

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

MANAGEMENT LETTER

For the Fiscal Year Ended June 30, 2011

INDEPENDENT SCHOOL DISTRICT NO. 877

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

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, 2011, 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, 2011. 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 September 30, 2011, 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

KERN, DEWENTER, VIERE, LTD.
Bloomington, Minnesota
September 30, 2011

INDEPENDENT SCHOOL DISTRICT NO. 877

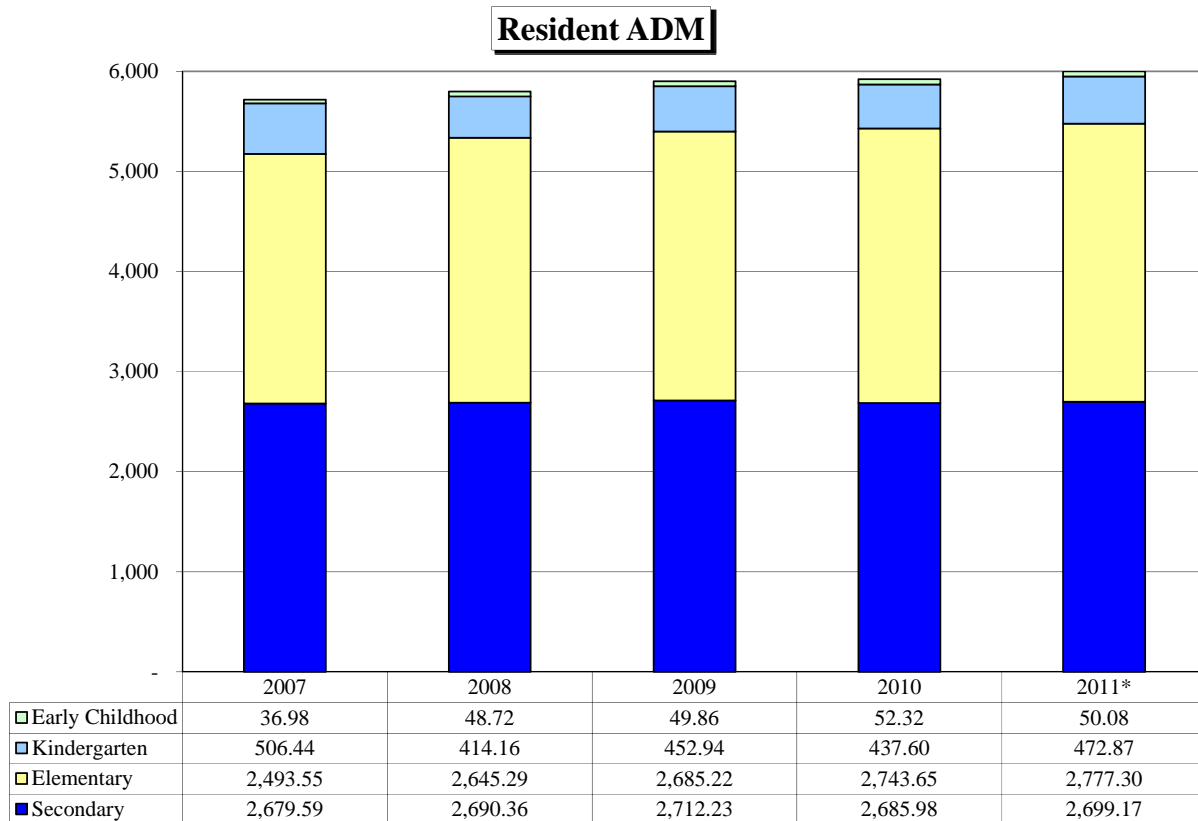
FINANCIAL ANALYSIS June 30, 2011

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.

RESIDENT AVERAGE DAILY MEMBERSHIP AND PUPIL UNITS

Approximately 78% 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.

