

INDEPENDENT SCHOOL DISTRICT NO. 877
Buffalo-Hanover-Montrose, Minnesota

Management Letter
For the Fiscal Year Ended June 30, 2010

Preliminary

**INDEPENDENT SCHOOL DISTRICT NO. 877
Buffalo-Hanover-Montrose, Minnesota**

TABLE OF CONTENTS

REPORT ON MATTERS IDENTIFIED AS A RESULT OF THE AUDIT OF THE FINANCIAL STATEMENTS	1
FINANCIAL ANALYSIS.....	3
LEGISLATIVE SUMMARY.....	16
MATERIAL WEAKNESS.....	19
OTHER DEFICIENCIES	20
SINGLE AUDIT COMPLIANCE FINDING.....	21
RECOMMENDATION FOR MANAGEMENT	22
REQUIRED COMMUNICATION	24

Preliminary



Expert advice. When you need it.SM

**REPORT ON MATTERS IDENTIFIED AS A RESULT OF
THE AUDIT OF THE FINANCIAL STATEMENTS**

October 18, 2010

To the School Board
Independent School District No. 877
Buffalo-Hanover-Montrose, Minnesota

In planning and performing our audit of the financial statements of Independent School District No. 877, Buffalo-Hanover-Montrose, Minnesota, as of and for the year ended June 30, 2010, in accordance with U.S. generally accepted auditing standards, we considered the District's internal control over financial reporting (internal control) as a basis for designing our auditing procedures for the purpose of expressing our opinions on the financial statements, but not for the purpose of expressing an opinion on the effectiveness of the District's internal control. Accordingly, we do not express an opinion on the effectiveness of the District's internal control.

Our consideration of internal control was for the limited purpose described in the preceding paragraph and would not necessarily identify all deficiencies in internal control that might be significant deficiencies or material weaknesses and, therefore, there can be no assurance that all deficiencies, significant deficiencies or material weaknesses have been identified. Material weaknesses and significant deficiencies identified, if any, are stated within this letter.

A deficiency in internal control exists when the design or operation of a control does not allow management or employees, in the normal course of performing their assigned functions, to prevent or detect and correct misstatements on a timely basis. A material weakness is a deficiency, or combination of deficiencies in internal control, such that there is a reasonable possibility that a material misstatement of the District's financial statements will not be prevented or detected and corrected on a timely basis.

A significant deficiency is a deficiency, or combination of deficiencies, in internal control that is less severe than a material weakness, yet important enough to merit attention by those charged with governance.



The accompanying memorandum includes financial analysis and recommendations for improvement of accounting procedures and internal control measures that came to our attention as a result of our audit of the financial statements of the District for the year ended June 30, 2010. The matters discussed herein were considered by us during our audit and they do not modify the opinion expressed in our Independent Auditor's Report dated October 18, 2010, on such statements.

This communication is intended solely for the information and use of the School Board, management, others within the District and state oversight agencies and is not intended to be and should not be used by anyone other than these specified parties.

KERN, DEWENTER, VIERE, LTD.
St. Cloud, Minnesota

Preliminary

**INDEPENDENT SCHOOL DISTRICT NO. 877
Buffalo-Hanover-Montrose, Minnesota**

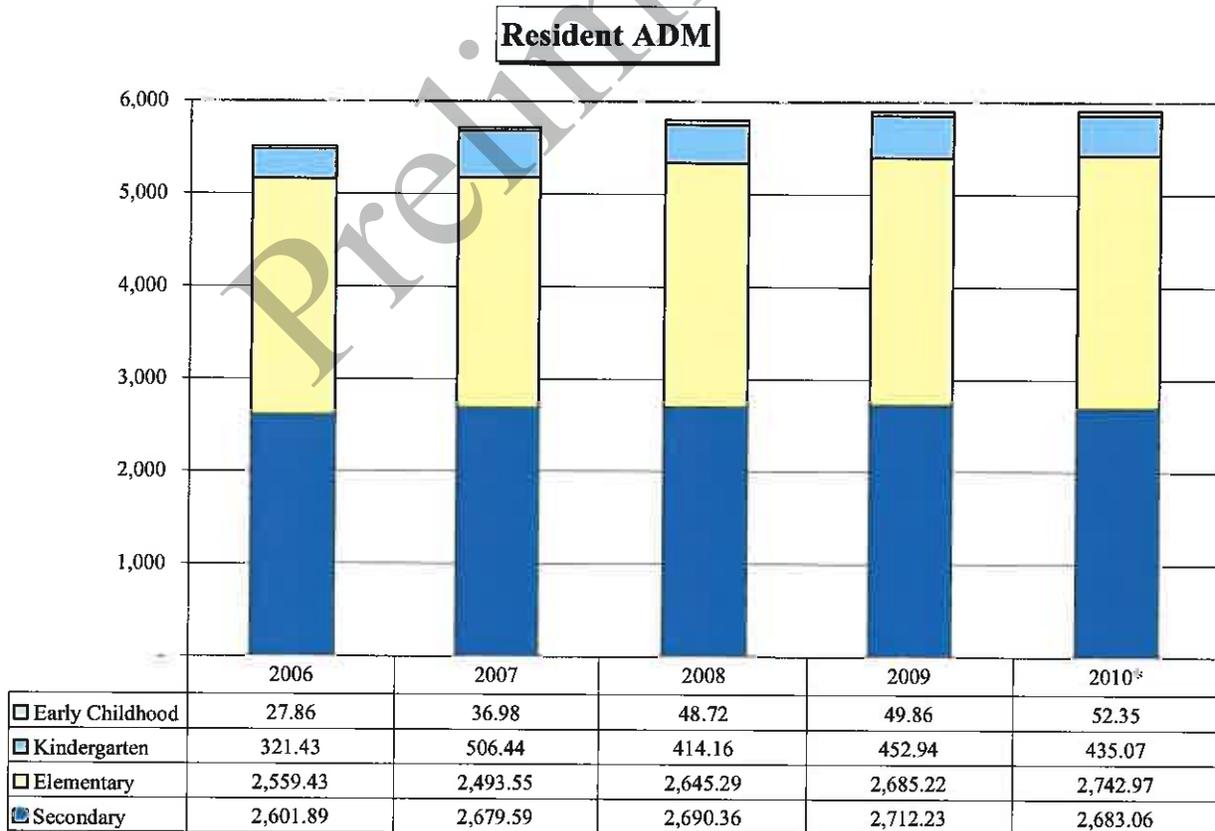
**FINANCIAL ANALYSIS
June 30, 2010**

The following pages provide graphic representation of select data pertaining to the financial position and operations of the District for the past five years. Our analysis of each graph is presented to provide a basis for discussion of past performance and how implementing certain changes may enhance future performance. A subsequent discussion of this information should be useful for planning purposes.

RESIDENT AVERAGE DAILY MEMBERSHIP AND PUPIL UNITS

Approximately 74% of the District's General Fund revenue is from the state. A majority of this funding is based on student counts, so an understanding of the District's population trends is critical to overall budgeting plans. The following table and graph summarizes resident average daily membership (ADM) of the District for the past five years ended June 30.

ADM's	2006	2007	2008	2009	2010*
Early Childhood	27.86	36.98	48.72	49.86	52.35
Kindergarten	321.43	506.44	414.16	452.94	435.07
Elementary	2,559.43	2,493.55	2,645.29	2,685.22	2,742.97
Secondary	2,601.89	2,679.59	2,690.36	2,712.23	2,683.06
Total Resident ADMs	5,510.61	5,716.56	5,798.53	5,900.25	5,913.45



* Estimate as of August 17, 2010

**INDEPENDENT SCHOOL DISTRICT NO. 877
Buffalo-Hanover-Montrose, Minnesota**

**FINANCIAL ANALYSIS
June 30, 2010**

RESIDENT AVERAGE DAILY MEMBERSHIP AND PUPIL UNITS

The chart and graph on the previous page illustrate the steady increase in resident ADMs encountered by the District over the past five years. Total resident ADMs increased 7.3% since 2006 and 0.2% between 2009 and 2010.

