no such consultations with other accountants.

MANAGEMENT REPRESENTATIONS

We have requested certain representations from management that are included in the management representation letter dated December 1, 2014.

OTHER AUDIT FINDINGS OR ISSUES

We generally discuss a variety of matters, including the application of accounting principles and auditing standards, with management each year prior to retention as the District's auditors. However, these discussions occurred in the normal course of our professional relationship and our responses were not a condition to our retention.

OTHER MATTERS

We applied certain limited procedures to Management's Discussion and Analysis, the Schedule of Funding Progress for the Other Post-Employment Benefits Plan, and the Schedule of Funding Progress for the Pension Benefits Plan, which are required supplementary information (RSI) that supplements the basic financial statements. Our procedures consisted of inquiries of management regarding the methods of preparing the information and comparing the information for consistency with management's responses to our inquiries, the basic financial statements, and other knowledge we obtained during our audit of the basic financial statements. We did not audit the RSI and do not express an opinion or provide any assurance on the RSI.

We were engaged to report on the supplemental information accompanying the financial statements and the separately issued Schedule of Expenditures of Federal Awards and Uniform Financial Accounting and Reporting Standards (UFARS) Compliance Table, which are not RSI. With respect to this supplementary information, we made certain inquiries of management and evaluated the form, content, and methods of preparing the information to determine that the information complies with accounting principles generally accepted in the United States of America, the method of preparing it has not changed from the prior period, and the information is appropriate and complete in relation to our audit of the financial statements. We compared and reconciled the supplementary information to the underlying accounting records used to prepare the financial statements or to the financial statements themselves.

We were not engaged to report on the introductory and statistical sections which accompany the financial statements but are not RSI. We did not audit or perform other procedures on this other information and we do not express an opinion or provide any assurance on it.

FUNDING PUBLIC EDUCATION IN MINNESOTA

Due to its complexity, it would be impossible to fully explain the funding of public education in Minnesota within this report. A summary of legislative changes affecting school districts and charter schools included later in this report gives an indication of how complicated the funding system is. This section provides some state-wide funding and financial trend information.

BASIC GENERAL EDUCATION REVENUE

The largest single funding source for Minnesota school districts is basic general education aid. Each year, the Legislature sets a basic formula allowance. Total basic general education revenue is calculated by multiplying the formula allowance by the number of pupil units for which a district is entitled to aid. Pupil units are calculated using a legislatively determined weighting system applied to average daily membership (ADM). Over the years, various modifications have been made to this calculation, including changes in weighting and special consideration for declining enrollment districts.

The table below presents a summary of the formula allowance for the past decade and as approved for the 2015 fiscal year. The amount of the formula allowance and the percentage change from year to year excludes non-comparable changes such as temporary funding increases, the “roll-in” of aids that were previously funded separately, potential reductions due to levying less than the maximum student achievement levy rate, and the one-time replacement of a portion of general education aid with federal fiscal stabilization funds in fiscal 2010.

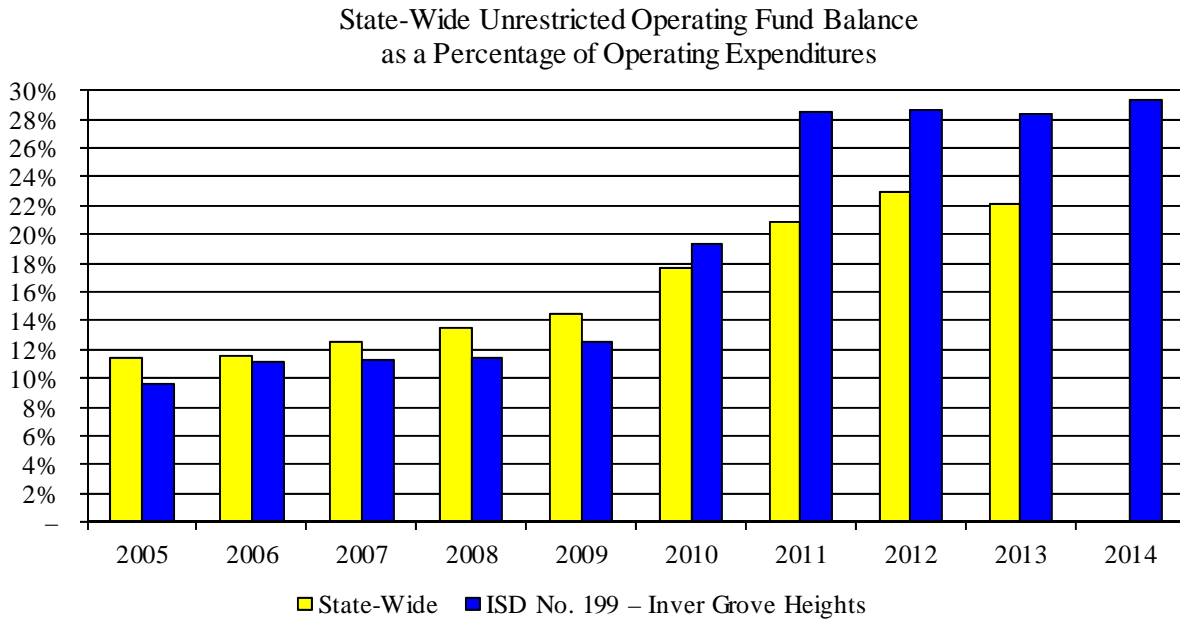
Fiscal Year Ended June 30,	Formula Allowance	
	Amount	Percent Increase
2005	\$ 4,601	– %
2006	\$ 4,783	4.0 %
2007	\$ 4,974	4.0 %
2008	\$ 5,074	2.0 %
2009	\$ 5,124	1.0 %
2010	\$ 5,124	– %
2011	\$ 5,124	– %
2012	\$ 5,174	1.0 %
2013	\$ 5,224	1.0 %
2014	\$ 5,302	1.5 %
2015	\$ 5,831	2.0 % *

* The \$529 increase in 2015 is offset by changes to pupil weightings and the general education aid formula that reduced the increase to the equivalent of \$105, or 2.0 percent, state-wide.

In recent years, modest increases in the formula allowance have forced many districts to continually cut expenditure budgets or seek increased referendum revenue in order to maintain programs.

STATE-WIDE SCHOOL DISTRICT FINANCIAL HEALTH

One of the most common and comparable statistics used to evaluate school district financial health is the unrestricted operating fund balance as a percentage of operating expenditures.



Note: State-wide information is not available for fiscal 2014.

The calculation above reflects only the unrestricted fund balance of the General Fund, and the corresponding expenditures, which is the same method the state uses for the calculation of statutory operating debt (SOD). We have also included the comparable percentages for your district.

Even with limited funding increases, Minnesota school districts have generally been maintaining a higher unrestricted fund balance as a percentage of operating expenditures in recent years. This trend is the result of many factors, including districts reducing operating expenditures, adapting to funding restrictions, efforts to maintain fund balance for cash flow purposes, and in some cases community support in the form of operating referendums.

