Management Report

for

Independent School District No. 831
Forest Lake, Minnesota

June 30, 2015

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MMKR
CERTIFIED PUBLIC
ACCOUNTANTS

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To the School Board and Management of
Independent School District No. 831
Forest Lake, Minnesota

We have prepared this management report in conjunction with our audit of Independent School District No. 831's (the District) financial statements for the year ended June 30, 2015. 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 17, 2015

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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, 2015, 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, 2015:

- We have issued an unmodified opinion on the District's basic financial statements.

- We reported no deficiencies in the District's internal control over financial reporting that we considered to be material weaknesses. It should be understood that internal controls are never perfected, and those controls which protect the District's funds from such things as fraud and accounting errors need to be continually reviewed by your management and modified as necessary.

- The results of our testing disclosed no instances of noncompliance required to be reported under *Government Auditing Standard*s.

- We noted 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 types of compliance requirements that could have a direct and material effect on each of its major federal programs.

- We reported no deficiencies in the District's internal controls over compliance that we consider to be material weaknesses with the types of compliance requirements that could have a direct and material effect on each of its major federal programs.

- 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, 2015 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 (2015-001) 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 ensure that all cash collections are recorded in the accounting records. Procedures such as the use and reconciliation of pre-numbered receipts, pre-numbered 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 (MAFA)*, in which we reported the findings listed below as a result of that testing as further detailed in the Schedule of Findings and Corrective Action:

- 2015-002 Improper Accounts and Activity
- 2015-003 Timely Deposit of Cash Receipts
- 2015-004 Receipt Documentation
- 2015-005 Approval of Disbursement Transactions
- 2015-006 Disbursement Documentation and Procedures
- 2015-007 Deficit Balances
- 2015-008 Inactive Accounts

We recommend the District review the recommendations provided in the separate report on student activities with individuals responsible for overseeing these accounts in order to comply with requirements detailed in the *MAFA.*

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.

The District implemented Governmental Accounting Standards Board (GASB) Statement No. 68, *Accounting and Financial Reporting for Pensions—an amendment of GASB Statement No. 27*. This statement provides new guidance on accounting and financial reporting for pensions accounted for in the financial statements of plan employers. This change required the District to report a change in accounting principle adjustment to beginning equity on the government-wide financial statements as described in Note 1 of the notes to basic financial statements.

The application of remaining policies was not changed during the fiscal year ended June 30, 2015. 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 clearly 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.

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 GASB Statement Nos. 45 and 68. 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.

The District's self-insured activities require recording a liability for claims incurred but not yet reported, which are based on estimates.

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.

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, 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.

MANAGEMENT REPRESENTATIONS

We have requested certain representations from management that are included in the management representation letter dated December 17, 2015.

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.

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 and the remaining pension and OPEB-related 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, the Schedule of Expenditures of Federal Awards, and the Uniform Financial Accounting and Reporting Standards (UFARS) Compliance Table accompanying the financial statements 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 section and other district information 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 2016 and 2017 fiscal years. 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.

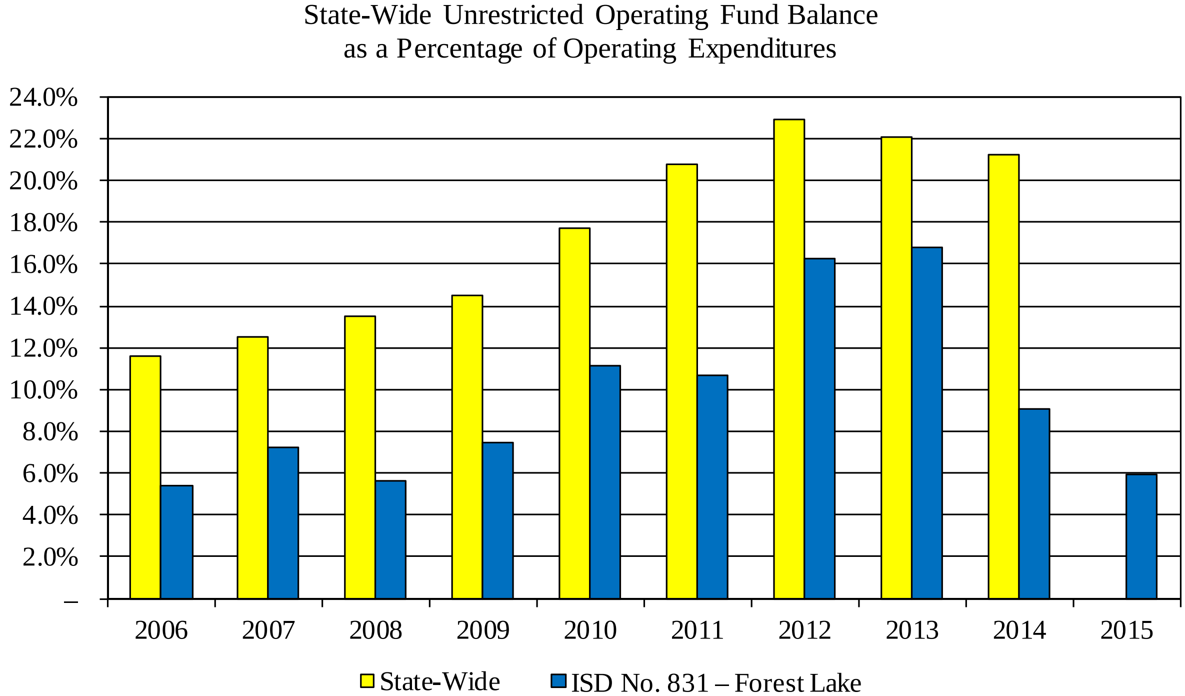
Fiscal Year Ended June 30,	Formula Allowance Amount	Formula Allowance Percent Increase
2006	$ 4,783	4.0 %
2007	$ 4,974	4.0 %
2008	$ 5,074	2.0 %
2009	$ 5,124	1.0 %
2010	$ 5,124	– %
2011	$ 5,124	– %
2012	$ 5,174	1.0 %
2013	$ 5,224	1.0 %
2014	$ 5,302	1.5 %
2015	$ 5,831	2.0 % *
2016	$ 5,948	2.0 %
2017	$ 6,067	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 2015.

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.