ADMs	2007	2008	2009	2010	2011*
Early Childhood	36.98	48.72	49.86	52.32	50.08
Kindergarten	506.44	414.16	452.94	437.60	472.87
Elementary	2,493.55	2,645.29	2,685.22	2,743.65	2,777.30
Secondary	2,679.59	2,690.36	2,712.23	2,685.98	2,699.17
Total Resident ADMs	5,716.56	5,798.53	5,900.25	5,919.55	5,999.42



* Estimate as of August 16, 2011

INDEPENDENT SCHOOL DISTRICT NO. 877

FINANCIAL ANALYSIS

June 30, 2011

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 4.9% since 2007 and 1.3% between 2010 and 2011.

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 2007	1.250/1.000	0.557	1.115/1.060	1.300
Fiscal 2008-2011	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.

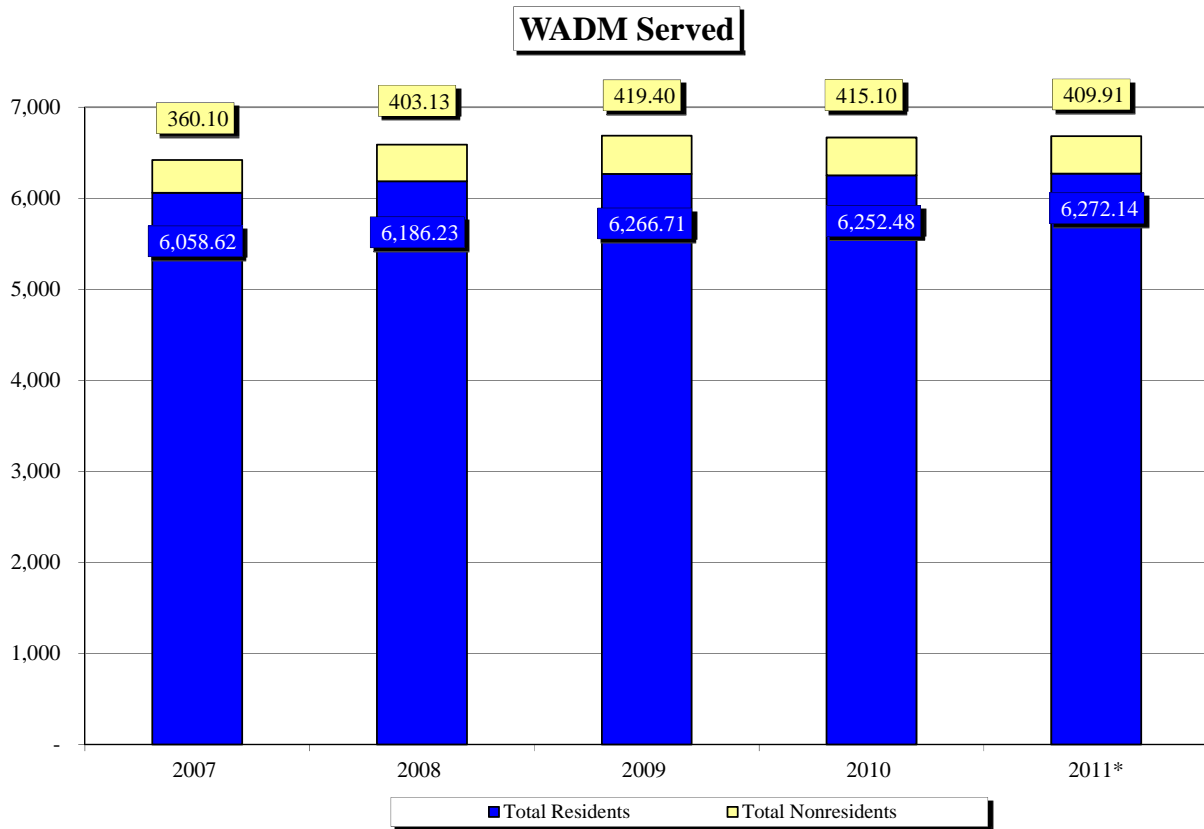
WADMs	2007	2008	2009	2010	2011*
Residents	6,537.12	6,702.95	6,797.13	6,823.62	6,889.92
Resident WADM Loss	(478.50)	(516.72)	(530.42)	(571.14)	(617.78)
Nonresident WADM Gain	360.10	403.13	419.40	415.10	409.91
Total WADMs Served	6,418.72	6,589.36	6,686.11	6,667.58	6,682.05