As of June 30, 2013, this ratio was 28.3 percent for the District, as compared to a state-wide average of 22.1 percent. The District's unrestricted operating fund balance as a percentage of operating expenditures was 29.3 percent at the end of the current year.

The table below shows a comparison of governmental fund revenue per ADM received by Minnesota school districts and your district. Revenues for all governmental funds are included, except for the Capital Projects – Building Construction Fund and Post-Employment Benefits Debt Service Fund. Other financing sources, such as proceeds from sales of capital assets, insurance recoveries, bond sales, loans, and interfund transfers, are also excluded.

Revenue per Student (ADM) Served								
	State-Wide		Seven-County Metro Area		ISD No. 199 – Inver Grove Heights			
	2012	2013	2012	2013	2012	2013	2014	
General Fund								
Property taxes	\$ 1,550	\$ 1,608	\$ 2,019	\$ 2,101	\$ 1,867	\$ 1,853	\$ 1,193	
Other local sources	448	444	378	372	435	381	328	
State	7,920	8,112	7,949	8,138	7,458	7,520	8,293	
Federal	588	489	621	519	540	395	350	
Total General Fund	10,506	10,653	10,967	11,130	10,300	10,149	10,164	
Special revenue funds								
Food Service	488	495	483	495	455	468	480	
Community Service	525	535	633	647	514	555	526	
Debt Service Fund	1,088	1,079	1,180	1,172	950	944	922	
Total revenue	<u>\$ 12,607</u>	<u>\$ 12,762</u>	<u>\$ 13,263</u>	<u>\$ 13,444</u>	<u>\$ 12,219</u>	<u>\$ 12,116</u>	<u>\$ 12,092</u>	
ADM served per MDE School District Profiles Report					<u>3,855</u>	<u>3,872</u>	<u>3,924</u>	
Note: Excludes the Capital Projects – Building Construction and Post-Employment Benefits Debt Service Funds.								
Source of state-wide and seven-county metro area data: School District Profiles Report published by the MDE								

ADM used in the table above is based on enrollments consistent with those used in the MDE School District Profiles Report, which include extended time ADM, and may differ from ADM reported in other tables.

The mix of local and state revenues vary from year to year primarily based on funding formulas and the state's financial condition. The mix of revenue components from district to district varies due to factors such as the strength of property values, mix of property types, operating and bond referendums, enrollment trends, density of population, types of programs offered, and countless other criteria.

The District earned \$47,451,170 in the governmental funds reflected above in fiscal 2014, an increase of \$536,974 (1.1 percent) from the prior year. However, due to the increase in students served, revenue per ADM decreased by \$24. In the General Fund, tax revenue decreased \$660 per ADM and state aid revenue increased \$773 per ADM, both mainly due to a \$2.2 million change in the tax shift, which shifts funding between taxes and state aids but is revenue neutral in total.

The following table reflects similar comparative data available from the MDE for all governmental fund expenditures, excluding the Capital Projects – Building Construction Fund and Post-Employment Benefits Debt Service Fund. Other financing uses, such as bond refundings and transfers, are also excluded.

Expenditures per Student (ADM) Served								
	State-Wide		Seven-County Metro Area		ISD No. 199 – Inver Grove Heights			
	2012	2013	2012	2013	2012	2013	2014	
General Fund								
Administration and district support	\$ 823	\$ 849	\$ 805	\$ 837	\$ 627	\$ 712	\$ 702	
Elementary and secondary								
regular instruction	4,866	4,982	5,103	5,273	4,197	4,424	4,373	
Vocational education instruction	138	138	136	132	45	45	52	
Special education instruction	1,866	1,909	2,004	2,055	1,899	1,931	1,819	
Instructional support services	459	477	537	562	637	636	784	
Pupil support services	895	919	957	991	831	866	953	
Sites, buildings, and other	802	850	755	800	1,179	1,120	1,086	
Total General Fund – noncapital	9,849	10,124	10,297	10,650	9,415	9,734	9,769	
General Fund capital expenditures	462	509	410	469	539	481	1,127	
Total General Fund	10,311	10,633	10,707	11,119	9,954	10,215	10,896	
Special revenue funds								
Food Service	486	500	480	500	454	423	453	
Community Service	526	535	630	646	500	526	554	
Debt Service Fund	1,337	1,234	1,312	1,322	933	939	1,000	
Total expenditures	\$ 12,660	\$ 12,902	\$ 13,129	\$ 13,587	\$ 11,841	\$ 12,103	\$ 12,903	
ADM served per MDE School District Profiles Report					3,855	3,872	3,924	
Note: Excludes the Capital Projects – Building Construction and Post-Employment Benefits Debt Service Funds.								
Source of state-wide and seven-county metro area data: School District Profiles Report published by the MDE								

Expenditure patterns also vary from district to district for various reasons. Factors affecting the comparison include the growth cycle or maturity of the District, average employee experience, availability of funding, population density, and even methods of allocating costs. The differences from program to program reflect the District's particular character, such as its community service programs, as well as the fluctuations from year to year for such things as capital expenditures.

The District spent \$50,630,909 in the governmental funds reflected above in fiscal 2014, an increase of \$3,766,564 (8.0 percent) from the prior year. On a per student basis, this represents an increase of \$800. The majority of this increase was in General Fund capital expenditures, which were \$646 per ADM higher than last year due to \$2.9 million in spending for technology equipment and an addition at Hilltop Elementary financed with capital leases.