Since the financially turbulent 2008–2009 biennium, Minnesota school districts have generally been maintaining a higher unrestricted fund balance as a percentage of operating expenditures. This trend reflects districts' efforts to limit budget cuts, retain educational programs, and maintain adequate operating cash flow during a period of uncertain funding. It was accomplished by districts reducing or limiting operating expenditures, adapting to funding restrictions, and in some cases community support in the form of operating referendums. As the state's economic condition has stabilized the last few years, this trend appears to be gradually reversing, with the state average decreasing in 2013 and 2014.

As of June 30, 2014, this ratio was 9.1 percent for the District, as compared to a state-wide average of 21.2 percent. The District's unrestricted operating fund balance as a percentage of operating expenditures was 5.9 percent at the end of the current year.

Having an appropriate fund balance is an important factor in assessing the District's financial health because a government, like any organization, requires a certain amount of equity to operate. As noted in the graph above, the District has recognized a decrease in this fund balance calculation each of the past two years. It is important to review fund balance levels on an ongoing basis to ensure a sufficient equity reserve is available to support programs and cash flow of the District.

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.

Governmental Funds Revenue per Student (ADM) Served

	State-Wide		Seven-County Metro Area		ISD No. 831 – Forest Lake		
	2013	2014	2013	2014	2013	2014	2015
General Fund							
Property taxes	$ 1,608	$ 972	$ 2,101	$ 1,285	$ 1,561	$ 747	$ 1,567
Other local sources	444	480	372	397	238	303	392
State	8,112	9,036	8,138	9,257	7,477	8,622	8,451
Federal	489	458	519	480	322	289	297
Total General Fund	10,653	10,946	11,130	11,419	9,598	9,961	10,707
Special revenue funds							
Food Service	495	504	495	500	548	551	561
Community Service	535	553	647	667	617	585	632
Debt Service Fund	1,079	1,090	1,172	1,187	619	627	611
Total revenue	$ 12,762	$ 13,093	$ 13,444	$ 13,773	$ 11,382	$ 11,724	$ 12,511
ADM served per MDE School District Profiles Report (current year estimated)					6,789	6,720	6,741

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's revenues per ADM have been below both the metro area and state-wide averages in recent years.

The District earned $84,336,221 in the governmental funds reflected above in fiscal 2015, an increase of $5,555,852 (7.1 percent) from the prior year. Total revenue per ADM served increased by $787 per student. The increase in the basic formula allowance as discussed earlier, along with an increase in other local sources for insurance reimbursements, contributed to the growth in per ADM revenue amounts.

Changes in enrollment also impact comparisons in the table above and on the next page when revenue and expenditures are based on fixed costs, such as debt levies and principal and interest on outstanding indebtedness.

Revenue neutral adjustments attributable to the legislatively-approved tax shift have significantly impacted the recognition of property tax and state sources by year, presented in the table above.

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.

Governmental Funds Expenditures per Student (ADM) Served

	State-Wide		Seven-County Metro Area		ISD No. 831 – Forest Lake		
	2013	2014	2013	2014	2013	2014	2015
General Fund							
Administration and district support	$ 849	$ 882	$ 837	$ 886	$ 794	$ 863	$ 947
Elementary and secondary regular instruction	4,982	5,091	5,273	5,408	4,087	4,585	4,429
Vocational education instruction	138	140	132	130	114	114	129
Special education instruction	1,909	1,987	2,055	2,144	1,590	1,751	1,798
Instructional support services	477	536	562	630	343	530	788
Pupil support services	919	950	991	1,019	1,421	1,472	1,510
Sites, buildings, and other	850	881	800	843	1,029	1,015	1,036
Total General Fund – noncapital	10,124	10,467	10,650	11,060	9,378	10,330	10,637
General Fund capital expenditures	509	512	469	442	230	364	363
Total General Fund	10,633	10,979	11,119	11,502	9,608	10,694	11,000
Special revenue funds							
Food Service	500	513	500	512	559	581	621
Community Service	535	556	646	674	606	606	654
Debt Service Fund	1,234	1,469	1,322	1,636	617	617	608
Total expenditures	$ 12,902	$ 13,517	$ 13,587	$ 14,324	$ 11,390	$ 12,498	$ 12,883
ADM served per MDE School District Profiles Report (current year estimated)					6,789	6,720	6,741

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's expenditures per ADM have also been below the averages above in recent years.

The District spent $86,845,673 in the governmental funds reflected above in fiscal 2015, an increase of $2,858,065 (3.4 percent) from the prior year. On a per student basis, this represents an increase of $385. General Fund expenditures increased $306 per student, which was spread across nearly every category presented above. Salary and benefit increases as contractually-approved along with an increase for the expansion of the all-day kindergarten program contributed to the overall increase in per ADM spending. The District's participation in the alternative compensation program in 2015 also increased salary and benefit spending.