To calculate a majority of the District's education aids, the ADM amounts are converted into pupil units by weighting, based on the student's grade level. These weighting factors are presented in the table below.

Pupil Units Weighting				
	Prekindergarten and Handicapped Kindergarten	Kindergarten	Elementary Grades 1-3/4-6	Secondary
Fiscal 2006-2007	1.250/1.000	0.557	1.115/1.060	1.300
Fiscal 2008-2010	1.250/1.000	0.612	1.115/1.060	1.300

The total pupil units are converted to adjusted pupil units, which also may be used to calculate the District's education aids. Adjusted pupil units are calculated by multiplying 77% of current year pupil units and 23% of prior year, or 100% of current year, whichever is greater. The adjusted pupil unit data is used for districts with declining enrollment to lessen the negative impact.

The weighted average daily membership (WADM) served table below and graph on the following page, converts the resident ADM into weighted or adjusted pupil unit data for the past five years taking into consideration the above weighting factors and open enrollment.

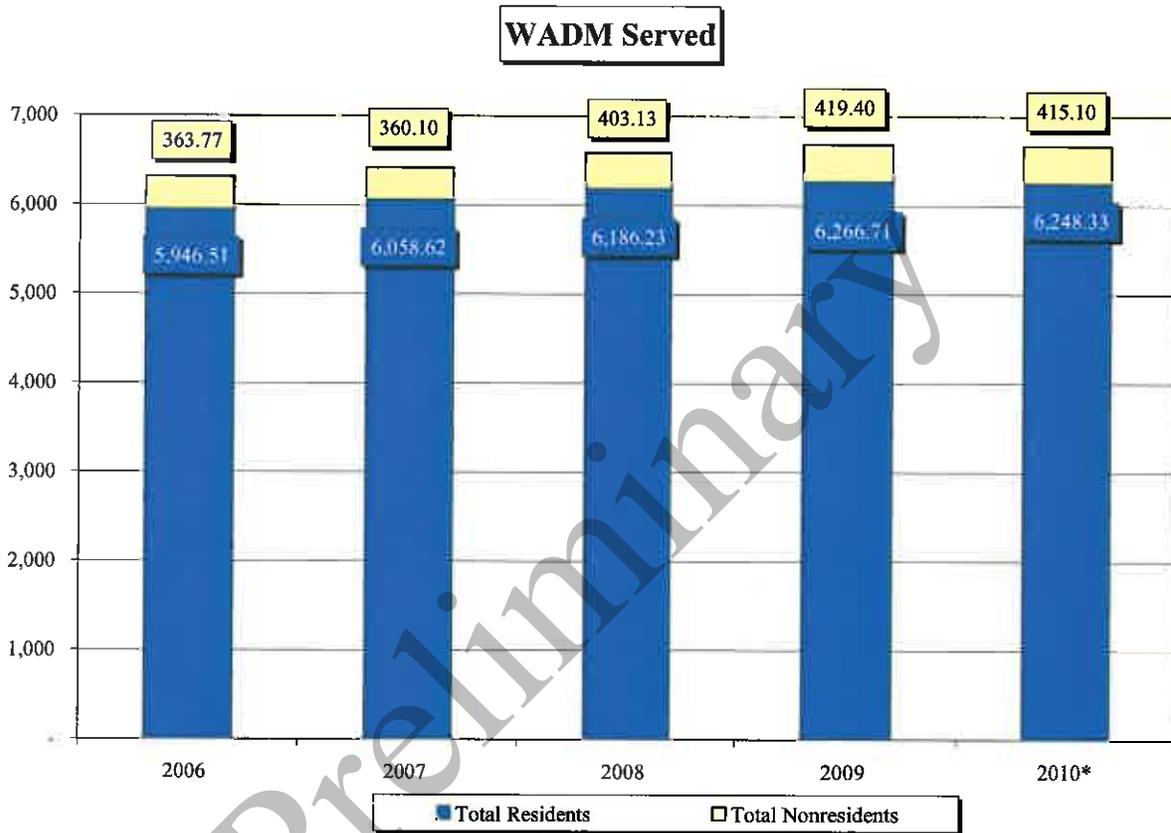
WADMs	2006	2007	2008	2009	2010*
Residents	6,389.52	6,537.12	6,702.95	6,797.13	6,817.29
Resident WADM Loss	(443.01)	(478.50)	(516.72)	(530.42)	(568.96)
Nonresident WADM Gain	363.77	360.10	403.13	419.40	415.10
Total WADMs Served	6,310.28	6,418.72	6,589.36	6,686.11	6,663.43

* Estimate as of August 17, 2010

**INDEPENDENT SCHOOL DISTRICT NO. 877
Buffalo-Hanover-Montrose, Minnesota**

**FINANCIAL ANALYSIS
June 30, 2010**

WEIGHTED AVERAGE DAILY MEMBERSHIP SERVED



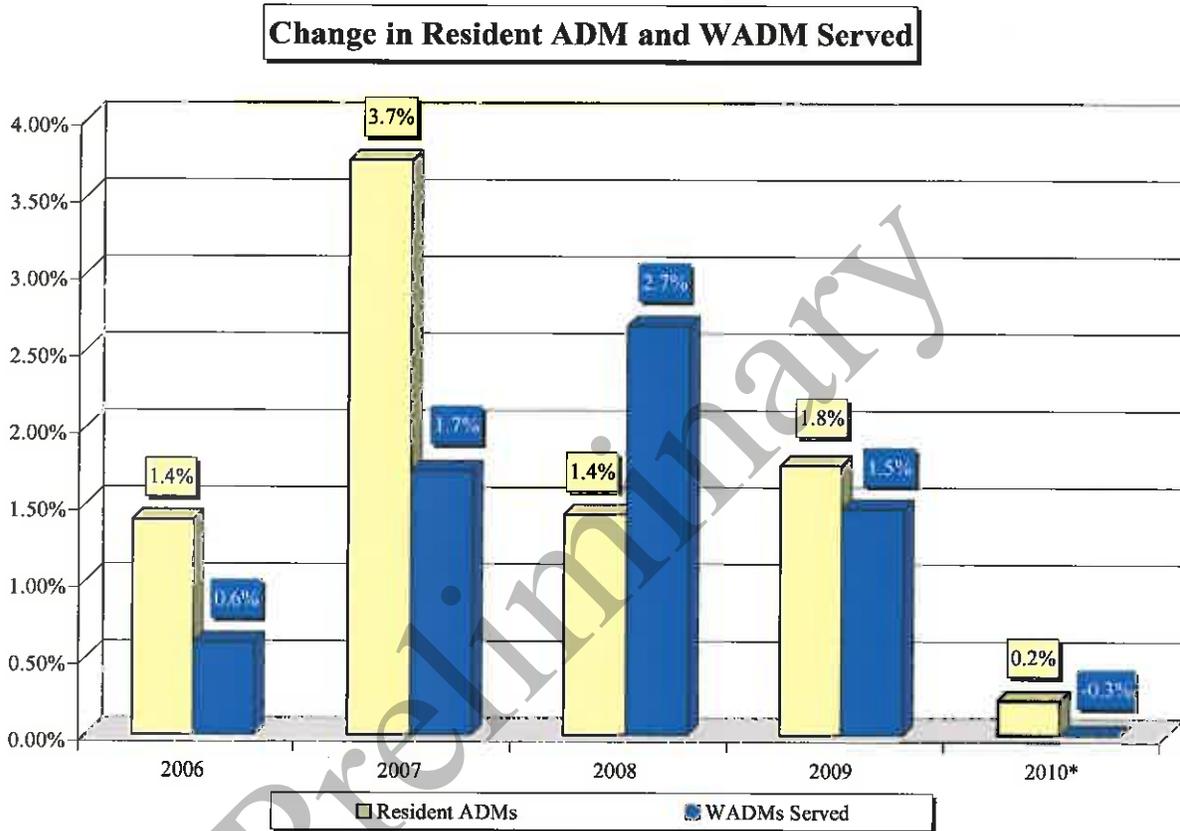
* Estimate as of August 17, 2010

Resident ADMs served has increased in all years presented as illustrated on the previous pages. WADMs served increased each year from 2006 to 2009, fluctuations in open enrollment have led to a decrease in WADMs served from 2009 to 2010 of 0.3%, or 22.68 WADMs. This is the first loss in WADMs served in the five years presented.