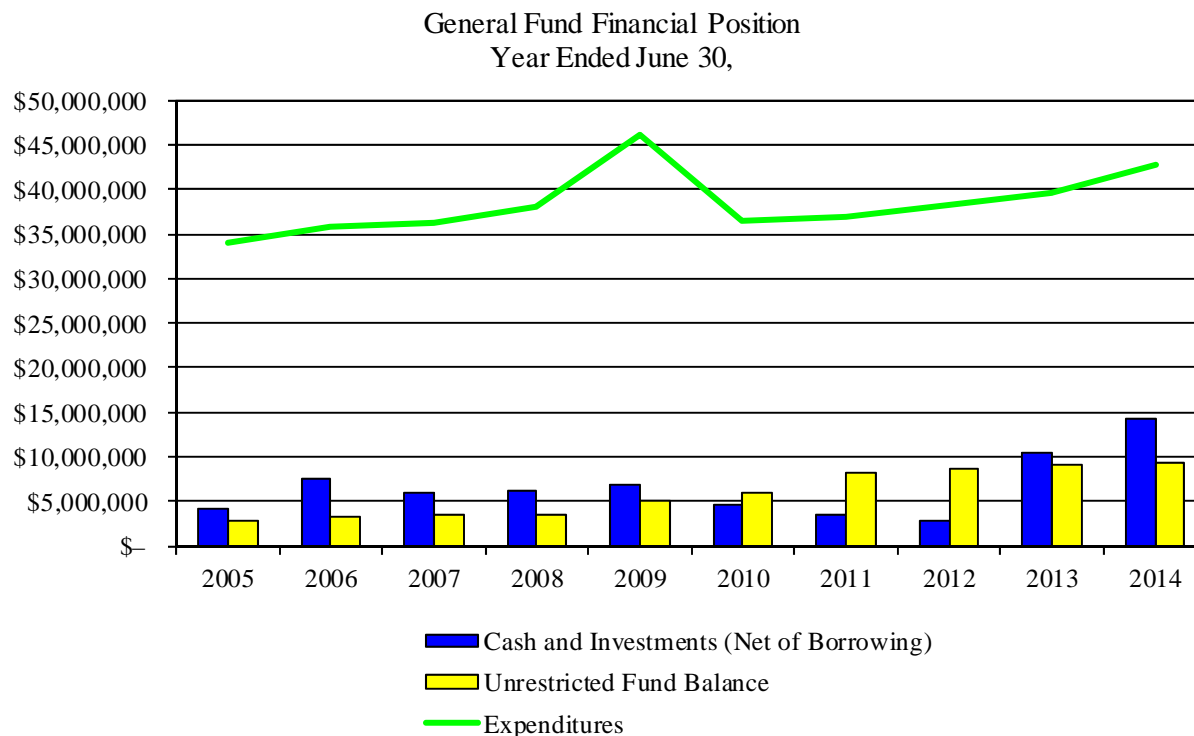
SUMMARY

The funding for and financial position of Minnesota school districts has fluctuated significantly over the past several years due to a number of factors, including those discussed above. This situation continues to present a challenge for school boards, administrators, and management of these districts in providing the best education with the limited resources available in a climate of unknown future funding levels.

FINANCIAL TRENDS OF YOUR DISTRICT

GENERAL FUND FINANCIAL POSITION

The following graph displays the District's General Fund trends of financial position and changes in the volume of financial activity. Unrestricted fund balance and cash balance are two indicators of financial health or equity, while annual expenditures are often used to measure the size of the operation.



The General Fund cash balance at the end of fiscal year 2014 was \$14,167,857, an increase of \$3,741,902 from the prior year. This change was primarily due to the state buy-down of the tax shift and a change in the metering of state aid payments. Total fund balance at year-end was \$11,616,416, a decrease of \$4,026, as compared to a budgeted decrease of \$384,125. Unrestricted fund balance at year-end was \$9,309,963 (excluding restricted fund balance account deficits).

The following table presents the components of the General Fund balance for the past five years:

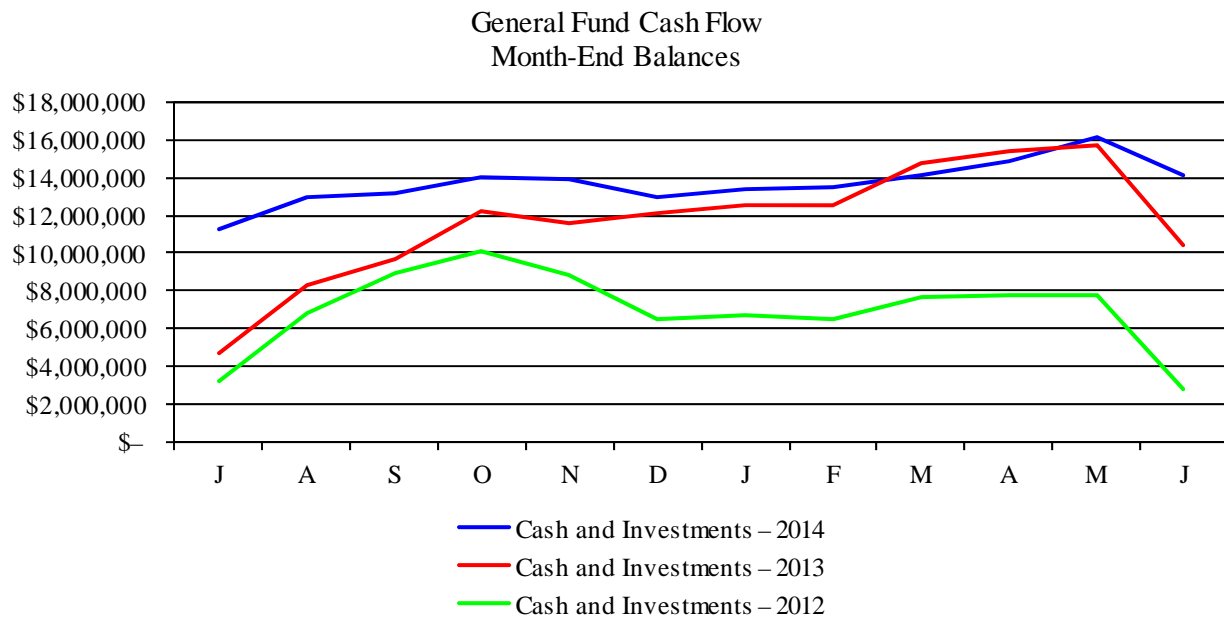
	Year Ended June 30,				
	2010	2011	2012	2013	2014
Nonspendable fund balances	\$ —	\$ 96,952	\$ 132,061	\$ 156,185	\$ 149,699
Restricted fund balances (1)	1,928,919	1,609,710	2,662,405	2,424,347	2,156,754
Unrestricted fund balances					
Assigned	1,283,225	3,477,118	3,587,226	4,129,697	4,295,345
Unassigned	4,708,296	4,807,206	5,153,505	4,910,213	5,014,618
Total fund balance	\$ 7,920,440	\$ 9,990,986	\$ 11,535,197	\$ 11,620,442	\$ 11,616,416
Unrestricted fund balances as a percentage of expenditures	16.4%	22.4%	22.8%	22.9%	21.8%
Unassigned fund balances as a percentage of expenditures	10.2%	13.2%	13.4%	12.4%	11.7%

(1) Includes deficits in restricted fund balance accounts allowed to accumulate deficits under UFARS, which are part of unassigned fund balance on the accounting principles generally accepted in the United States of America-based financial statements.

In the table on preceding page, General Fund unrestricted fund balances and the related percentages of total General Fund expenditures differ from those used in the previous discussion of state-wide fund balances, which are based on the state SOD formula. The resources represented by this fund balance are critical to a district's ability to maintain adequate cash flow throughout the year, to retain its programs, and to cushion against the impact of unexpected costs or funding shortfalls. At June 30, 2014, unrestricted fund balances in the General Fund represented 21.8 percent of annual expenditures, or less than three months of operations assuming level spending throughout the year.