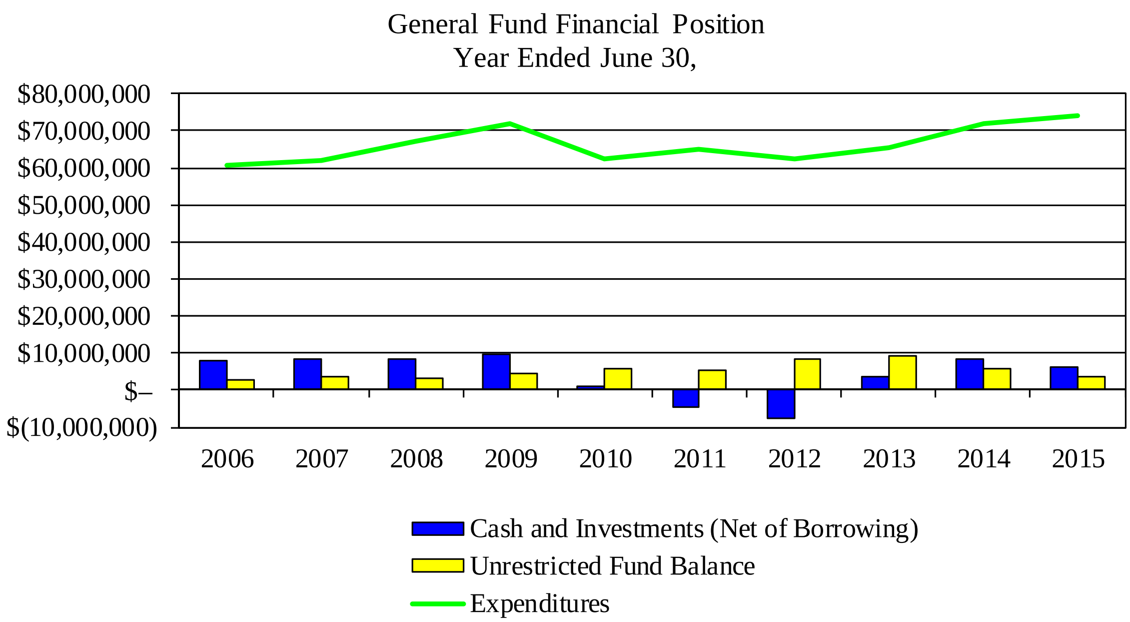
SUMMARY

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, while annual expenditures are often used to measure the size of the operation.



The District ended fiscal year 2015 with a General Fund cash and investments balance (net of borrowing) of $6,309,046, decreasing $2,035,659 from the prior year. The unrestricted fund balance in the General Fund at year-end was $3,520,055, a decrease of $2,115,655. Total fund balance of the General Fund decreased by $1,618,759 compared to a decrease of $1,986,589 as approved in the final budget.

Changes in the metering of state aid payments to school districts and in the tax shift, as legislatively-approved, have significantly impacted cash and investment balances in recent years.

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

	June 30,				
	2011	2012	2013	2014	2015
Nonspendable fund balances	$ 206,330	$ 237,671	$ 289,105	$ 36,858	$ 182,737
Restricted fund balances (1)	1,701	(96,844)	(803,674)	(1,766,679)	(1,415,662)
Unrestricted fund balances					
Assigned	823,777	3,177,283	2,811,186	2,766,366	1,355,685
Unassigned	4,578,641	5,399,132	6,345,392	2,869,344	2,164,370
Total fund balance	$ 5,610,449	$ 8,717,242	$ 8,642,009	$ 3,905,889	$ 2,287,130
Unrestricted fund balances as a percentage of expenditures	8.3%	13.8%	14.0%	7.8%	4.7%
Unassigned fund balances as a percentage of expenditures	7.1%	8.7%	9.7%	4.0%	2.9%

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

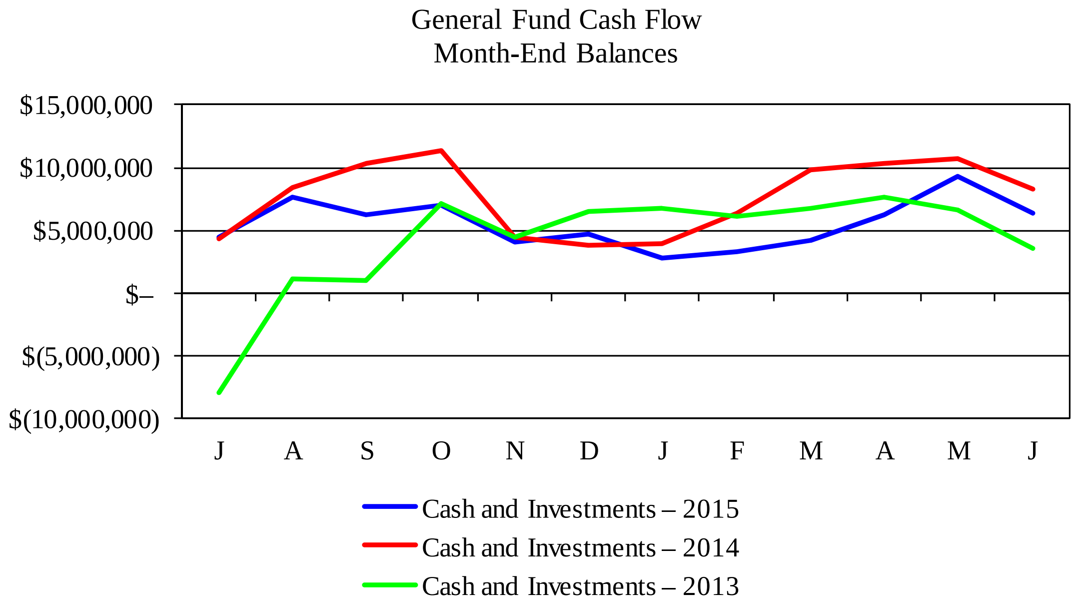
The table above reflects the total General Fund unrestricted fund balance and percentages, which differs from those used in the previous discussion of state-wide fund balances, which are based on a state formula.

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, 2015, unrestricted fund balance in the General Fund represented 4.7 percent of annual expenditures, or just over two weeks of operations assuming level spending throughout the year. This compares to an unrestricted fund balance of 7.8 percent of annual expenditures, or about four weeks of operations for the General Fund in the prior 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 short-term cash flow borrowing) over the past three years:

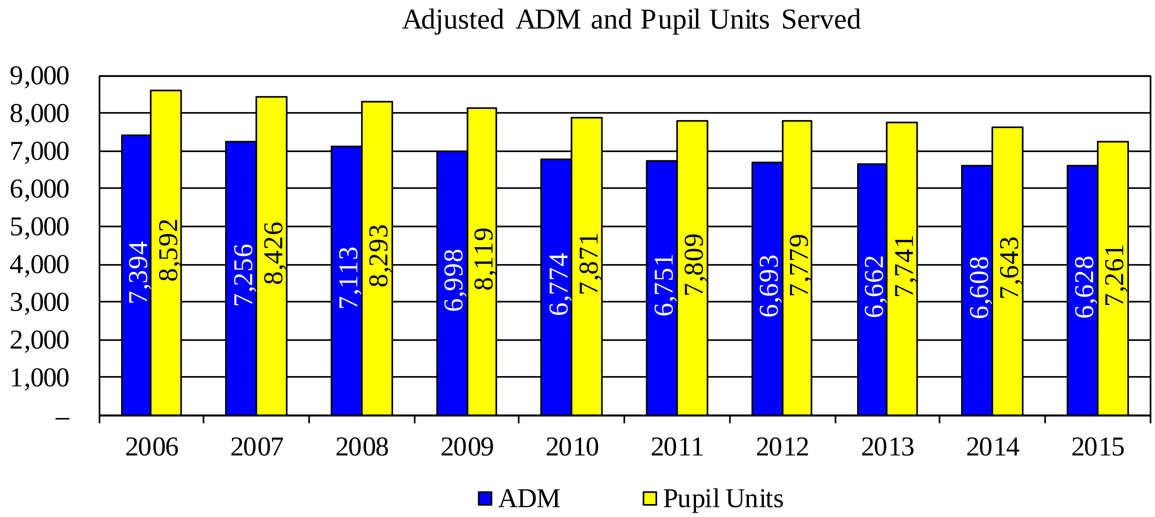


The graph above shows the peaks and valleys of the General Fund cash and investments balance (net of borrowing and interfund balances) on a monthly basis. The swing between its high and low month-end cash balances was about $6.5 million for fiscal 2015.