* Estimate as of August 16, 2011

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FINANCIAL ANALYSIS
June 30, 2011

WEIGHTED AVERAGE DAILY MEMBERSHIP SERVED



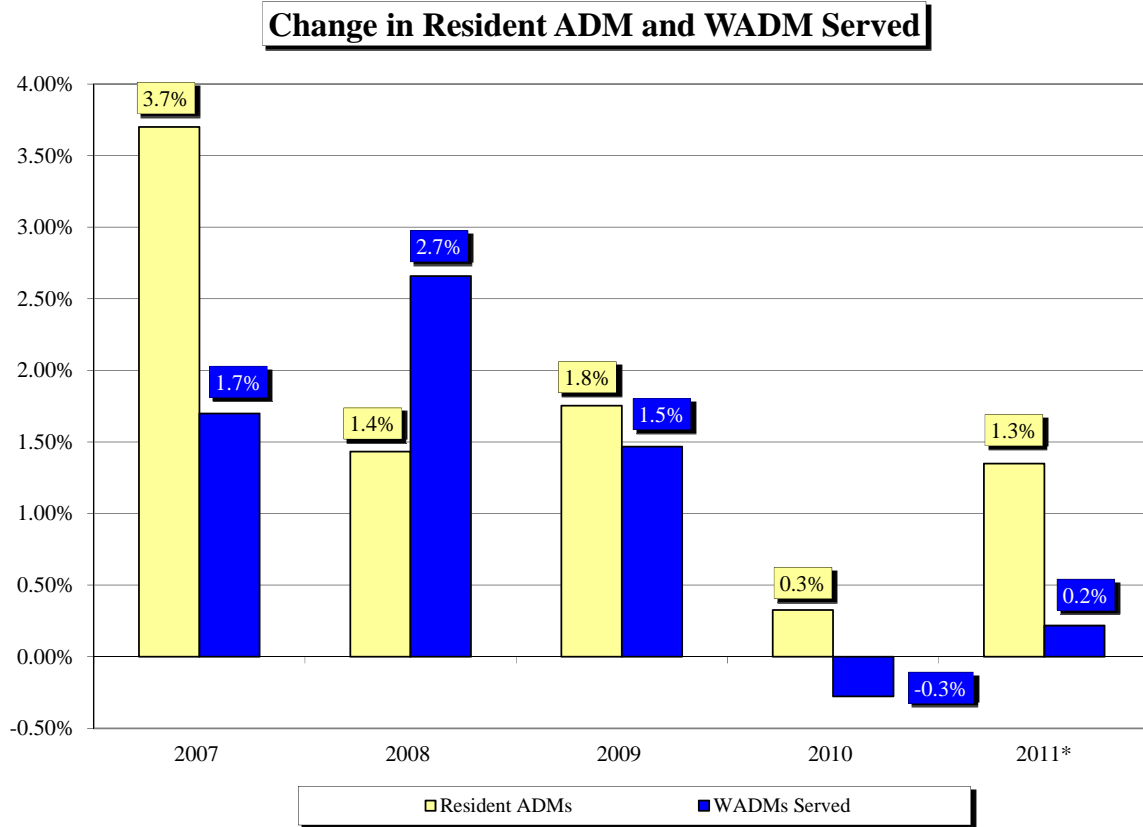
* Estimate as of August 16, 2011

Resident ADMs served has increased in all years presented as illustrated on the previous pages. WADMs served increased each year from 2007 to 2009; fluctuations in open enrollment have led to a decrease in WADMs served from 2009 to 2010 and a subsequent increase from 2010 to 2011 of 14.5, or 0.2%, WADMs.