GENERAL FUND CASH FLOW

The level of cash and investments varies considerably during the year due to the timing of various revenues and expenditures. The following graph summarizes the level of cash and investments (net of borrowing) over the past three years:

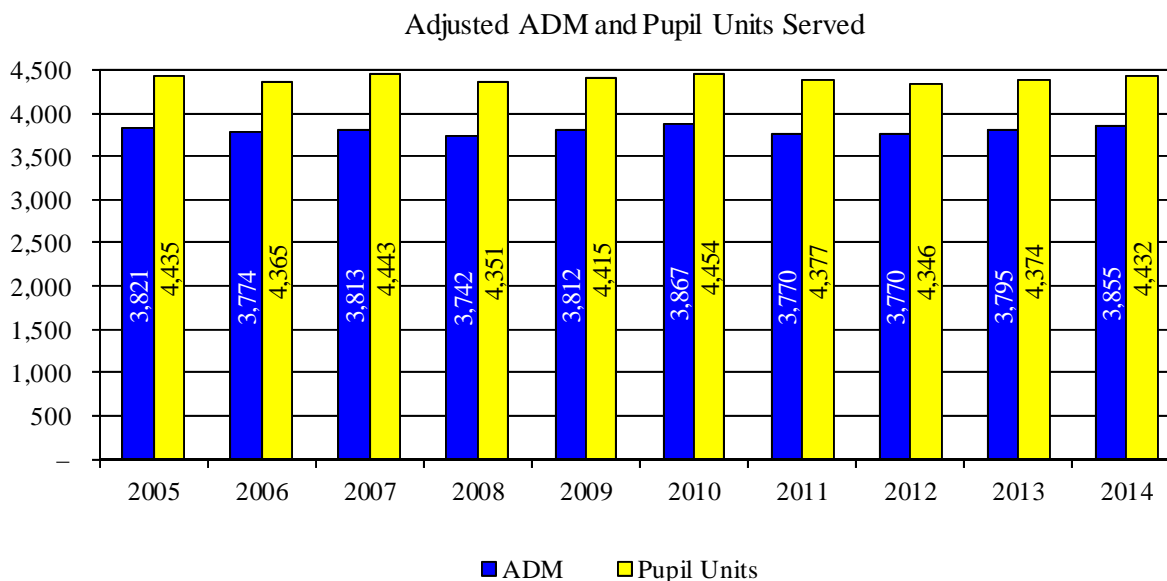


The graph above shows the peaks and valleys of the General Fund cash and investments balance on a monthly basis.

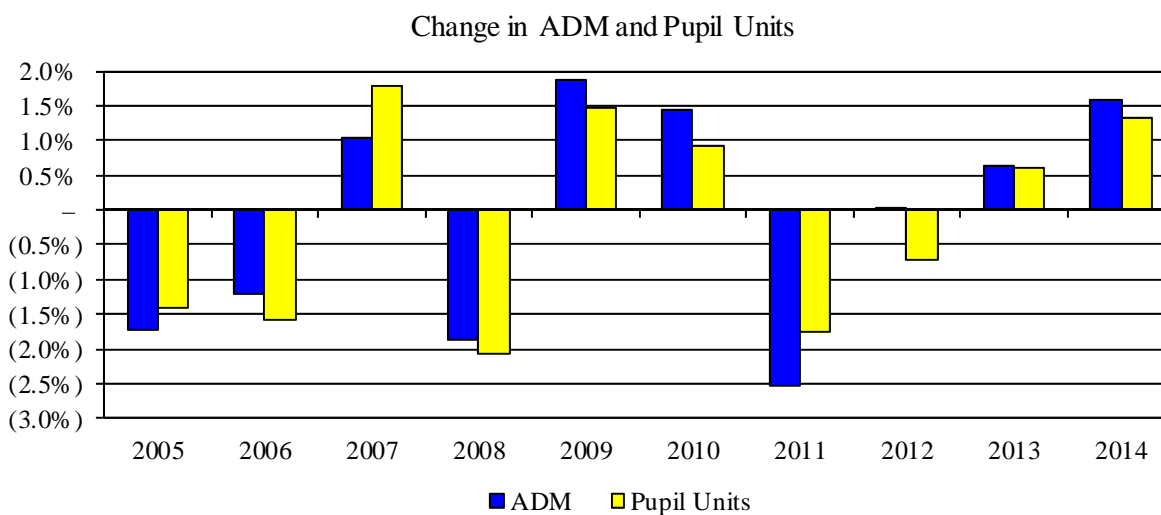
Legislative changes in the tax shift and state aid payment schedules used to help balance the state budget have a significant effect on the cash flow of Minnesota school districts. In fiscal 2012, the state holdback on aids normally paid on a 90–10 schedule was up to 40 percent, and the tax shift was at 48.6 percent of non-debt service levies. As the financial condition of the state began to improve, the holdback on state aid payments was reduced to 13.6 percent by the end of fiscal 2013. In fiscal 2014, the state was able to restore the metering of state aid payments to a 90–10 schedule, and buy the tax shift back down to zero (except for the shift of 31 percent of a district's payable 2001 referendum levy that remains frozen by statute). These changes have resulted in a dramatic improvement in the District's cash flow over the last two years, as illustrated by the graph above.

AVERAGE DAILY MEMBERSHIP AND PUPIL UNITS

The following graph presents the District's adjusted ADM and pupil units served for the past 10 years:



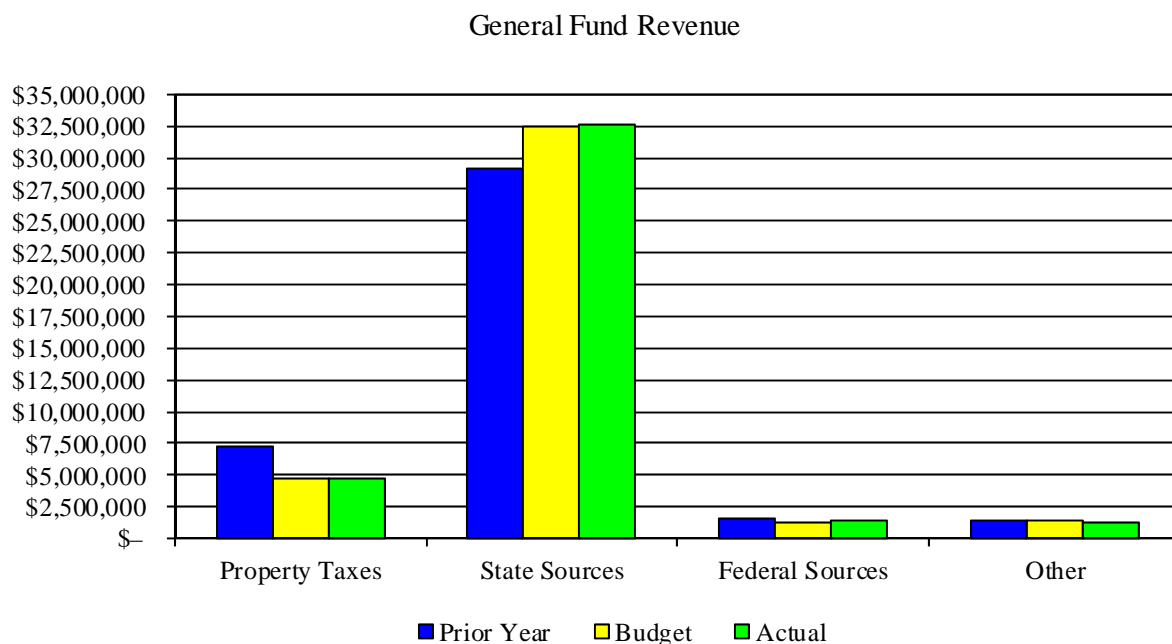
The following graph shows the rate of change in ADM served by the District from year-to-year, along with the change in the resulting pupil units:



ADM is a measure of students attending class, which is converted to pupil units (the base for determining revenue) using a statutory formula. Not only is the original budget based on ADM estimates, the final audited financial statements are based on updated, but still estimated, ADM since the counts are not finalized until around January of the following year. When viewing revenue budget variances, one needs to consider these ADM changes, the impact of the prior year final adjustments which affect this year's revenue, and also the final adjustments caused by open enrollment gains and losses.