INDEPENDENT SCHOOL DISTRICT NO. 877
Buffalo-Hanover-Montrose, Minnesota

FINANCIAL ANALYSIS
June 30, 2010

RESIDENT ADM AND WADM MEMBERSHIP SERVED



* Estimate as of August 17, 2010

**INDEPENDENT SCHOOL DISTRICT NO. 877
Buffalo-Hanover-Montrose, Minnesota**

**FINANCIAL ANALYSIS
June 30, 2010**

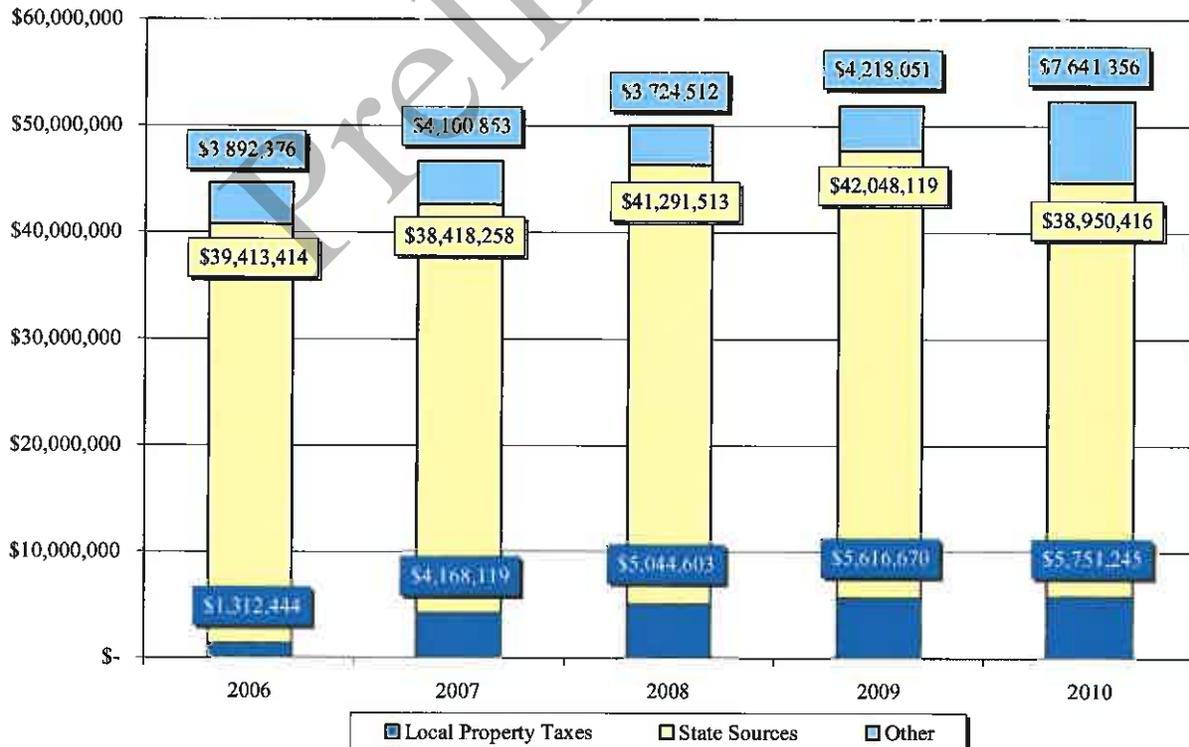
GENERAL FUND SOURCES OF REVENUE

General Fund sources of revenue are summarized as follows for the last five years:

	2006	2007	2008	2009	2010
Local Property Taxes	\$ 1,312,444	\$ 4,168,119	\$ 5,044,603	\$ 5,616,670	\$ 5,751,245
State Sources	39,413,414	38,418,258	41,291,513	42,048,119	38,950,416
Other	3,892,376	4,100,853	3,724,512	4,218,051	7,641,356
Total	\$ 44,618,234	\$ 46,687,230	\$ 50,066,628	\$ 51,882,840	\$ 52,343,017

State revenue sources, which make up approximately 74.4% of total revenues, decreased by \$ 3,097,703 for the fiscal year ended June 30, 2010. Factors contributing to this decrease include federal aid replacing a portion of the state's general education aid, as well as a decrease in WADMs served, as discussed earlier. Local property taxes increased during fiscal year 2010 by \$ 134,575 as a result of an increased levy. Other sources increased by \$ 3,423,305 due to increased monies received from the federal government as the result of the American Recovery and Reinvestment Act (ARRA). Included in other revenues are local, county and federal revenues. Total General Fund revenue increased 0.9% from 2009 to 2010.

General Fund Sources of Revenue



**INDEPENDENT SCHOOL DISTRICT NO. 877
Buffalo-Hanover-Montrose, Minnesota**

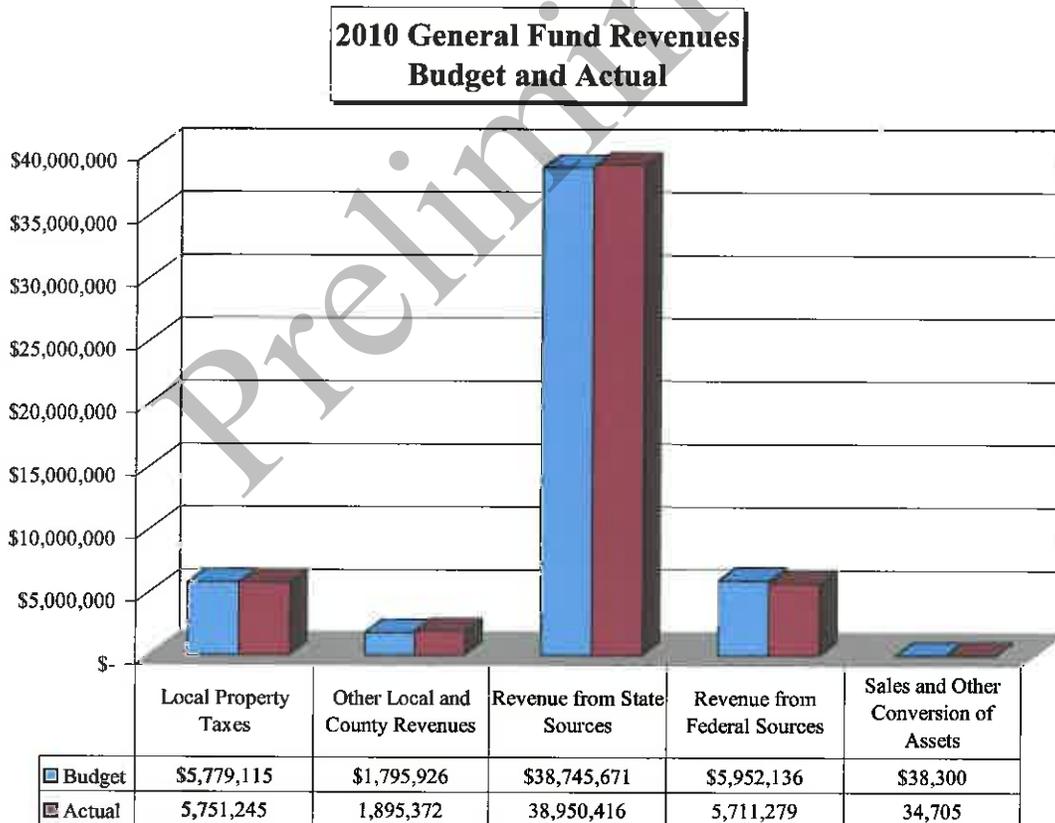
**FINANCIAL ANALYSIS
June 30, 2010**

GENERAL FUND REVENUES BUDGET AND ACTUAL

The graph below outlines the District's final budget and actual results for the General Fund revenues.