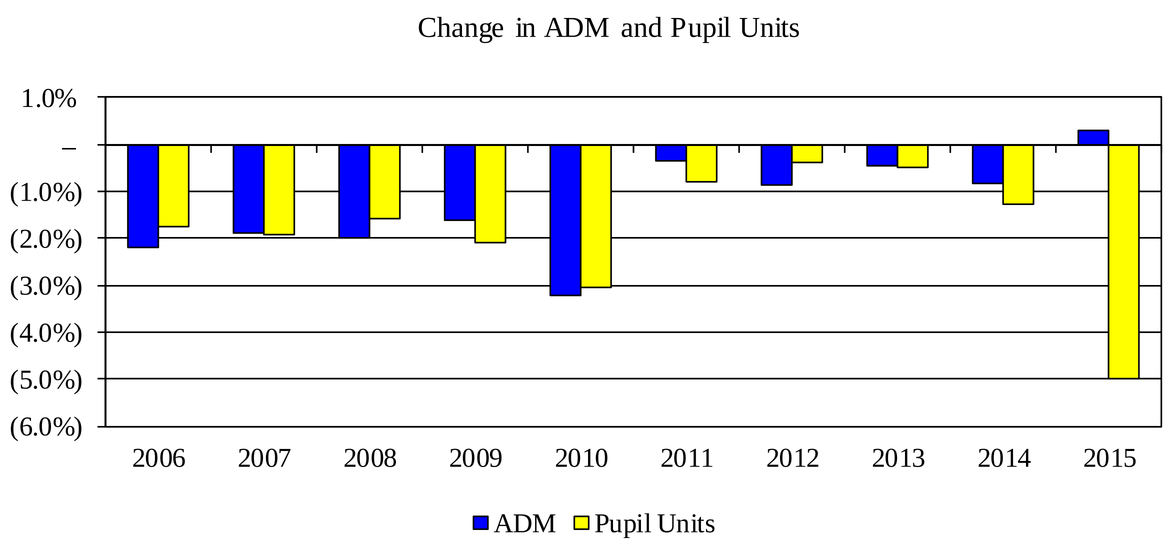
Legislative changes in the tax shift and state aid payment schedules used to help balance the state budget have a significant effect on the cash flow of Minnesota school districts. In fiscal 2012, the state holdback on aids normally paid on a 90–10 schedule was up to 40 percent, and the tax shift was 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 in recent years.

AVERAGE DAILY MEMBERSHIP (ADM) AND PUPIL UNITS

The following graph presents the District's adjusted ADM and resulting 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:



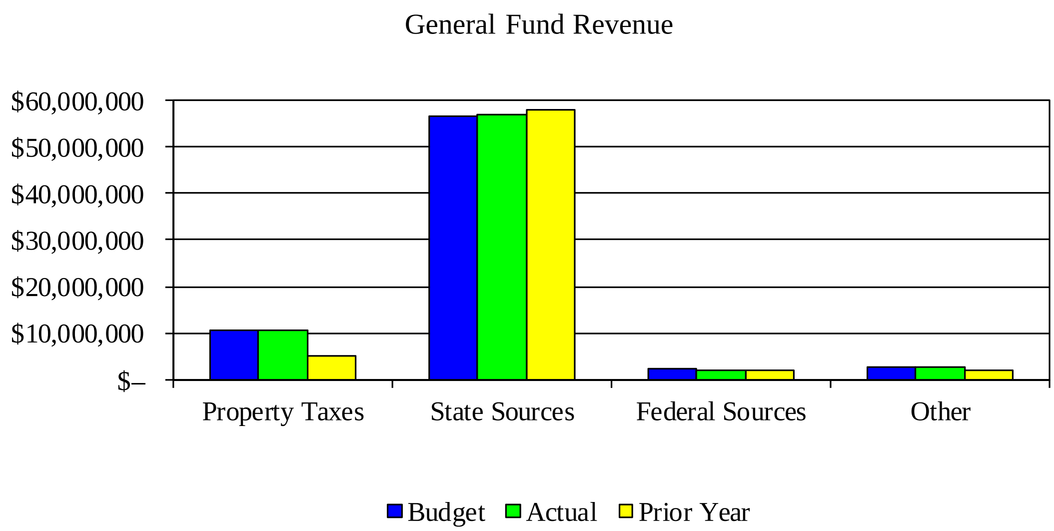
The change in pupil units for 2015 includes the effect of legislative reductions to pupil units.

ADM is a measure of students attending class, which is then 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 ADM of 6,628, an increase of 20 ADM, or 0.3 percent, from the prior year. Resulting pupil units, used to drive aid calculations, decreased due to legislative changes in pupil weightings used to convert ADM to pupil units.

General Fund Revenues

The following graph presents the District's General Fund revenues for 2015:



Total General Fund revenues were $72,177,527 for the year ended June 30, 2015, which was $231,120 (0.3 percent) over the final budget and $5,243,608 (7.8 percent) more than the prior year.