The District served an estimated adjusted ADM of 3,855 in 2014, an increase of 1.6 percent from the prior year. Pupil units served by the District were 4,432, an increase of 1.3 percent.

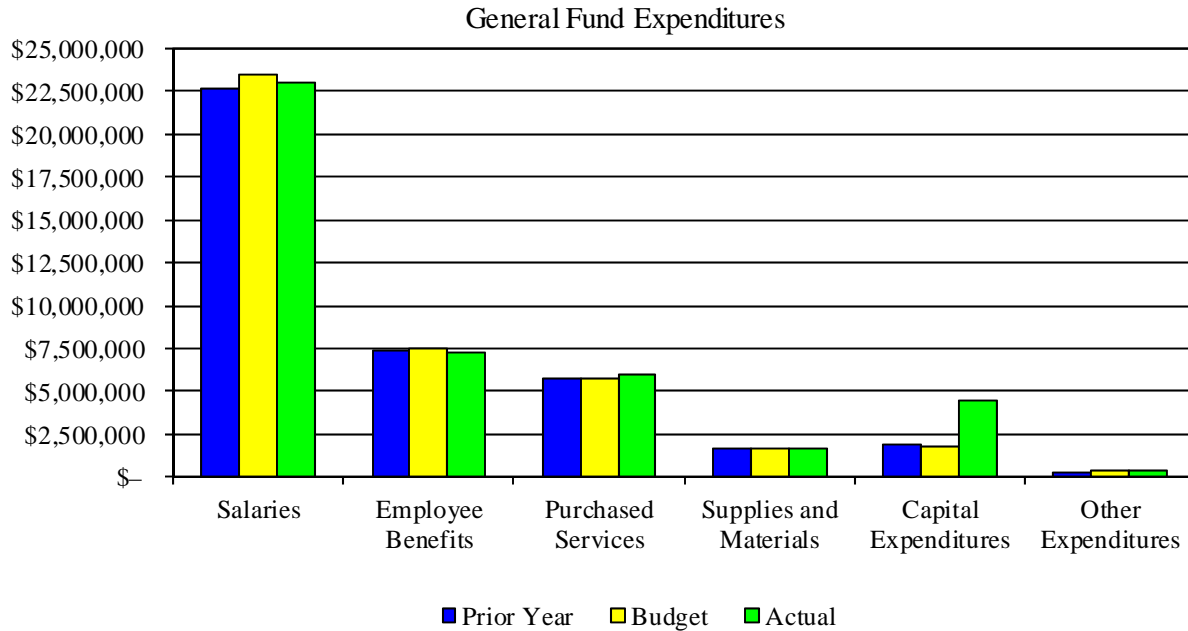
The following graph summarizes the District's General Fund revenue for 2014:



Total General Fund revenues were \$39,884,219 for the year ended June 30, 2014, which was \$137,996 (0.3 percent) under the final budget. Property tax revenue was under budget by \$114,302. Revenues from other local sources, including investment income, gifts, bequests, tuition, and rental income, were \$184,586 under budget, due to the District receiving less rent revenue from other districts (related to the Family Connections program), less revenue from third party billings, and fewer donations than anticipated.

General Fund total revenues were \$583,705 (1.5 percent) more than the previous year. The change in revenue between property taxes and state aids from year-to-year was the result of the \$2.2 million state buy-down of the tax shift discussed earlier in this report. Excluding the impact of the tax shift, property tax revenue decreased \$266,223 due to decreases in the District's levies. Revenue from state aids, excluding the tax shift, was \$1,198,300 higher than the prior year. General education aid increased \$611,089 due to increases in students served and the basic formula allowance. The District also earned more state aid for special education and integration than the prior year. Revenue from federal sources declined by \$158,267 from the previous year, due to decreased Title I, Title II, and special education federal entitlements. Finally, revenue from other local sources was \$190,105 less than last year, due to lower revenue from rent, third party billings, and donations.

The following graph summarizes the District's General Fund expenditures for 2014:

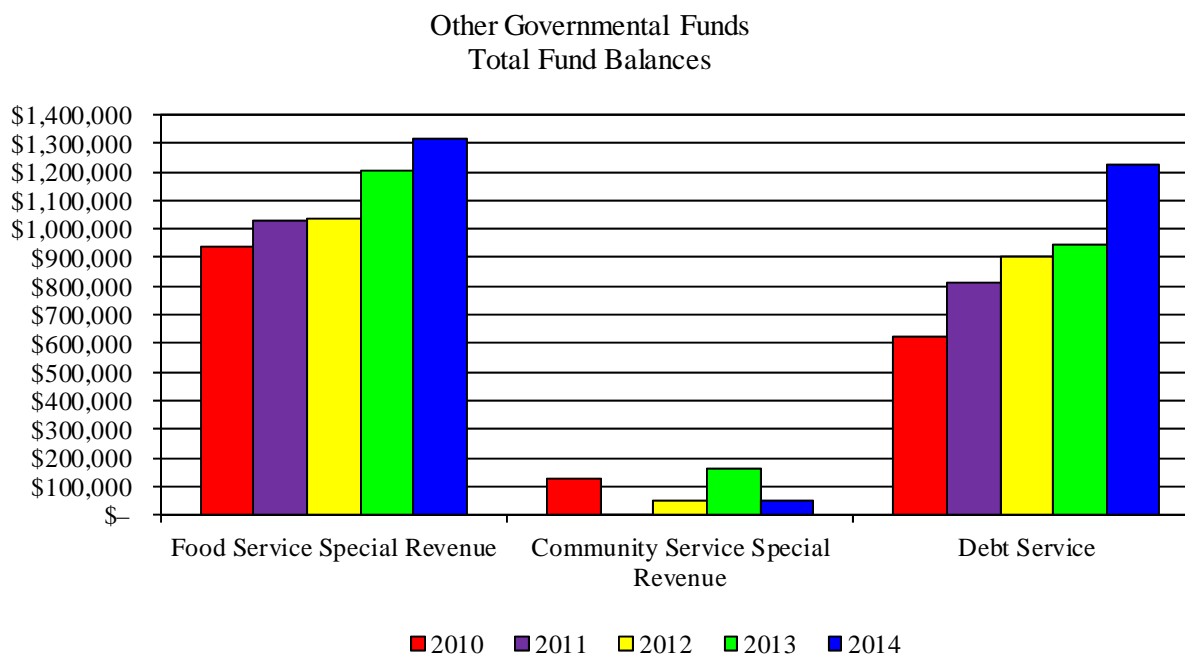


Total General Fund expenditures for 2014 were \$42,755,028, an increase of \$3,204,120 (8.1 percent) from the prior year. Personnel-related costs were \$216,078 (0.7 percent) higher than last year, mainly due to contracted increases in salaries. Purchased services were \$289,296 higher than the prior year, mainly in the pupil support program area, due to increased costs for transportation, maintenance, and integration-related services. The largest increase was in capital expenditures, which were \$2,557,886 higher than the previous year, mainly due to the Hilltop addition project financed through a capital lease.