In June 2009, the District approved a General Fund revenue budget of \$ 51,839,972. This was modified in May 2010 by \$ 471,176 to a final revenue budget of \$ 52,311,148. With actual revenues coming in at \$ 52,343,017, the final budget produced a variance of \$ 31,869, or 0.1%.

The largest variance was in revenue from federal sources which was under budget by \$ 240,857. This budget variance was the result of the District budgeting for more ARRA funds than were received. Revenue from state sources was over budget by \$ 204,745, much of this related to the anticipation of larger budget cuts at the state level. All other revenue categories budgets were in line with actual revenue.



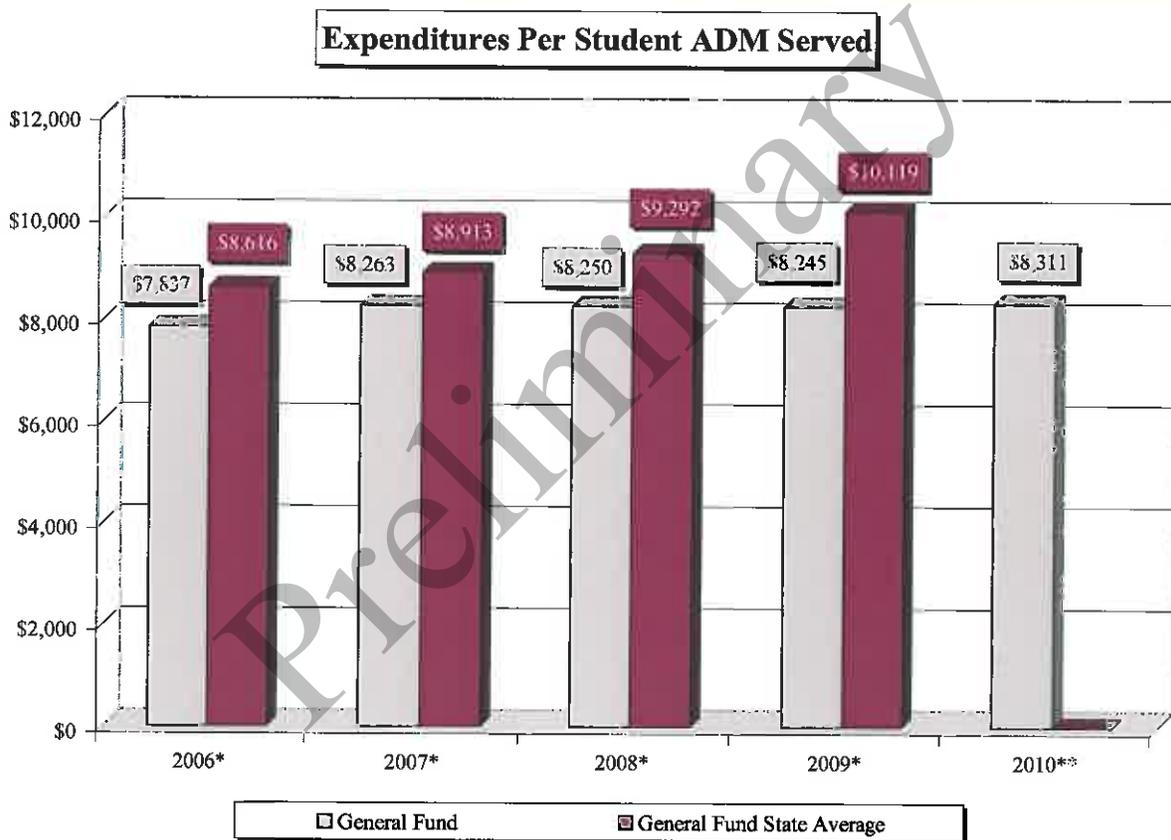
**INDEPENDENT SCHOOL DISTRICT NO. 877
Buffalo-Hanover-Montrose, Minnesota**

**FINANCIAL ANALYSIS
June 30, 2010**

EXPENDITURES PER ADM SERVED

General Fund expenditures per students (ADM) served, not including capital outlay and OPEB, are summarized in the following table and graph:

	2006*	2007	2008*	2009*	2010**
General Fund	\$ 7,837	\$ 8,263	\$ 8,250	\$ 8,245	\$ 8,311
General Fund State Average	8,616	8,913	9,292	10,119	N/A



* Source: *School District Profiles*

** Estimate as of August 17, 2010 excluding other post employment benefits (OPEB) costs in the General Fund; state-wide averages are not available.

The District has seen an increase in expenditures per student ADM served from 2006 to 2010. Operating General Fund expenditures per student increased 0.8% from 2009 to 2010, due to a .6% decrease in ADMs served and a 2.0% increase in expenditures.

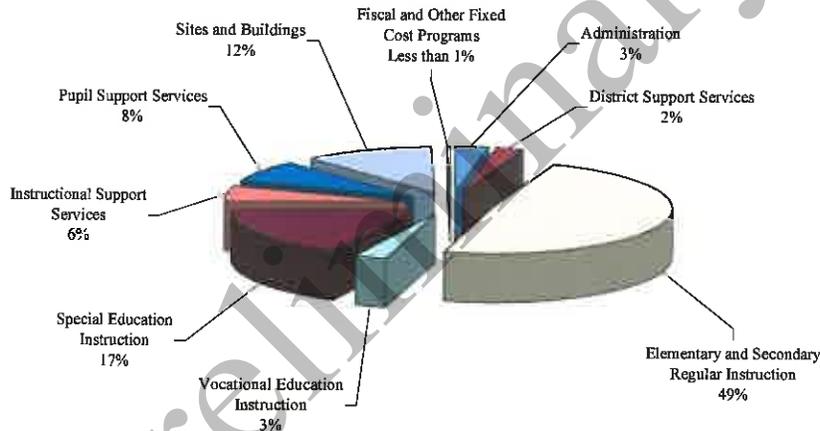
**INDEPENDENT SCHOOL DISTRICT NO. 877
Buffalo-Hanover-Montrose, Minnesota**

**FINANCIAL ANALYSIS
June 30, 2010**

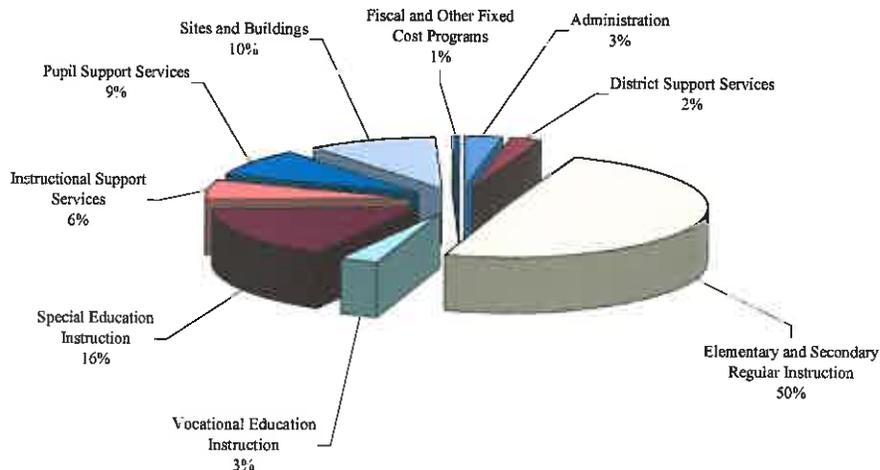
GENERAL FUND EXPENDITURES

The graphs below depict the percentage of expenditures by function in the General Fund for fiscal years 2009 and 2010. Expenditures increased by \$ 10,701,537, or 21.2%, from 2009 to 2010, and the allocation of expenditures remained very consistent. The large increase was a result of the District bonding for OPEB and contributing the bond proceeds to an irrevocable trust fund. Education programs made up 69% of the District's expenditures and only 5% was attributable to administration and District support services for 2009 and 2010.