INDEPENDENT SCHOOL DISTRICT NO. 877

FINANCIAL ANALYSIS
June 30, 2011

RESIDENT ADM AND WADM MEMBERSHIP SERVED



* Estimate as of August 16, 2011

INDEPENDENT SCHOOL DISTRICT NO. 877

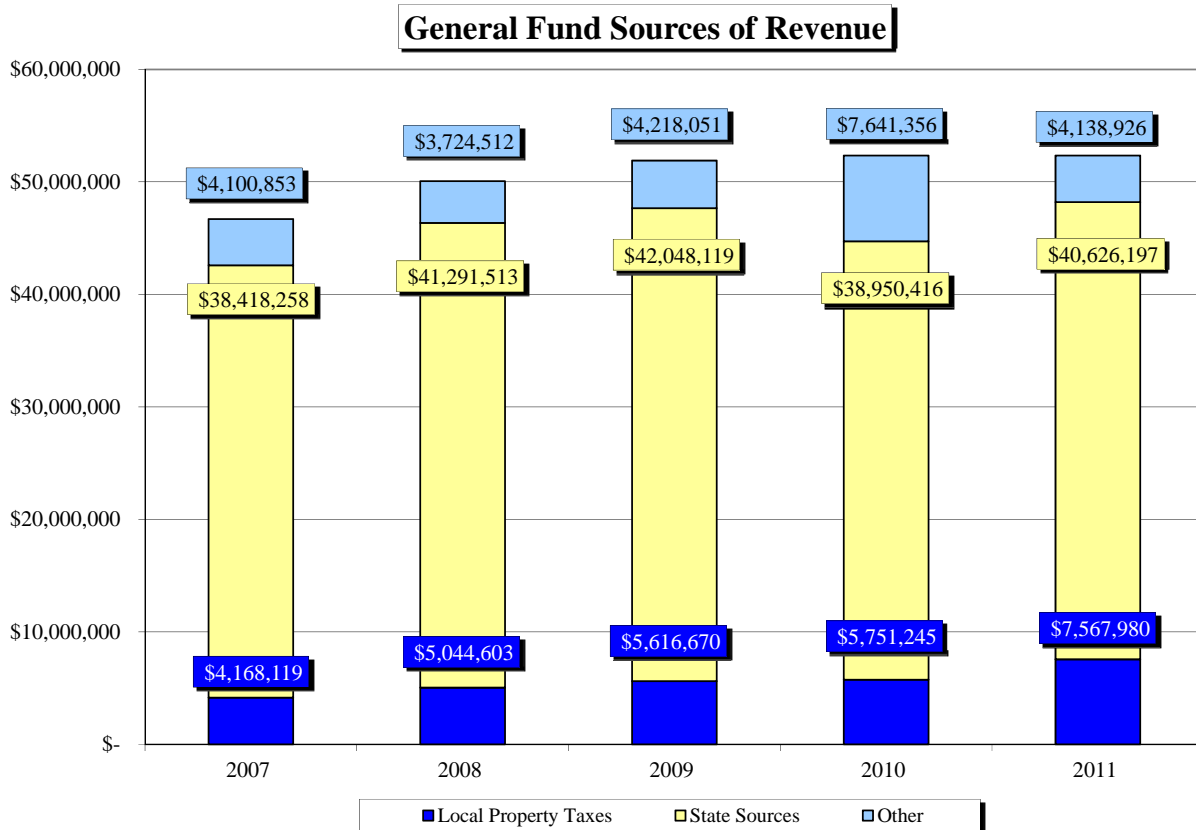
**FINANCIAL ANALYSIS
June 30, 2011**

GENERAL FUND SOURCES OF REVENUE

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

	2007	2008	2009	2010	2011
Local Property Taxes	\$ 4,168,119	\$ 5,044,603	\$ 5,616,670	\$ 5,751,245	\$ 7,567,980
State Sources	38,418,258	41,291,513	42,048,119	38,950,416	40,626,197
Other	4,100,853	3,724,512	4,218,051	7,641,356	4,138,926
Total	\$ 46,687,230	\$ 50,060,628	\$ 51,882,840	\$ 52,343,017	\$ 52,333,103

State revenue sources, which make up approximately 77.6% of total revenues, increased by \$ 1,675,781 for the fiscal year ended June 30, 2011, while local property taxes increased by \$ 1,816,735 and other sources decreased \$ 3,502,430. Included in other revenues are local, county and federal revenues. Factors contributing to these changes include federal aid replacing a portion of the state's General Education Aid in 2010 and a large tax shift for fiscal year 2011, where the state shifts revenue from state sources to property taxes and the District recognizes a portion of next year's levy as current year revenue. Total General Fund revenue decreased 0.2% from 2010 to 2011.