Total General Fund expenditures were over budget by \$2,051,623 (5.0 percent) in 2014. Salaries and benefits were \$842,794 under budget, mainly in the regular instruction program area. Capital Expenditures, however, were over budget by \$2,594,103 due to technology equipment purchases and the Hilltop addition project, financed through capital leases. The District did not include expenditures related to these capital leases, or the offsetting "other financing source" from the lease proceeds, in its budget.

OTHER FUNDS OF THE DISTRICT

The following graph presents fund balances for the District's Food Service Special Revenue, Community Service Special Revenue, and Debt Service Funds for the last five years:



Food Service Special Revenue Fund

The District's Food Service Special Revenue Fund ended fiscal 2014 with a fund balance of \$1,313,759, which represents an increase of \$107,469, compared to a budgeted decrease of \$22,590. Food service revenue was \$1,884,595, which was over budget by \$96,567, mainly due to an increase in federal reimbursements. Total expenditures of \$1,777,126 were \$33,492 under budget, as supplies (food) and materials were \$101,605 less than projected.

Community Service Special Revenue Fund

The District's Community Service Special Revenue Fund ended the year with a fund balance of \$52,987, a decrease of \$110,481, as compared to a breakeven budget. Revenues were below budget by \$113,419, mainly in fees from the "Kids' Choice" program, which was negatively impacted by weather-related closings. Total expenditures were under budget by \$2,938, a variance of just 0.1 percent. However, there were a number of larger variances in the individual expenditure categories (underspending for purchased services of \$218,915, offset by salaries, benefits, and other expenditures being over budget by \$87,409, \$44,556, and \$97,801, respectively), which were caused by a change in tri-district shared program costs due to reorganization.

Over the years, we have emphasized to our clients that food service and community service operations should be self-sustaining, and should not become an additional burden on general education funds.

Debt Service Fund

The funding of debt service is controlled in accordance with each outstanding debt issue's financing plan. At June 30, 2014, the Debt Service Fund had a fund balance of \$1,222,332 available for future debt service.

Internal Service Funds

The District maintains two internal service funds (not pictured) established to finance the costs of its severance, pension, and retiree health OPEB as they accrue.

At June 30, 2014, the Severance and Pension Benefits Internal Service Fund had accumulated \$1,795,751 of cash and investments available to pay estimated future severance benefits of \$1,175,982 and a net pension obligation of \$319,163. The net pension obligation liability at year-end does not represent the District's full pension liability, which was estimated to be in excess of \$2.5 million in the most recent actuarial study done for the District. Instead, it represents the cumulative excess of the actuarially determined annual required contributions necessary to amortize the pension liability through the current year-end and the actual pension costs paid by the District to date. The remaining unrestricted net position of \$300,606 at year-end is available to finance future benefits costs.

The District's OPEB Internal Service Fund ended the year with cash and investments of \$10,362,613 available to pay future OPEB. The cash and investments in this fund are being held in a revocable trust account the District established to finance its OPEB liabilities, and can only be used to pay OPEB costs. However, because the District elected to make the trust revocable (meaning that under certain specific and very restrictive circumstances the District may take the assets back out of the trust and use them for other purposes) these assets must be accounted for in an internal service fund, which is included in the District's government-wide financial statements. The net OPEB asset of \$3,665 at year-end represents the cumulative actual OPEB costs paid by the District to date in excess of the actuarially determined annual required contributions necessary to amortize the OPEB liability through the current year-end. The District's full OPEB liability was estimated to be \$6.4 million in the most recent actuarial study done for the District.

GOVERNMENT-WIDE FINANCIAL STATEMENTS

The District's financial statements include fund-based information that focuses on budgetary compliance, and the sufficiency of the District's current assets to finance its current liabilities. The GASB Statement No. 34 reporting model also requires the inclusion of two government-wide financial statements designed to present a clear picture of the District as a single, unified entity. These government-wide financial statements provide information on the total cost of delivering educational services, including capital assets and long-term liabilities.

Theoretically, net position represents district resources available for providing services after its debts are settled. However, those resources are not always in expendable form, or there may be restrictions on how some of those resources can be used. Therefore, this statement divides net position into three components: net investment in capital assets, restricted, and unrestricted. The following table presents a summarized reconciliation of the District's governmental fund balances to net position, and the separate components of net position for the last two years:

	June 30,		Increase (Decrease)
	2014	2013	
Net position – governmental activities			
Total fund balances – governmental funds	\$ 35,646,320	\$ 13,933,248	\$ 21,713,072
Capital assets, less accumulated depreciation	51,155,268	46,559,383	4,595,885
Long-term liabilities	(74,510,890)	(49,146,570)	(25,364,320)
Other	11,023,657	10,750,572	273,085
Total net position – governmental activities	<u>\$ 23,314,355</u>	<u>\$ 22,096,633</u>	<u>\$ 1,217,722</u>
Net position			
Net investment in capital assets	\$ 8,787,376	\$ 8,200,160	\$ 587,216
Restricted	4,815,014	4,477,781	337,233
Unrestricted	<u>9,711,965</u>	<u>9,418,692</u>	<u>293,273</u>
Total net position	<u>\$ 23,314,355</u>	<u>\$ 22,096,633</u>	<u>\$ 1,217,722</u>

Some of the District's fund balances translate into restricted net position by virtue of external restrictions (statutory restrictions) or by the nature of the fund they are in (e.g. Food Service Special Revenue Fund balance can only be spent for food service program costs). The unrestricted net position category consists mainly of the General Fund unrestricted fund balances, offset against noncapital long-term obligations such as vacation or severance payable. Consequently, many Minnesota school districts have accumulated deficits in this component of net position.

Total net position increased by \$1,217,722 during fiscal 2014. The District's net investment in capital assets increased \$587,216, due to a portion of some facilities improvement projects being paid from available funds rather than debt, and debt principal retirements exceeding depreciation expense for the year. Restricted assets increased \$337,233, primarily in net position restricted for OPEB. Unrestricted net position increased \$293,273, mainly due to the increased unrestricted fund balance in the General Fund.

LEGISLATIVE SUMMARY

The 2014 legislative session began with a projected budget excess for the remainder of the biennium of \$1.09 billion, later revised upward to a projected excess of \$1.23 billion in the February 2014 economic forecast. In addition to the bonding bill and supplemental budget typically addressed during an even-year short session, the projected excess enabled the Legislature to repay \$246 million of K–12 education finance shifts and to replenish the state “Rainy Day Fund” budget reserve with the addition of \$150 million. The supplemental budget adopted by the 2014 Legislature contained \$54.0 million in additional state aid appropriations for K–12 education for fiscal year 2015, including a \$25 increase to the basic general education formula allowance. The 2014 Legislature also adopted a number of technical corrections and modifications to the significant education funding changes adopted by the 2013 legislature.