General Fund Expenditures 2010



General Fund Expenditures 2009



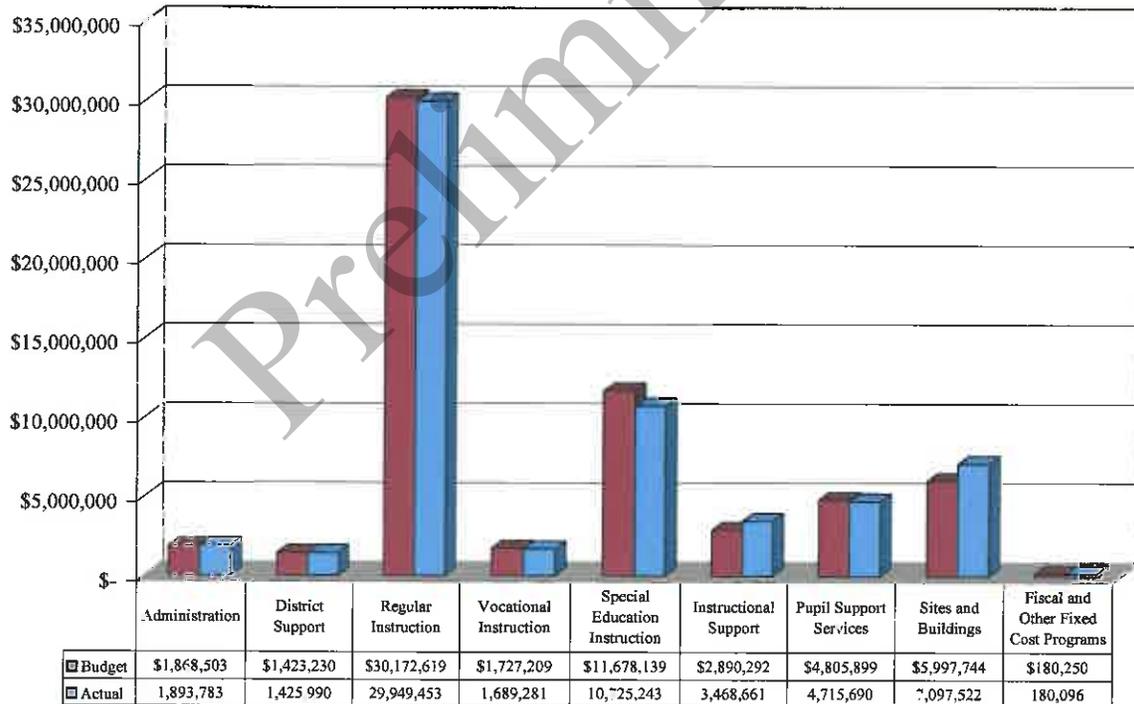
**INDEPENDENT SCHOOL DISTRICT NO. 877
Buffalo-Hanover-Montrose, Minnesota**

**FINANCIAL ANALYSIS
June 30, 2010**

GENERAL FUND BUDGET AND ACTUAL

In total, General Fund expenditures were \$ 401,834 over budget. As noted in the graph below, special education, instructional support and sites and buildings were the categories with the largest variances. Special education instruction expenditures were under budget by \$ 952,896 due to the District budgeting twice for benefits, once as regular benefits and once as stimulus spending. Instructional support services expenditures were over budget by \$ 578,369 due to a reallocation of the benefit expenditures budget, which offset the variance in special education instruction, and an effort to carry over budget amounts for supplies and materials to fiscal year 2010. Sites and buildings expenditures were \$ 1,099,778 over budget as a result of capital outlay expenses exceeding the budget by \$ 1,186,864 due to the issuance of the Montrose early childhood capital lease of \$ 1,324,474.

**2010 General Fund Expenditures
Budget and Actual**



**INDEPENDENT SCHOOL DISTRICT NO. 877
Buffalo-Hanover-Montrose, Minnesota**

**FINANCIAL ANALYSIS
June 30, 2010**

GENERAL FUND OPERATIONS

The following table presents five years of comparative operating results for the District's General Fund:

	2006	2007	2008	2009	2010
Revenues	\$ 44,618,234	\$ 46,687,230	\$ 50,060,628	\$ 51,882,840	\$ 52,343,017
Expenditures, Excluding OPEB	45,836,400	49,571,249	49,795,805	50,444,182	51,433,583
OPEB Expenditures	-	-	-	-	9,712,136
Excess of Revenues Over (Under) Expenditures	(1,218,166)	(2,884,019)	264,823	1,438,658	(8,802,702)
Transfers/Other Financing Sources	200	1,200,220	-	1,473	11,082,861
Fund Balance, July 1	10,133,212	8,915,246	7,231,447	7,496,270	8,936,401
Fund Balance, June 30	\$ 8,915,246	\$ 7,231,447	\$ 7,496,270	\$ 8,936,401	\$ 11,216,560
Components:					
Unreserved, Undesignated	\$ 3,733,679	\$ 3,432,201	\$ 4,233,226	\$ 4,255,850	\$ 6,151,513
Designated for:					
New Facilities	1,780,841	980,841	-	-	-
Student Activities	342,202	276,081	278,113	278,117	202,258
Severance Pay	1,638,868	1,459,200	1,430,324	1,834,523	3,474,913
3rd Party Special Education	-	-	-	260,000	-
Stimulus	-	-	-	-	341,200
Capital	-	-	-	327,355	327,355
Carryover	348,749	318,253	269,847	469,191	164,257
Dental Insurance	111,326	187,041	227,390	259,291	275,723
Reserved for:					
Staff Development	-	-	-	74,801	74,801
Severance Pay	346,271	581,908	669,869	658,484	-
Deferred Maintenance	-	-	-	-	18,871
Operating Capital	20,825	40	412,851	390,331	38,273
Gifted and Talented	25,258	-	-	-	-
Health and Safety	567,227	(4,118)	(25,350)	128,458	147,396
Total	\$ 8,915,246	\$ 7,231,447	\$ 7,496,270	\$ 8,936,401	\$ 11,216,560

As previously stated, total General Fund revenue increased 0.9% from 2009 to 2010 as a result of increased federal revenues received and an increase in the local property tax levy offset with a decrease in general education aid.