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FINANCIAL ANALYSIS June 30, 2011

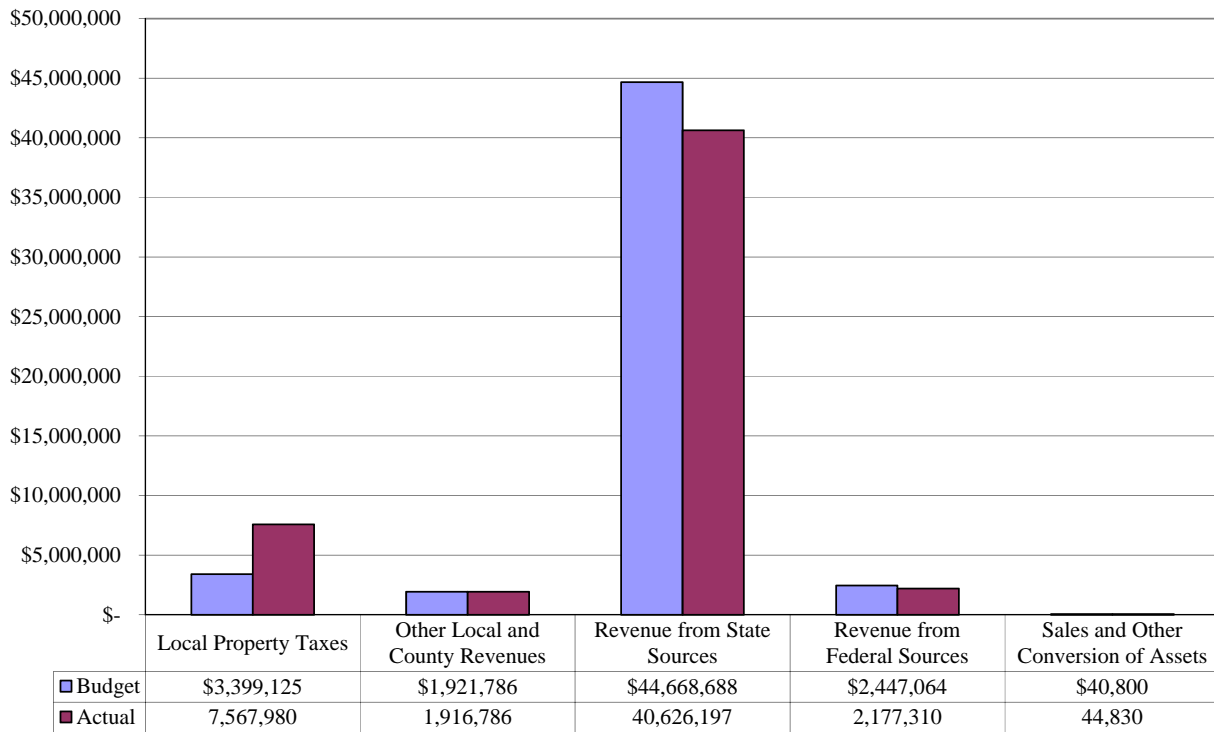
GENERAL FUND REVENUES BUDGET AND ACTUAL

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

In June 2010, the District approved a General Fund revenue budget of \$ 52,345,227. This was modified in May 2011 by \$ 132,236 to a final revenue budget of \$ 52,477,463. With actual revenues coming in at \$ 52,333,103, the final budget produced a variance of \$ 144,360, or 0.3%.

The largest variances were in revenue from state sources and local property taxes, which are due to the tax shift adjustment by the state as discussed earlier. Revenue from federal sources was \$ 269,754 under budget as a result of less federal funds being used for tuition payments. All other revenue categories budgets were in line with actual revenue.