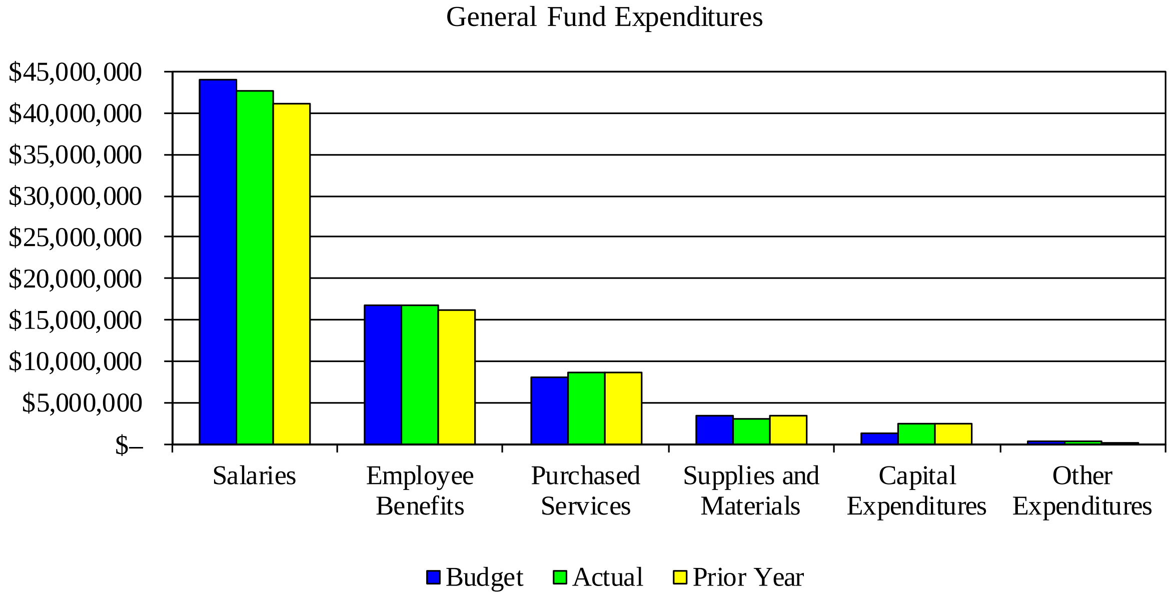
The increase over the prior year was due to the District serving more students along with improvements in the basic formula allowance as previously discussed. The District's participation in the alternative compensation program also increased state aid sources recognized in the current year. An increase in other local sources for insurance reimbursements also contributed to the revenue growth.

Property taxes and state sources were over budget $176,174 and $292,643 respectively, for a total variance of $468,817 above projected levels for the District's two primary funding sources of the General Fund. Federal sources ended the year $183,438 under budget, primarily in federal special education funding. Revenues from other local sources (including gifts, bequests, tuition, rental, and investment income) were $54,259 under budget due to the uncertain nature of these revenues.

The graph above reflects the concentration of state sources (78.9 percent) followed by property taxes (14.6 percent) received to finance General Fund operations. The graph also reflects $5,038,634 of change for the tax shift between state aids and tax sources that offset dollar-for-dollar in the current year.

GENERAL FUND EXPENDITURES

The following graph presents the District's General Fund expenditures for 2015:

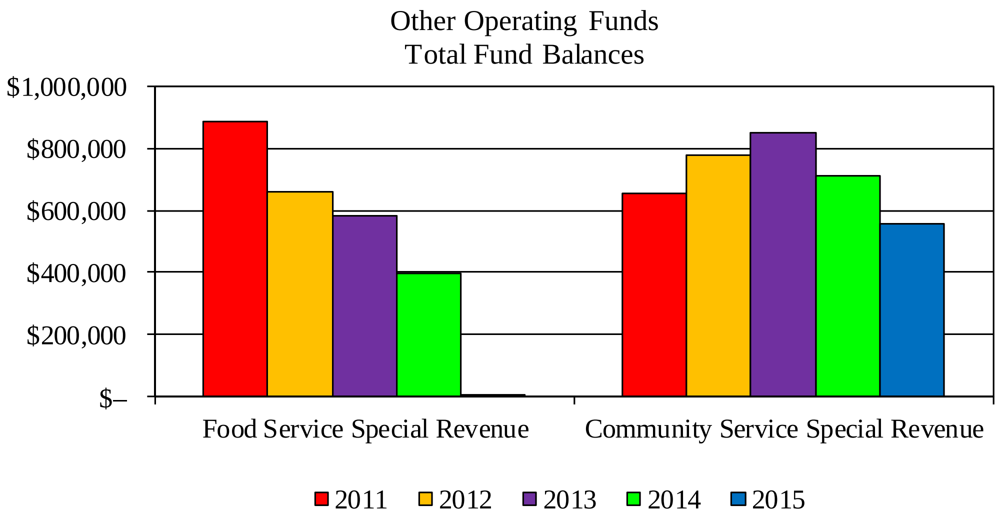


Total General Fund expenditures were $74,151,543 for the year ended June 30, 2015, which was $218,547 (0.3 percent) over the final budget and $2,286,404 (3.2 percent) more than the prior year.

Salaries and related benefits comprise 80.2 percent of General Fund spending. Salaries and employee benefits increased $2,186,394, or 3.8 percent, over the prior year, while ending the year $1,334,080, or 2.2 percent, less than approved in the budget, primarily due to open positions and conservative budgeting. This increase included additional costs for serving more students and was due to normal pay raises and step and lane changes within employment contracts. The District's participation in the alternative compensation program, as previously discussed, contributed to the growth in salaries and benefits. Purchased services were $107,805 more than the prior year and $562,539 over projected amounts, primarily in elementary and secondary regular instruction and pupil support services. Supplies and materials were $299,910 less than the prior year and $294,644 under budget. Capital expenditures increased $1,039, and were over budget by $1,173,249 due to the timing of approved projects in comparison to budget expectations. Other expenditures were $291,076 more than prior year and were $111,483 more than expected in the budget.

OTHER FUNDS OF THE DISTRICT

The following graph shows what is referred to as the other operating funds. The remaining nonoperating funds are only included in narrative form below, since their level of fund balance can fluctuate significantly due to such things as issuing and spending the proceeds of refunding or building bonds and, therefore, the trend of fund balance levels are not necessarily a key indicator of financial health. It does not mean that these funds cannot experience financial trouble or that their fund balances are unimportant.