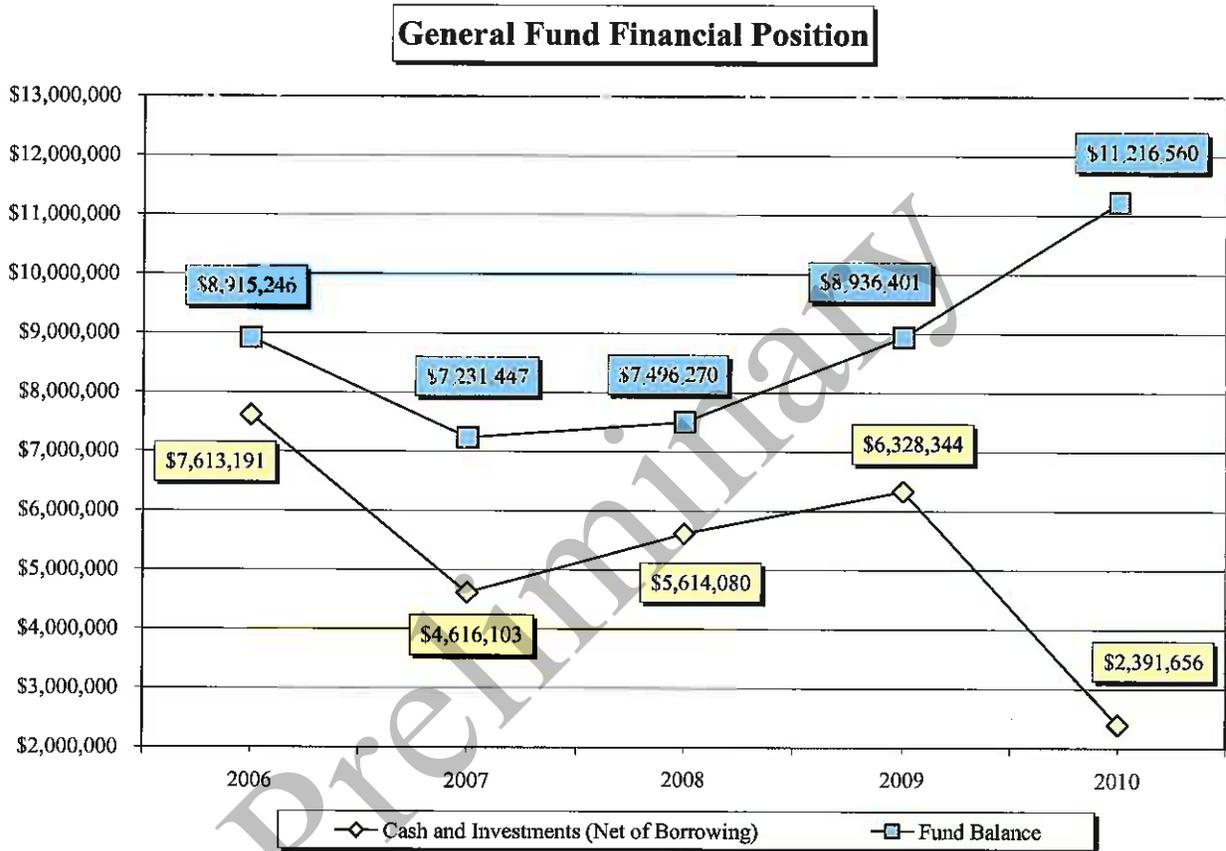
Total General Fund expenditures increased 21.2% from 2009 to 2010 as a result of bonding for OPEB. An increase in capital outlay expenses related to various projects and the issuance of the Montrose building capital lease also contributed to the increased expenditures.

Expenditures exceeded revenues during 2010; however, with the other financing sources, the fund balance increased \$ 2,280,159, or 25.5%, resulting in the increase in designated fund balance for severance pay and unreserved, undesignated fund balance.

**INDEPENDENT SCHOOL DISTRICT NO. 877
Buffalo-Hanover-Montrose, Minnesota**

**FINANCIAL ANALYSIS
June 30, 2010**

GENERAL FUND OPERATIONS



The decrease in cash and investments balance from 2009 to 2010 is a result of state hold-backs in aid. During 2009, the District saw approximately 10% of general education aid held back by the state; during 2010, that amount increased to 27%. The state receivable for 2010 increased approximately 141.5%, or \$ 6,152,764 in the General Fund.

INDEPENDENT SCHOOL DISTRICT NO. 877
Buffalo-Hanover-Montrose, Minnesota

FINANCIAL ANALYSIS
June 30, 2010

FOOD SERVICE FUND

The following table presents five years of comparative operating results for the District's Food Service Fund:

For the Year Ended June 30,	2006	2007	2008	2009	2010
Revenues	\$ 2,355,108	\$ 2,425,265	\$ 2,553,237	\$ 2,701,594	\$ 2,757,354
Expenditures, Excluding OPEB	2,325,805	2,282,633	2,770,468	2,788,100	2,693,406
OPEB Expenditures	-	-	-	-	352,780
Excess of Revenues Over (Under) Expenditures	29,303	142,632	(217,231)	(86,506)	(288,832)
Transfers/Other Financing Sources	35,169	-	-	6,860	353,180
Fund Balance, July 1	128,095	192,567	335,199	117,968	38,322
Fund Balance, June 30	\$ 192,567	\$ 335,199	\$ 117,968	\$ 38,322	\$ 102,670

Expenditures once again exceeded revenues in the Food Service Fund; however, when OPEB expenditures are excluded, revenues exceeded expenditures for the year. Food service revenues increased 2.1% due to additional revenue received from the federal government for free and reduced meals, while expenditures, excluding OPEB, decreased 3.4% due to a decrease in food commodities, supplies and capital expenditures. The District issued OPEB bond in 2010, resulting in OPEB expenditures of \$ 352,780 which are offset by the bond proceeds. The District should continue to monitor this Fund to ensure revenues are covering the cost of operations.

COMMUNITY SERVICE FUND

The following table presents five years of comparative operating results for the District's Community Service Fund:

For the Year Ended June 30,	2006	2007	2008	2009	2010
Revenues	\$ 2,249,176	\$ 2,498,143	\$ 2,787,017	\$ 2,826,137	\$ 2,794,718
Expenditures, Excluding OPEB	2,312,985	2,457,020	2,697,060	2,857,589	2,761,569
OPEB Expenditures	-	-	-	-	625,383
Excess of Revenues Over (Under) Expenditures	(63,809)	41,123	89,957	(31,452)	(592,234)
Transfers/Other Financing Sources	-	-	-	3,743	625,383
Fund Balance, July 1	205,138	141,329	182,452	272,409	244,700
Fund Balance, June 30	\$ 141,329	\$ 182,452	\$ 272,409	\$ 244,700	\$ 277,849

Components:					
Unreserved, Undesignated	\$ (12,131)	\$ 3,467	\$ 11,914	\$ 12,550	\$ 8
Reserved for:					
ECFE	33,415	50,984	81,676	69,226	133,840
Community Education	94,803	107,270	136,853	107,205	83,107
School Readiness	11,705	11,425	20,553	44,430	48,587
Adult Basic Education	13,537	9,306	21,413	11,289	12,307
Total	\$ 141,329	\$ 182,452	\$ 272,409	\$ 244,700	\$ 277,849

**INDEPENDENT SCHOOL DISTRICT NO. 877
Buffalo-Hanover-Montrose, Minnesota**

**FINANCIAL ANALYSIS
June 30, 2010**

COMMUNITY SERVICE FUND

Expenditures exceeded revenues in the Community Service Fund for the third time in five years; however, when OPEB expenditures are excluded, revenues exceeded expenditures for the year. During the year ended June 30, 2010, revenues decreased 1.1% due to decreased program participation. Expenditures, excluding OPEB, decreased 3.4% as a result of the decreased program participation. The District issued OPEB bonds in 2010, resulting in OPEB expenditures of \$ 625,383 which are offset by the bond proceeds.

Preliminary

INDEPENDENT SCHOOL DISTRICT NO. 877
Buffalo-Hanover-Montrose, Minnesota

LEGISLATIVE SUMMARY
June 30, 2010

The following is a brief summary of current legislative changes and issues affecting the funding of Minnesota school districts. More detailed and extensive summaries are available from the Minnesota Department of Education (MDE).

State Aid Appropriations

The formula allowance for the fiscal year 2011 general education aid remains unchanged from the fiscal year 2010 allowance. The state was the recipient of \$ 167 million in federal Education Jobs Fund (Ed Jobs) money for the 2010-2011 school year. This is a one time federal program to provide assistance to states to save or create education jobs. These funds are allocated to the districts based on general education aid, state special education and excess cost aid. An estimate is available on the MDE web site.

During fiscal year 2011, payments for state aids will be paid at 70% current and 30% final payment. The 90% current and 10% final payment is reinstated for fiscal year 2012. Districts and charter schools in statutory operating debt (SOD) can receive early final payment on June 20 to bring total general education aid for the year up to 90% of the aid entitlement but not to exceed the amount of SOD in the district.