**2011 General Fund Revenues
Budget and Actual**



INDEPENDENT SCHOOL DISTRICT NO. 877

FINANCIAL ANALYSIS June 30, 2011

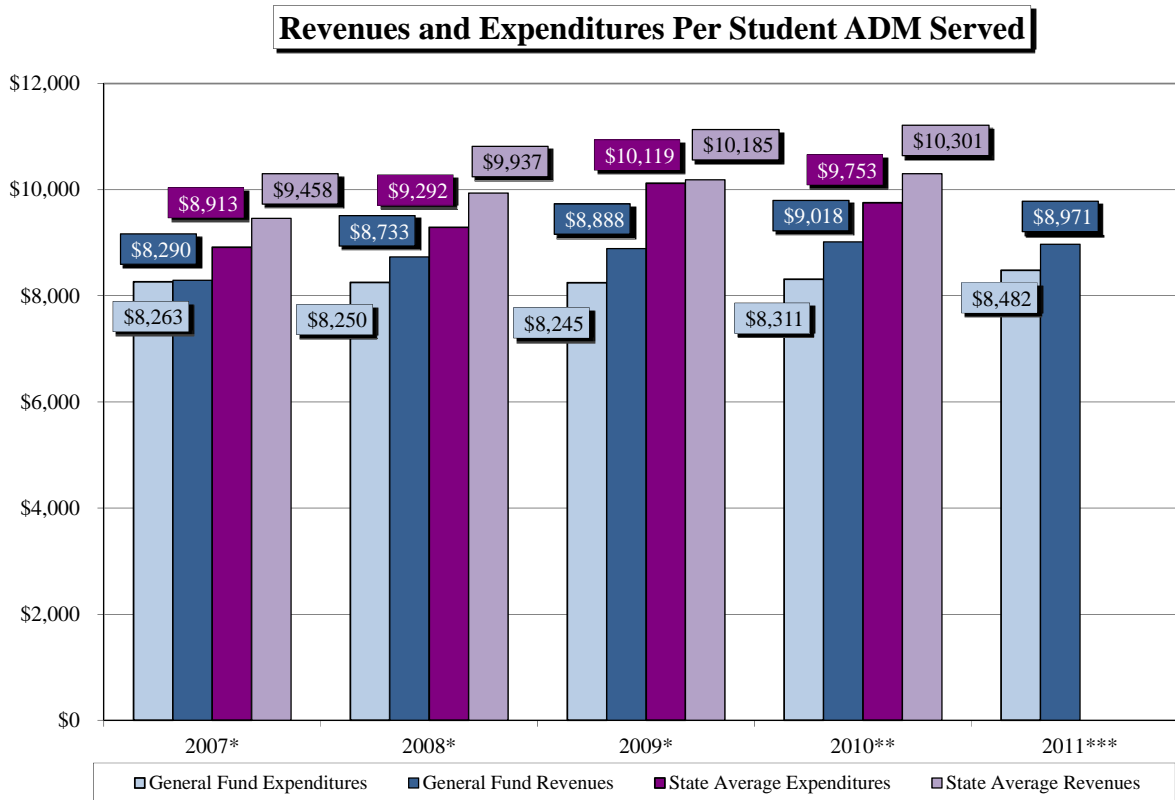
REVENUES AND EXPENDITURES PER ADM SERVED

General Fund revenues per students (ADM) served, are summarized in the following table and graph:

	2007*	2008*	2009*	2010*	2011***
General Fund	\$ 8,290	\$ 8,733	\$ 8,888	\$ 9,018	\$ 8,971
General Fund State Average	9,458	9,937	10,185	10,301	N/A

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

	2007*	2008*	2009*	2010**	2011***
General Fund	\$ 8,263	\$ 8,250	\$ 8,245	\$ 8,311	\$ 8,482
General Fund State Average	8,913	9,292	10,119	9,753	N/A



* Source: *School District Profiles*

** Estimate excluding OPEB costs in the General Fund

*** Estimate as of August 16, 2011; state-wide averages are not available

The District has seen an increase in revenues and expenditures per student ADM served from 2007 to 2011, although amounts for all years are well under the state averages. Expenditures per ADM served increased 2.1% from 2010 to 2011, while revenues per ADM served decreased 0.5% over the same period.