Food Service Special Revenue Fund

The District's Food Service Special Revenue Fund equity decreased $393,892 in 2015, compared to a planned increase of $67,817. Revenues were $182,079 over budget, mainly in state and federal sources, while expenditures were $653,848 over budget, primarily in salaries and benefits and supplies and materials. The Food Service Special Revenue Fund had a year-end fund balance of $1,200, representing 0.03 percent of annual expenditures totaling $4,184,342. As presented in the graph above, fund balance has declined each of the past four years.

Over the years we have emphasized to our school district clients that food service operations should be self-sustaining, and should not become an additional burden on general education funds. This would include the accumulation of fund balance for future capital improvements to food service facilities and to provide a cushion in the event of a negative trend in operations.

Community Service Special Revenue Fund

The District's Community Service Special Revenue Fund equity decreased $151,106 in 2015, compared to a budgeted decrease of $41,429. Revenues were $357,426 over budget, mainly in other tuition and fees. Expenditures were over appropriated amounts, ending $467,103 over budget for associated program salary and benefit costs. The Community Service Special Revenue Fund had a year-end fund balance of $558,065, representing 12.6 percent of annual expenditures totaling $4,411,792.

The Community Service Special Revenue Fund, like the Food Service Special Revenue Fund, needs to be self-sustaining. In addition to cost controls, financial analysis of the costs of providing programs, including overhead, is important. Fees and tuition charges should be sufficient to cover these costs as well as potential funding shortfalls from state, federal, or property tax sources.

Capital Projects – Building Construction Fund

The Capital Projects – Building Construction Fund has a fund balance deficit of $1,416,144 at June 30, 2015. This fund is used to account for major capital project costs and alternative facility project costs as approved by the MDE that will be financed with future alternative facility levies.

Debt Service Fund

The funding of debt service is controlled in accordance with each outstanding debt issue's financing plan. It is important to remember that resources of the Debt Service Fund are dedicated to payment of outstanding debt obligations of the District.

Total fund balance in the Debt Service Fund increased by $31,355 in the current year to a year-end balance of $975,639, available for future debt service payments.

Internal Service Fund

The Internal Service Fund is considered a proprietary fund and is used to account for health and dental insurance offered by the District to its employees as a self-insured plan.

Post-Employment Benefits Trust Fund

The District has established a Post-Employment Benefits Trust Fund to account for an irrevocable trust account established to finance the District's liability for post-employment healthcare benefits. At year-end, trust net position of $3,663,017 is available for future OPEB payments.

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 governmental 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
	2015	2014	(Decrease)
Net position – governmental activities			
Total fund balances – governmental funds	$ 2,405,890	$ 3,968,791	$ (1,562,901)
Total capital assets, net of depreciation	50,216,927	50,683,919	(466,992)
PERA and TRA pension adjustments	(46,198,346)	–	(46,198,346)
Total other long-term debt	(27,328,283)	(31,108,608)	3,780,325
Other adjustments	4,574,635	4,264,450	310,185
Total net position – governmental activities	$ (16,329,177)	$ 27,808,552	$ (44,137,729)
Net position			
Net investment in capital assets	$ 31,611,377	$ 28,802,808	$ 2,808,569
Restricted	1,187,313	1,658,618	(471,305)
Unrestricted	(49,127,867)	(2,652,874)	(46,474,993)
Total net position	$ (16,329,177)	$ 27,808,552	$ (44,137,729)

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 and net pension liabilities.

Total net position decreased by $44,137,729 during fiscal 2015. The District's net investment in capital assets increased $2,808,569 this year. The change in this category of net position typically depends on the relationship between the rate at which the District's capital assets are being depreciated, and how that compares to the rate at which the District is repaying the debt issued to purchase or construct those assets. The increases the District has seen in recent years have also been impacted by projects financed using alternative facilities levies, which have allowed the District to undertake improvement projects without having to issue bonds.

The restricted portion of the District's net position decreased $471,305 in 2015, due to a decrease in the restrictions for food service and community service. Unrestricted net position decreased $46,474,993. The District recorded a change in accounting principle in the current year for reporting the District's participation in the Public Employees Retirement Association and Teachers Retirement Association pension plans. This change reduced beginning net position in the government-wide financial statements by $46,711,505, impacting the unrestricted portion of net position.

LEGISLATIVE SUMMARY

After two years with Democratic control of the governor's office and both legislative chambers, the Republicans picked up 11 seats in the House of Representatives (the House) in the 2014 elections, gaining control of that chamber for 2015. Despite the 2015 legislative session beginning with a projected budget excess of $1.87 billion for the 2016–2017 biennium, the most favorable budget forecast in over a decade, little was accomplished during the session due to partisan disagreement. One of the many areas of contention was the education finance bill, which was passed by the House and Senate late in the regular session without a universal preschool provision demanded by the governor. As promised, the governor vetoed the education finance bill along with several others, forcing a special session. Ultimately, the K–12 education finance bill was passed in a special session adding $525 million in state funding for K–12 education over the 2016–2017 biennium.

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 increased $529 to $5,831 for fiscal year (FY) 2015, with simultaneous changes to pupil weights and the general education formula structure reducing the increase to the equivalent of $105 per pupil state-wide. The 2015 Legislature approved 2 percent increases for each of the two subsequent fiscal years, raising the per pupil allowance to $5,948 for FY 2016 and $6,067 for FY 2017.

A number of other changes were made to the general education formula, including:

- The extended time allowance increased from $5,017 to $5,117 beginning in FY 2016.
- Charter schools with extended time programs will receive 25 percent of the state average per adjusted pupil unit (about $19 per adjusted pupil unit [APU]) beginning in FY 2016.
- Funding eligibility for English learner revenue is extended from 6 to 7 years in FY 2017.
- School districts not in a compensatory pilot project are allowed to allocate up to 50 percent of compensatory revenue among building sites based on a local plan beginning in FY 2016.

The following changes were made to elements of the general education tax levy:

- The student achievement levy, reestablished to allow districts to levy up $20 million state-wide for FY 2016 (taxes payable 2015), is being phased out. There will be no change to the $20 million limit for FY 2017 (taxes payable 2016). The levy is reduced to $10 million state-wide for FY 2018 (taxes payable 2017), and eliminated for FY 2019.
- The equalization factor for operating capital was increased from $14,500 for FY 2016 to $14,740 for FY 2017, $17,473 for FY 2018, and $20,510 for FY 2019 and later years.