The following is a brief summary of recent legislative changes and issues affecting the future funding of Minnesota school districts:

Basic General Education Revenue – The per pupil basic general education formula allowance for fiscal year (FY) 2015 was set to increase \$504 to \$5,806, with simultaneous changes to pupil weights and the general education formula structure reducing the increase to the equivalent of \$80 per pupil state-wide. The 2014 Legislature approved an additional \$25 increase, bringing the FY 2015 formula allowance to \$5,831. This also increases the other aids linked to the formula allowance.

Pupil Unit Weights – Pupil unit weights for FY 2015 will change as follows:

	<u>FY 2014</u>	<u>FY 2015</u>
Pre-Kindergarten and Disabled Kindergarten	1.25	1.0
Part-Time Kindergarten (under 850 instruction hours)	0.612	0.55
All-Day Kindergarten (at least 850 instruction hours)	0.612	1.0
Grades 1–3	1.115	1.0
Grades 4–6	1.06	1.0
Grades 7–12	1.30	1.2

Other Changes to the General Education Formula – A number of other changes were made to general education formula for FY 2015, including:

- Marginal cost pupil units are eliminated and a new declining enrollment revenue component of general education aid is established equal to the decline in adjusted pupil units between the prior year and current year times 28 percent of the basic general education aid allowance.
- The extended time allowance increases from \$4,601 to \$5,017.
- The gifted and talented revenue allowance increases from \$12 to \$13.
- The revenue set aside for learning and development is converted to a flat amount per ADM of \$299 per kindergarten student and \$459 per student in Grades 1 through 6.
- The small schools allowance increases from \$522.40 to \$544, and the qualifying threshold decreases from 1,000 to 960 pupil units.
- Operating capital revenue increases from \$73 per pupil unit + \$100 times the building age index to \$79 per pupil unit + \$109 times the building age index.
- The equity revenue allowance increases from \$75 to \$80 for sliding scale, and from \$46 to \$50 for flat rate.
- The pension adjustment reduction to general education aid is eliminated, with districts having a below average pension adjustment guaranteed to receive a minimum of the state average gain from the elimination of the pension adjustment.
- Quality Compensation (Q Comp) revenue is rolled out of the general education formula and established as a separate categorical aid, and the transition revenue calculation is amended to adjust for the roll-out.
- General education revenue generated for all-day kindergarten may be used for programs to meet the needs of 3 and 4-year-olds within the district.

Special Education Funding Reform – State funding for special education is being transitioned to new funding formulas that will be effective beginning in FY 2016.

The funding formula for state special education aid remains the same through FY 2015. For FY 2016, special education will be the lesser of: 62 percent of old formula special education expenditures for the prior year; 50 percent of nonfederal special education expenditures for the prior year; or 56 percent of the amount calculated using a new pupil driven formula based on prior year data.

Beginning in FY 2015, special education tuition billing is changed so that the resident district is responsible for 90 percent of unfunded costs (versus 100 percent currently) and the serving district or charter school is responsible for 10 percent of unfunded costs for open-enrolled students. This does not apply to students placed by tuition agreement, or served by a charter school with at least 70 percent special education students.

Beginning in FY 2016, special education aid will be paid directly to cooperatives and intermediate districts, rather than flowing through the resident districts. Tuition bills will be reduced by the aid paid directly to these entities.

A new special education cross subsidy reduction aid was added for FY 2014 and FY 2015 only. Aid for FY 2015 will equal the lesser of \$48 per ADM served or 2.27 percent of the amount generated for the district under the new pupil-based formula, with a state-wide limit of \$30 million.

The formula for special education excess cost aid was simplified beginning in FY 2014 by basing the calculation on prior year data and excluding special education tuition receipts and expenditures. For FY 2016, excess cost aid will be the greater of: 56 percent of the difference between the district's unreimbursed nonfederal special education costs and 7 percent of the district's general education revenue; or 62 percent of the difference between the district's unreimbursed old formula special education costs and 2.5 percent of the district's general education revenue.

Teacher Development and Evaluation Aid – For FY 2015 only, school districts, intermediate districts, and charter schools not receiving Q Comp revenue are eligible for teacher development and evaluation aid equal to \$302 times the number of full-time equivalent teachers employed on October 1 of the previous school year. The entitlement is limited to \$10 million state-wide.

Alternative Learning Center (ALC) Reserve – ALC reserve requirements and tuition billing language was amended to clarify that the amount required to be reserved or paid to the serving district under tuition billing is at least 90 percent *but no more than 100 percent* of general education revenue, and that local optional revenue is not included in the calculation.

General Education Levy Reform – The following changes were made to various elements of the general education tax levy effective FY 2015:

- A uniform general education levy, known as the “student achievement levy,” is reestablished. All districts may levy up to the student achievement rate, which is set to raise \$20 million state-wide in FY 2015. Districts that levy less than the maximum permitted rate will be subject to a proportionate reduction in its general education aid.
- The equalization factor for operating capital is increased to offset the impact of the student achievement levy.
- Operating referendum revenue is converted from an amount based of resident marginal cost pupil units to an amount based on adjusted pupil units (APUs), due to the elimination of marginal cost pupil units. The separate alternative attendance adjustment is eliminated and rolled into the allowance per APU. The allowance per APU will be set so the total revenue prior to applicable caps is the same as under the old law.

- Districts are allowed to convert up to \$300 per APU of existing voter-approved operating referendum revenue to board-approved. Districts with approved operating referendums of less than \$300 per APU are permitted to authorize additional referendum revenue up to the \$300 per APU limit. Operating referenda will be equalized based on a new, three-tiered formula.
- A new “Location Equity levy” was established, providing school districts with land in the seven-county metro area with authority for a location equity levy of \$424 per APU. Districts with adjusted ADM of greater than 2,000 that do not qualify as metro districts are eligible for a location equity levy of \$212 per APU. Both levies are equalized at \$510,000. Districts may opt out of location equity revenue by a board vote taken by September 1 of the fiscal year preceding the fiscal year when the revenue takes effect (e.g. September 2013 for FY 2015 revenue). Beginning in FY 2016 (levy payable 2015), the name of this levy is changed from “Location Equity” to “Local Option”; does not require districts to have land in the seven-county metro area; and will no longer require a board resolution to opt out of the levy.

Safe Schools Levy – Beginning in FY 2015, the safe schools levy increases from \$30 to \$36 per pupil unit, with \$4 of the increase representing new revenue and \$2 to adjust for the changes to pupil weightings. Beginning in FY 2016, the levy allowance for intermediate districts increases from \$10 to \$15 per pupil unit. The use of this levy is expanded to include facility security enhancements, efforts to improve school climate, and mental health services.

Fund Transfers – The authority for school districts to transfer money from one fund or account to another, as long as the transfer does not increase state aid obligations or increase local property taxes, was extended through FY 2015. School boards may only approve such transfers after adopting a resolution stating that the transfer will not diminish instructional opportunities for students. This authorization excludes transfers from the food service or community service funds, and prohibits transfers from the reserved account for staff development through FY 2015.