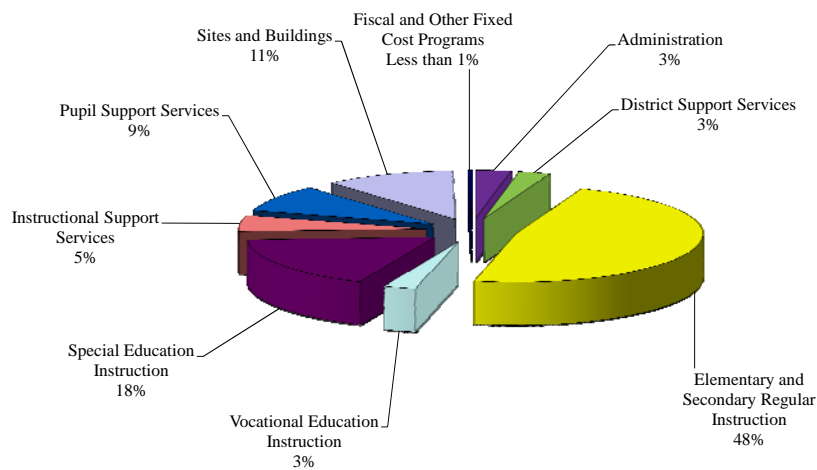
INDEPENDENT SCHOOL DISTRICT NO. 877

FINANCIAL ANALYSIS June 30, 2011

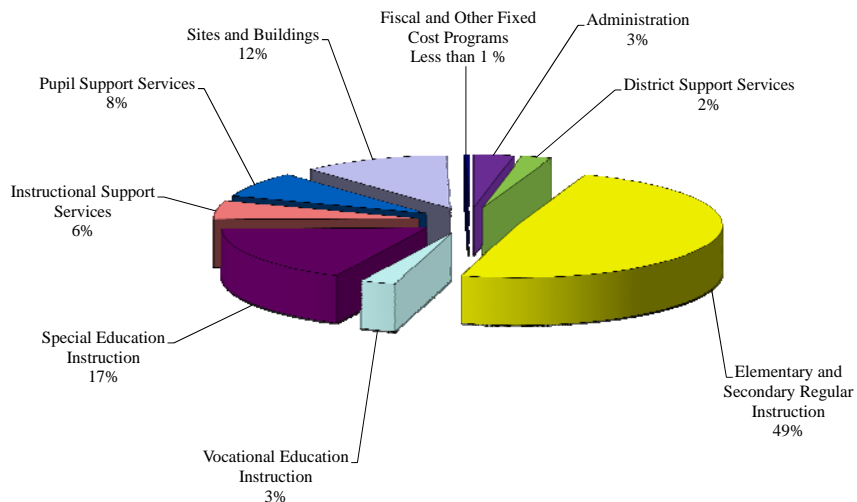
GENERAL FUND EXPENDITURES

The graphs below depict the percentage of expenditures by function in the General Fund for fiscal years 2010 and 2011. Expenditures decreased by \$ 9,258,510, or 15.1%, from 2010 to 2011, and the allocation of expenditures remained very consistent. The large decrease was a result of the District bonding for OPEB and contributing the bond proceeds to an irrevocable trust fund in 2010. Education programs made up 69% of the District's expenditures for both years presented, and only 5% and 6% were attributable to administration and District support services for 2010 and 2011, respectively.