Language was also added requiring districts to use the 2 percent general education staff development set-aside for: teacher development and evaluation, principal development and evaluation, professional development, in-service education, and staff development plans. Staff development plans are required to be aligned and integrated with teacher development and evaluation agreements.

Quality Compensation Program (Q Comp) – The 2015 Legislature made the following changes to the Q Comp alternative compensation for teachers program:

- The cap on basic Q Comp aid increases 16.5 percent to $75,636,000 beginning in FY 2017.
- Cooperatives other than intermediate districts are eligible to participate in Q Comp beginning in FY 2017. The year prior to participating, 70 percent of the teachers employed by the cooperative must agree to adopt a Q Comp system.
- Beginning in FY 2017, the Q Comp aid formula for intermediates and other cooperatives changes to $3,000 per licensed teacher employed on October 1 of the previous year.
- Alternative teacher pay systems are now allowed to include incentives for teachers to pursue training, advanced certifications, or master's degrees; and for teachers identified as effective or highly effective to work in hard-to-fill positions or hard-to-staff schools.

Compensatory Pilot Grants – Funding for compensatory pilot grants has been extended, with state-wide funding for FY 2016 and later set at the FY 2015 level of $7,342,500. Recipient districts are required to post plans and accountability measures on their website.

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

For FY 2016, state regular special education aid 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 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.

The formula for special education excess cost aid for FY 2016 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.

Long-Term Facilities Maintenance Revenue – Beginning in FY 2017, the current deferred maintenance, health and safety, and alternative facilities programs will be rolled into a new long-term facilities maintenance revenue program.

The new revenue for FY 2017 will be $193 per APU, multiplied by the lessor of one, or the ratio of the district's average building age to 35 years. Funding will increase to $292 per APU for FY 2018 and $380 per APU for FY 2019, multiplied by the same building age factor. Additional funding will be available for approved indoor air quality, fire alarm and suppression, and asbestos abatement projects with a cost per site of $100,000 or more. Districts may issue bonds for this program, levy on a pay-as-you-go basis, or a combination of the two. The 25 largest districts currently eligible for alternative facilities revenue will continue to be eligible for reimbursement of approved project costs without a per-pupil limit.

Revenue for long-term facilities maintenance will be equalized up to a limit of one times the annual allowance per APU. The aid/levy mix for the equalized portion of the revenue will be calculated using an equalizing factor of 123 percent of the state average adjusted net tax capacity (ANTC) per pupil unit, calculated with an exclusion of 50 percent of the value of class 2a Agricultural Land from ANTC. Levy equalization will be the same regardless of whether the district chooses to issue bonds or make annual pay-as-you-go levies. Debt service levies under the program will be excluded from regular debt service equalization.

All districts are guaranteed to receive at least as much revenue and at least as much state aid as they would have received under the existing law.

American Indian Education Aid – The Success for the Future Grant Program is being replaced with a new American Indian Education Aid, effective FY 2016. Districts, charters, and Bureau of Indian Education schools with at least 20 American Indian students are eligible for aid. The aid entitlement will equal the lessor of approved costs or $20,000, plus $358 per American Indian student enrolled on October 1 of the previous year in excess of 20. There will be a hold harmless for districts currently receiving Success for the Future grants.

College Entrance Exams – Taking a nationally recognized college entrance exam is now optional. However, districts must provide and administer the test upon request once to a student in the 11th or 12th Grade. The Legislature appropriated $6 million to reimburse districts for the costs of providing the nationally recognized college entrance exam at the students' option. Costs will be reimbursed until the appropriation is exhausted.

Post-Secondary Enrollment Options (PSEO) – Students in 9th and 10th Grades are now allowed to enroll in PSEO courses if approved by their serving district and the postsecondary institution. They may also enroll in world language courses available to 11th and 12th Graders consistent with world language standards and proficiency seals and certificates. Students not on track to graduate are no longer restricted from PSEO participation.

Full Service Community Schools – Eligible school sites can receive grants in FY 2016 and FY 2017 through a new Full-Service Community Schools Program. To be eligible, a school must be on a development plan for continuous improvement or be in a district with an approved achievement and integration program, and have established two programs in specified program areas to meet school community needs. Sites can earn up to $100,000 each year for a site coordinator and up to $20,000 for one year of implementation planning.

Early Learning Programs – While the Governor's proposed universal preschool provision did not become law, funding increases of $92.5 million for several early learning programs were approved for the 2016–2017 biennium, including: $48.25 million for the Early Learning Scholarship Program; $30.75 million for School Readiness; $10 million for Head Start; and $3.5 million for the "Parent Aware" early childhood rating system. Funding for Early Childhood Family Education linked to the general education formula also increased.

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 2017. 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.

Four-Day School Week – Future approvals of districts adopting a four-day week will depend upon meeting "World's Best Workforce" goals. Districts that currently have four-day week schedules are grandfathered in until the FY 2020 school year. If discontinued, districts are allowed one year to transition off the four-day week schedule.

Withdrawal from Cooperatives – In the event of a dispute involving a district's withdrawal from a cooperative, any administrative law judge fees are required to be split equally by the district and the cooperative.

Financial Reporting Dates – The deadline for districts or charters to make prior year financial data corrections for final payments was moved from December 30 to December 15 following the fiscal year-end.

ACCOUNTING AND AUDITING UPDATES

GASB STATEMENT NO. 72, *FAIR VALUE MEASUREMENT AND APPLICATION*

The primary objective of this statement is to address accounting and financial reporting issues related to fair value measurements. Fair value is the price that would be received to sell an asset or paid to transfer a liability in an orderly transaction between market participants at the measurement date. This statement provides guidance for determining a fair value measurement for financial reporting purposes. It also provides guidance for applying fair value to certain investments and disclosures related to all fair value measurements.

This statement generally requires investments to be measured at fair value. An investment is defined as a security or other asset that (a) a government holds primarily for the purpose of income or profit and (b) has a present service capacity based solely on its ability to generate cash or to be sold to generate cash. This statement is effective for financial statements for fiscal years beginning after June 15, 2015. Earlier application is encouraged.