State Aid Payment Delays

Minnesota Statutes 127A.46 was modified to make state aid payment delays to districts optional instead of mandatory before the state does short-term borrowing. The modification also limits the delays to districts with fund balances of \$ 700 per resident pupil unit or more and deducts the first \$ 700 per pupil unit of cash balances in calculating the delays.

The state exercised this option for fiscal year 2011 aids and currently estimates that between \$ 156 million and \$ 83 million of aids will be delayed for approximately 138 districts that meet the above cash and fund balance limits. Delays began on September 15 and will be paid in full by May 30, 2011.

Property Tax Levies

There are no new levies for taxes payable in 2011. The property tax shift was ratified at a 48.6% shift for fiscal year 2011 and later and uses the same calculation method and percent as the previous tax shift enacted in 2003, to be repaid when the state budget improves (after the state cash flow account balance reaches \$ 350 million, the state budget reserve reaches \$ 653 million and the aid payment schedule is restored to 90-10).

Beginning in fiscal year 2011, the first half of the school levy payments (amounts received in May, June and July settlements) is shifted back into the current fiscal year and recognized early as revenue.

INDEPENDENT SCHOOL DISTRICT NO. 877
Buffalo-Hanover-Montrose, Minnesota

LEGISLATIVE SUMMARY
June 30, 2010

MDE Budget

Due to the current economic condition of the state, the MDE budget has been reduced by \$ 796,000 for fiscal year 2010 and \$ 1.132 million for fiscal year 2011 and later.

Debt Service Equalization Aid

Sets standing appropriations for debt service equalization aid are set at \$ 17,161,000 for fiscal year 2012 and at \$ 19,175,000 for fiscal year 2013, which should eliminate the need for the MDE to increase the 2010 payable 2011 debt service levies for districts receiving the debt service equalization aid to cover potential proration of the aid.

Omnibus Pension Bill, PERA and TRA

Increases employee and employer contributions rates for various public employee pension programs will be as follows:

- PERA – Employee and employer contribution rates for PERA Coordinated Plan will increase by 0.25% effective January 1, 2011.
 - Employee rates from 6% to 6.25%
 - Employer rates from 7% to 7.25%
- TRA – Rates are currently 5.5% and will rise by 0.5% annually over a four year period beginning July 1, 2011. TRA automatic 2.5% annual post retirement adjustment is suspended for 2011 and 2012 followed by a 2% increase until the plan becomes 90% funded.

OPEB Bonding and Levies

Voter approval is required for bonds issued after October 1, 2009. Any new levy to fund annual OPEB expense initiated with taxes payable is capped. Pay 2010 levy was prorated at 60.4%. Currently, the fiscal year Pay 2011 levy is prorated at 100%.

Staff Development

The staff development reserve is temporarily suspended for fiscal years 2010 and 2011. The reserve is equal to 2% of the district's basic general education revenue.

INDEPENDENT SCHOOL DISTRICT NO. 877
Buffalo-Hanover-Montrose, Minnesota

LEGISLATIVE SUMMARY
June 30, 2010

Early Childhood Education – School Readiness Program

Children eligible to participate are defined as follows:

- Must be at least three years old on September 1,
- Must have completed the Early Childhood Health and Developmental Screening within 90 days of the program enrollment and
- Must meet one or more of the following criteria:
 - Qualify for free or reduced price lunch
 - Be an English language learner
 - Be homeless
 - Be eligible for special education services
 - Be identified through screening as having a potential risk factor that may influence learning or
 - Be identified as at risk by the district

School readiness aid must be used for eligible children, but children who do not meet eligibility criteria may participate in the program on a fee-for-service basis. This program is now an allowable use of general community education revenue.

Security Lending Agreements

This statute allows districts to enter into security lending agreements with qualified financial institutions that have a bank office located in Minnesota.

**INDEPENDENT SCHOOL DISTRICT NO. 877
Buffalo-Hanover-Montrose, Minnesota**

**MATERIAL WEAKNESS
June 30, 2010**

MATERIAL AUDIT ADJUSTMENT

During the course of our engagement, we proposed a material audit adjustment that was not identified as a result of the District's existing internal controls and, therefore, could have resulted in a material misstatement of the District's financial statements.

In order to ensure the financial statements were free from material misstatement, an audit adjustment was required related to the issuance of a capital lease. The adjustment had no affect on financial position and was a result of the new capital lease being entered into during the year.

We recommend the District ensure all entries are prepared and posted prior to the audit.

Preliminary

**INDEPENDENT SCHOOL DISTRICT NO. 877
Buffalo-Hanover-Montrose, Minnesota**

**OTHER DEFICIENCIES
June 30, 2010**

IMPROVE CAPITAL ASSET TRACKING

During our audit, we noted the District does not have adequate procedures in place to ensure capital assets are being properly removed from the listing when disposed. As a result, we identified an asset on the District's asset listing that was previously disposed. It was also observed that several items selected for testing were not in the same classroom or building as indicated on the master list of capital assets. In addition, none of the assets selected for testing were tagged.

We recommend the District implement an inventory system where responsible officials are given a listing of assets in their assigned location to verify the accuracy of the listing. All persons with custody of capital assets need to be informed they are responsible for the asset(s) and need to inform the appropriate persons of the need for disposal, transfer, replacement or maintenance of the asset(s). In addition, we recommend the District tag all assets to match the tag numbers in the system in order to improve the completeness and accuracy of the asset listing.

INSUFFICIENT CONTROL OVER ATHLETIC ACTIVITY FEE

During our audit, it was noted there were insufficient controls over the reconciliation and verification process relating to ticket sales at events of the district. There were some events missing the reconciliation forms created by the district and others were incomplete. Without these reconciliations, it is impossible to determine that all receipts are being deposited into district accounts.

We recommend the district follow the reconciliation process and verify all forms are fully completed. This will insure the entire revenue is being collected for activities.

INDEPENDENT SCHOOL DISTRICT NO. 877
Buffalo-Hanover-Montrose, Minnesota

SINGLE AUDIT COMPLIANCE FINDING
June 30, 2010

COMPUTE TIME DOCUMENTATION FOR FEDERAL PROGRAMS

According to the *OMB Circular A-87*, when employees work on multiple activities or cost objectives, a distribution of their salaries or wages will be supported by personnel activity reports or equivalent documentation. Such documentary support will be required where employees work on more than one federal award, a federal award and a nonfederal award, an indirect cost activity and a direct cost activity, two or more indirect activities which are allocated using different allocation bases or an unallowable activity and a direct or indirect cost activity.

Personnel activity reports or equivalent documentation must meet the following standards:

- Reflect an after the fact distribution of the actual activity of each employee,
- Account for the total activity for which each employee is compensated,
- Be prepared at least monthly and must coincide with one or more pay periods and
- Be signed by the employee.

Budget estimates or other distribution percentages determined before the services are performed do not qualify as support for charges to federal awards, but may be used for interim accounting purposes, provided that the governmental unit's system for establishing the estimates produces reasonable approximations of the activity actual performed, at least quarterly comparisons of actual costs to budgeted distributions based on the monthly activity reports are made, the budget estimates or other distribution percentages are revised at least quarterly to reflect changed circumstances.

Substitute systems for allocating salaries and wages to federal awards may be used in place of activity reports. These systems are subject to approval if required by the cognizant agency. Such systems may include, but are not limited to, random moment sampling, case counts or other quantifiable measures of employee effort.

During our audit, we noted that for Special Education and Title I, there was one employee in each federal program that had not completed Personal Activity Reports. It was also noted that the quarterly comparisons between budgeted costs and actual costs on the Personal Activity Reports were not being completed.

We recommend the District implement a system requiring this certification to be filled out monthly or on a semiannual basis depending on the percentage worked in the federal program for the year.