Child Nutrition Program Aids – Beginning in FY 2015, state school lunch aid for reduced price lunch students increases from 12.5 cents per lunch to 52.5 cents, making lunches free for those students. State aid for school breakfasts for kindergarten students increases from 55 cents to \$1.30, making school breakfasts free for all kindergarten students.

Early Childhood Family Education (ECFE) – Beginning in FY 2015, the ECFE formula is linked to the general education formula, equaling 2.3 percent of the basic general education allowance. For FY 2015, this increases the EFCE allowance from \$120 to \$134.11. New program requirements were also added related to the assessment of community needs for program services.

School Readiness – Beginning in FY 2015, the state-wide entitlement for school readiness will increase \$2 million per year.

Early Learning Scholarships – State-wide funding for early learning scholarships increases \$4.65 million for FY 2015 and \$4.884 million for later years. The \$5,000 limit on scholarships is eliminated beginning in FY 2015, and the Commissioner of Education is directed to establish a target for the average scholarship based on the results of a rate survey.

Community Education Reserve Limits – The limitations on the community education, early childhood family education, and school readiness reserve accounts and the associated aid and levy reductions have been repealed beginning in FY 2014.

Review and Comment – The estimated cost threshold at which facility projects are required to undergo review and comment was raised from \$1.4 million to \$2.0 million. Facility additions, remodeling, or maintenance projects funded entirely with certain revenue sources (general education, health and safety, alternative facilities, deferred maintenance, lease levies, or facilities bonding), and technology purchases funded with capital projects referendum, are exempted from review and comment. The consultation requirement for smaller projects was eliminated.

ACCOUNTING AND AUDITING UPDATES

GASB STATEMENT NO. 68, *ACCOUNTING AND FINANCIAL REPORTING FOR PENSIONS*—AN AMENDMENT OF GASB STATEMENT NO. 27

The primary objective of this statement is to improve accounting and financial reporting by state and local governments for pensions. This statement replaces the requirements of GASB Statement Nos. 27 and 50, as they relate to pensions that are provided through pension plans administered as trusts or equivalent arrangements that meet certain criteria. The requirements of GASB Statement Nos. 27 and 50 remain applicable for pensions that are not covered by the scope of this statement.

This statement establishes standards for measuring and recognizing liabilities, deferred outflows of resources, deferred inflows of resources, and expense/expenditures. In addition, this statement details the recognition and disclosure requirements for employers with liabilities (payables) to a defined benefit pension plan and for employers whose employees are provided with defined contribution pensions. This statement also addresses circumstances in which a nonemployer entity has a legal requirement to make contributions directly to a pension plan. This statement is effective for financial statements for fiscal years beginning after June 15, 2014. Earlier application is encouraged.

Included in this statement are major changes in how employers that participate in cost-sharing pension plans, such as TRA and PERA, account for pension benefit expenses and liabilities. In financial statements prepared using the economic resources measurement focus and accrual basis of accounting (government-wide and proprietary funds), a cost-sharing employer that does not have a special funding situation is required to recognize a liability for its proportionate share of the net pension liability of all employers with benefits provided through the pension plan. A cost-sharing employer is required to recognize pension expense and report deferred outflows of resources and deferred inflows of resources related to pensions for its proportionate share of collective pension expense and collective deferred outflows of resources and deferred inflows of resources related to pensions. In addition, the effects of (1) a change in the employer's proportion of the collective net pension liability and (2) differences during the measurement period between the employer's contributions and its proportionate share of the total of contributions from employers included in the collective net pension liability are required to be determined. These effects are required to be recognized in the employer's pension expense in a systematic and rational manner over a closed period equal to the average of the expected remaining service lives of all active and inactive employees that are provided with pensions through the pension plan.

CHANGES TO FEDERAL GRANT AUDIT REQUIREMENTS

In December 2013, the OMB issued *Uniform Administrative Requirements, Cost Principles, and Audit Requirements for Federal Audits*, which supersedes all or parts of eight OMB circulars; consolidating federal cost principles, administrative principles, and audit requirements in one document. The "Super Circular" includes a number of significant changes to the federal Single Audit process, including: an increase in dollar threshold for requiring a Single Audit from \$500,000 to \$750,000; changes to the thresholds and process used for determining major programs; reductions in the percentages of expenditures required to be covered by a Single Audit from 50 percent to 40 percent for high risk auditees and from 25 percent to 20 percent for low risk auditees; revised criteria for determining low-risk auditees; and an increase in the threshold for reporting questioned costs from \$10,000 to \$25,000. Auditees are required to implement the administrative requirements of the new Super Circular by December 26, 2014. The revised audit requirements will be effective for fiscal year 2016 district audits.

COSO INTERNAL CONTROL FRAMEWORK

The clarified auditing standards applicable to governmental audits incorporate a definition of internal control that is based on the internal control integrated framework developed and issued in 1992 by the Committee of Sponsoring Organizations of the Treadway Commission (COSO). In May 2013, COSO issued an updated framework which supersedes the original after December 15, 2014. The new COSO framework retains the basic definition of internal control and its five components established in its original framework, along with the fundamental requirements to consider these five components and to use judgment when assessing and evaluating the effectiveness of a system of internal controls. The new COSO framework enhances and clarifies a number of concepts from the original framework to make it easier to use and apply. One of the more significant enhancements was the establishment of 17 principles, associated with the 5 components of internal control, intended to assist users in understanding the requirements of effective internal control and designing effective systems of internal control.

The 5 components of internal control and 17 underlying principles are as follows:

Control Environment –

1. Organization demonstrates a commitment to integrity and ethical values.
2. Governing body is independent from management and exercises oversight control.
3. Management establishes structure, reporting lines, authority, and responsibilities.
4. Organization demonstrates a commitment to the competence of individuals involved with internal control.
5. Organization holds individuals accountable for internal control responsibilities.

Risk Assessment –

6. Organization specifies clear objectives for the identification and assessment of risks.
7. Organization identifies and analyzes risk.
8. Organization assesses the potential for fraud risks.
9. Organization identifies and assesses significant changes that could impact internal control.

Control Activities –

10. Organization selects and develops control activities to mitigate risks.
11. Organization selects and develops general information technology (IT) controls.
12. Organization establishes and implements control policies and procedures.

Information and Communication –

13. Organization uses relevant, quality information to support internal control.
14. Organization communicates internal control information internally.
15. Organization communicates internal control information externally.

Monitoring –

16. Organization conducts ongoing and/or separate internal control evaluations.
17. Organization evaluates and communicates deficiencies to responsible parties for corrective action.

COSO defines an effective system of internal control as one that reduces to an acceptable level the risk of failing to achieve an organizational objective in the areas of operations, compliance, or reporting. According to the new framework, an organization can achieve effective internal control by applying all of the principles listed above. To achieve this, each of these five components and the relevant principles must be present and functioning, and the five components must operate in an integrated manner. Local governments should be reviewing their internal control systems to assure these principles have been incorporated and implemented.

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