GASB STATEMENT NO. 73, *ACCOUNTING AND FINANCIAL REPORTING FOR PENSIONS AND RELATED ASSETS THAT ARE NOT WITHIN THE SCOPE OF GASB STATEMENT NO. 68, AND AMENDMENTS TO CERTAIN PROVISIONS OF GASB STATEMENT NOS. 67 AND 68*

The objective of this statement is to improve the usefulness of information about pensions included in financial statements of state and local governments for making decisions and assessing accountability. This statement also clarifies the application of certain provisions of GASB Statement Nos. 67 and 68 regarding 10-year schedules of required supplementary information and other recognition issues pertaining to employers and nonemployer contributing entities. These changes will improve financial reporting by establishing a single framework for the presentation of information about pensions, enhancing comparability for similar information reported by employers and nonemployer contributing entities.

The requirements of this statement that address accounting and financial reporting by employers and governmental nonemployer contributing entities for pensions not within the scope of GASB Statement No. 68 are effective for financial statements for fiscal years beginning after June 15, 2016, and the requirements of this statement that address financial reporting for assets accumulated for purposes of providing those pensions are effective for fiscal years beginning after June 15, 2015. The requirements of this statement for pension plans that are within the scope of GASB Statement No. 67 or for pensions that are within the scope of GASB Statement No. 68 are effective for fiscal years beginning after June 15, 2015. Earlier application is encouraged.

GASB STATEMENT NO. 74, *FINANCIAL REPORTING FOR POSTEMPLOYMENT BENEFIT PLANS OTHER THAN PENSION PLANS*

The objective of this statement is to improve the usefulness of information about post-employment benefits other than pensions (other post-employment benefits [OPEB]). This statement replaces GASB Statement Nos. 43 and 57. It also includes requirements for defined contribution OPEB plans that replace the requirements for those OPEB plans in GASB Statement Nos. 25, 43, and 50. GASB Statement No. 75, *Accounting and Financial Reporting for Postemployment Benefits Other Than Pensions*, establishes new accounting and financial reporting requirements for governments whose employees are provided with OPEB, as well as for certain nonemployer governments that have a legal obligation to provide financial support for OPEB provided to the employees of other entities.

This statement will improve financial reporting primarily through enhanced note disclosures and schedules of required supplementary information that will be presented by OPEB plans administered through trusts meeting the specified criteria. The new information will enhance the decision-usefulness of the financial reports of those OPEB plans, their value for assessing accountability, and their transparency by providing information about measures of net OPEB liabilities and explanations of how and why those liabilities changed from year to year. The net OPEB liability information, including ratios, will offer an up-to-date indication of the extent to which the total OPEB liability is covered by the fiduciary net position of the OPEB plan. The comparability of the reported information for similar types of OPEB plans will be improved by the changes related to the attribution method used to determine the total OPEB liability. The contribution schedule will provide measures to evaluate decisions related to the assessment of contribution rates in comparison with actuarially determined rates, if such rates are determined. In addition, new information about rates of return on OPEB plan investments will inform financial report users about the effects of market conditions on the OPEB plan's assets over time and provide information for users to assess the relative success of the OPEB plan's investment strategy and the relative contribution that investment earnings provide to the OPEB plan's ability to pay benefits to plan members when they come due.

This statement is effective for financial statements for fiscal years beginning after June 15, 2016. Earlier application is encouraged.

GASB STATEMENT NO. 75, *ACCOUNTING AND FINANCIAL REPORTING FOR POSTEMPLOYMENT BENEFITS OTHER THAN PENSIONS*

The primary objective of this statement is to improve accounting and financial reporting by state and local governments for post-employment benefits other than pensions (OPEB). It also improves information provided by state and local governmental employers about financial support for OPEB that is provided by other entities. This statement replaces the requirements of GASB Statement Nos. 45 and 57. GASB Statement No. 74 establishes new accounting and financial reporting requirements for OPEB plans.

This statement establishes standards for recognizing and measuring liabilities, deferred outflows of resources, deferred inflows of resources, and expense/expenditures. For defined benefit OPEB, this statement identifies the methods and assumptions that are required to be used to project benefit payments, discount projected benefit payments to their actuarial present value, and attribute that present value to periods of employee service. Note disclosure and required supplementary information requirements about defined benefit OPEB also are addressed. This statement is effective for fiscal years beginning after June 15, 2017. Earlier application is encouraged.

Similar to changes implemented for pensions, this statement requires the liability of employers and nonemployer contributing entities to employees for defined benefit OPEB (net OPEB liability) to be measured as the portion of the present value of projected benefit payments to be provided to current active and inactive employees that is attributed to those employees' past periods of service (total OPEB liability), less the amount of the OPEB plan's fiduciary net position.

GASB STATEMENT NO. 77, *TAX ABATEMENT DISCLOSURES*

This statement requires disclosure of tax abatement information about (1) a reporting government's own tax abatement agreements, and (2) those that are entered into by other governments and that reduce the reporting government's tax revenues. Tax abatements are widely used by state and local governments, particularly to encourage economic development. For financial reporting purposes, this statement defines a tax abatement as resulting from an agreement between a government and an individual or entity in which the government promises to forgo tax revenues and the individual or entity promises to subsequently take a specific action that contributes to economic development or otherwise benefits the government or its citizens.

The requirements of this statement improve financial reporting by giving users of financial statements essential information that is not consistently or comprehensively reported to the public at present. Disclosure of information about the nature and magnitude of tax abatements will make these transactions more transparent to financial statement users. As a result, users will be better equipped to understand (1) how tax abatements affect a government's future ability to raise resources and meet its financial obligations, and (2) the impact those abatements have on a government's financial position and economic condition. The requirements of this statement are effective for financial statements for periods beginning after December 15, 2015. Earlier application is encouraged.

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. This new Uniform Guidance includes a number of significant changes to both administrative requirements and the federal Single Audit process.

Significant changes in administrative requirements include: changes to time and effort documentation, updating internal control framework to be consistent with changes to the Committee of Sponsoring Organizations) of the Treadway Commission (COSO) internal control framework, creating written policies and procedures to implement requirements of cash management and allowability of costs, implementing new procurement standards, and additional compliance and control requirements for districts making subawards. Auditees are required to implement the administrative requirements of the new Uniform Guidance for new awards or funding increments on or after December 26, 2014.

Significant changes to the federal Single Audit process include: 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. The revised audit requirements will be effective for audits of fiscal years beginning on or after December 26, 2014.

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