**INDEPENDENT SCHOOL DISTRICT NO. 877
Buffalo-Hanover-Montrose, Minnesota**

**RECOMMENDATION FOR MANAGEMENT
June 30, 2010**

**CONSIDER THE IMPLICATIONS OF GOVERNMENTAL ACCOUNTING
STANDARDS BOARD STATEMENT NO. 54, *FUND BALANCE REPORTING AND
GOVERNMENTAL FUND TYPE DEFINITIONS***

Governmental Accounting Standards Board (GASB) Statement No. 54 was enacted to enhance the usefulness of fund balance information by providing clearer fund balance classifications that can be more consistently applied and by clarifying the existing governmental fund type definitions. The initial distinction that is made in reporting fund balance information is identifying amounts that are considered nonspendable, such as fund balance associated with inventories or prepaid expenses. This Statement also provides for additional classification as restricted, committed, assigned and unassigned based on the relative strength of the constraints that control how specific amounts can be spent.

The restricted fund balance category includes amounts that can be spent only for the specific purposes stipulated by constitution, external resource providers or through enabling legislation. The committed fund balance classification includes amounts that can be used only for the specific purposes determined by a formal action of the government's highest level of decision-making authority. Amounts in the assigned fund balance classification are intended to be used by the government for specific purposes but do not meet the criteria to be classified as restricted or committed. In governmental funds other than the general fund, assigned fund balance represents the remaining amount that is not restricted or committed, unless that is a negative balance. Unassigned fund balance is the residual classification for the government's general fund and includes all spendable amounts not contained in the other classifications. In other funds, the unassigned classification should be used only to report a deficit balance resulting from overspending for specific purposes for which amounts have been restricted, committed or assigned.

Governments are allowed to have stabilization amounts which are formally set aside for use in emergency situations or when revenue shortages or budgetary imbalances arise. These funds must be restricted or committed for a specific purpose and cannot occur routinely.

Governments are required to have a fund balance policy which addresses a reasonable minimum level of unrestricted fund balance to be maintained, how the unrestricted fund balance can be used or spent down and how that fund balance will be replenished if it falls below the minimum level.

Elimination of the reserved component of fund balance in favor of a restricted classification will enhance the consistency between information reported in the government-wide statements and information in the government fund financial statements and avoid confusion about the relationship between the reserved fund balance and restricted net assets. The Statement is also designed to enhance the usefulness of fund balance information by clarifying the definitions of governmental fund types. For example, special revenue funds are created only to report a revenue source that is restricted or committed to a specified purpose, and that revenue source should constitute a substantial portion of the resources reported in the fund. In addition, the definition of the capital project fund type has been clarified to focus on the broader, more consistent understanding of capital outlays and capital activities in today's environment.

**INDEPENDENT SCHOOL DISTRICT NO. 877
Buffalo-Hanover-Montrose, Minnesota**

**RECOMMENDATION FOR MANAGEMENT
June 30, 2010**

**CONSIDER THE IMPLICATIONS OF GOVERNMENTAL ACCOUNTING
STANDARDS BOARD STATEMENT NO. 54, *FUND BALANCE REPORTING AND
GOVERNMENTAL FUND TYPE DEFINITIONS***

This Statement is effective for the year ending June 30, 2011. Fund balance reclassifications made to conform to the provisions of this Statement should be applied retroactively by restating fund balance for all prior periods presented.

Preliminary

INDEPENDENT SCHOOL DISTRICT NO. 877
Buffalo-Hanover-Montrose, Minnesota

REQUIRED COMMUNICATION
June 30, 2010

We have audited the financial statements of the District for the year ended June 30, 2010, and have issued our report dated October 18, 2010. Professional standards require that we provide you with the following information related to our audit.

OUR RESPONSIBILITY UNDER U.S. GENERALLY ACCEPTED AUDITING STANDARDS, GOVERNMENT AUDITING STANDARDS AND OMB CIRCULAR A-133

As stated in our engagement letter, our responsibility, as described by professional standards, is to express an opinion about whether the financial statements prepared by management with your oversight are fairly presented, in all material respects, in conformity with U.S. generally accepted accounting principles. Our audit of the financial statements does not relieve you or management of your responsibilities. Our responsibility is to plan and perform our audit to obtain reasonable, but not absolute, assurance that the financial statements are free of material misstatement. As part of our audit, we considered the internal control of the District. Such considerations were solely for the purpose of determining our audit procedures and not to provide any assurance concerning such internal control. We are responsible for communicating significant matters related to the audit that are, in our professional judgment, relevant to your responsibilities in overseeing the financial reporting process. However, we are not required to design procedures specifically to identify such matters.

As part of obtaining reasonable assurance about whether the District's financial statements are free of material misstatement, we performed tests of its compliance with certain provisions of laws, regulations, contracts and grant agreements, noncompliance with which could have a direct and material effect on the determination of financial statement amounts. However, providing an opinion on compliance with those provisions was not an objective of our audit.

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

Also, in accordance with OMB *Circular A-133*, we examined, on a test basis, evidence about the District's compliance with the types of compliance requirements described in the OMB *Circular A-133 Compliance Supplement* applicable to its major federal program for the purpose of expressing an opinion on the District's compliance with those requirements. While our audit provides a reasonable basis for our opinion, it does not provide a legal determination on the District's compliance with those requirements.

PLANNED SCOPE AND TIMING OF THE AUDIT

We performed the audit according to the planned scope and timing previously communicated to you.

INDEPENDENT SCHOOL DISTRICT NO. 877
Buffalo-Hanover-Montrose, Minnesota

REQUIRED COMMUNICATION
June 30, 2010

QUALITATIVE ASPECTS OF ACCOUNTING PRACTICES

Management is responsible for the selection and use of appropriate accounting policies. In accordance with the terms of our engagement letter, we will advise management about the appropriateness of accounting policies and their application. The significant accounting policies used by the District are described in Note 1 to the financial statements. No new accounting policies were adopted and the application of existing policies was not changed during fiscal year 2010. We noted no transactions entered into during the year for which there is a lack of authoritative guidance or consensus. There are no significant transactions that have been recognized in the financial statements in a different period than when the transaction occurred.

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:

Depreciation – The District is currently depreciating its capital assets over their estimated useful lives, as determined by management, using the straight-line method.

General Education and Special Education Aid – General education aid is an estimate until ADM values are final. Since this is normally not done until after the reporting deadline, this aid is an estimate. Special education aid is also dependent upon ADM value; however, in addition to those, this aid is dependent on the availability of funds and complex formulas that are finalized after reporting deadlines.

Net OPEB Assets – This balance is based on an actuarial study using the estimates of future obligations of the District for post employment benefits.

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

The disclosures in the financial statements are neutral, consistent and clear.

DIFFICULTIES ENCOUNTERED IN PERFORMING THE AUDIT

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

INDEPENDENT SCHOOL DISTRICT NO. 877
Buffalo-Hanover-Montrose, Minnesota

REQUIRED COMMUNICATION
June 30, 2010

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. Management has determined that the effects of uncorrected misstatements of the financial statements are immaterial, both individually and in the aggregate, to the financial statements taken as a whole. In addition, the capital lease material misstatement detected as a result of audit procedures was corrected by management.

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.

MANAGEMENT REPRESENTATIONS

We requested certain representations from management which were provided to us in the management representation letter.

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 the consultant has all the relevant facts. We are not aware of any consultations by the District's management with other accountants during the course of our audit.

OTHER 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 INFORMATION IN DOCUMENTS CONTAINING AUDITED FINANCIAL STATEMENTS

We have not reviewed, and it is our understanding, that no other published documents exist that contain audited financial statement information, for which we are currently auditing. As stated in our engagement letter, if you publish or reproduce the financial statements or make reference to our Firm name in relation to such documents, you agree to provide us with a copy of the final reproduced material for our approval before it is distributed.