General Fund Expenditures 2011



General Fund Expenditures 2010



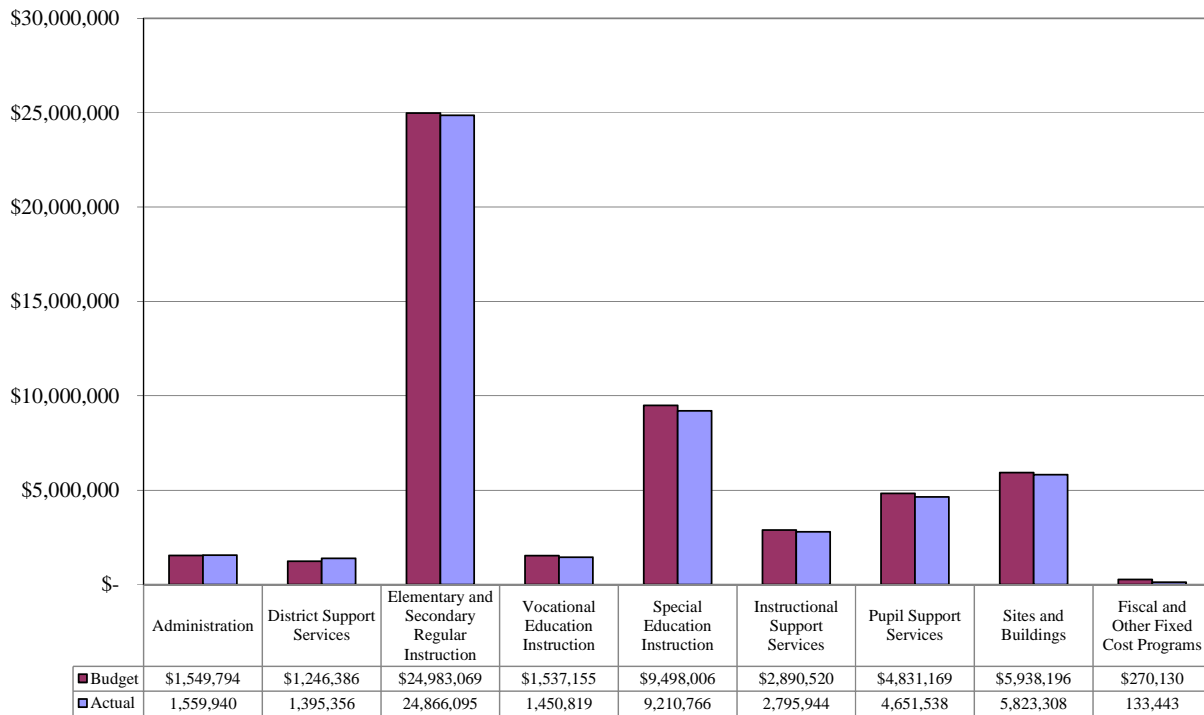
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FINANCIAL ANALYSIS June 30, 2011

GENERAL FUND BUDGET AND ACTUAL

In total, General Fund expenditures were \$ 857,216 under budget. As noted in the graph below, special education, instructional support and pupil support were the categories with the largest variances. Special education instruction expenditures were under budget by \$ 287,240 due to the way federal tuition payments were handled with the stimulus dollars. Instructional support came in under budget due to conservative spending for supplies and not using the contingent dollars set aside. Pupil support expenditures were \$ 179,631 under budget due to lower than expected costs for the transportation contract.

**2011 General Fund Expenditures
Budget and Actual**



INDEPENDENT SCHOOL DISTRICT NO. 877

FINANCIAL ANALYSIS

June 30, 2011

GENERAL FUND OPERATIONS

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

	2007	2008	2009	2010	2011
Revenues	\$ 46,687,230	\$ 50,060,628	\$ 51,882,840	\$ 52,343,017	\$ 52,333,103
Expenditures, Excluding OPEB	49,571,249	49,795,805	50,444,182	51,433,583	51,887,209
OPEB Expenditures	-	-	-	9,712,136	-
Excess of Revenues Over (Under) Expenditures	(2,884,019)	264,823	1,438,658	(8,802,702)	445,894
Transfers/Other Financing Sources	1,200,220	-	1,473	11,082,861	396,910
Fund Balance, July 1	8,915,246	7,231,447	7,496,270	8,936,401	11,216,560
Fund Balance, June 30	\$ 7,231,447	\$ 7,496,270	\$ 8,936,401	\$ 11,216,560	\$ 12,059,364
Components:					
Unreserved/Unassigned	\$ 3,432,201	\$ 4,233,226	\$ 4,255,850	\$ 6,151,513	\$ 6,277,042
Nonspendable	-	-	-	-	398,695
Reserved/Restricted for:					
Staff Development	-	-	74,801	74,801	74,801
Severance Pay	581,908	669,869	658,484	-	-
Deferred Maintenance	-	-	-	18,871	11,890
Operating Capital	40	412,851	390,331	38,273	61,415
Health and Safety	(4,118)	(25,350)	128,458	147,396	(77,456)
Designated/Committed/Assigned for:					
Separation Benefits	1,459,200	1,430,324	1,834,523	3,474,913	3,965,750
New Facilities	980,841	-	-	-	-
Student Activities	276,081	278,113	278,117	202,258	171,444
3rd Party Special Education	-	-	260,000	-	186,840
Stimulus	-	-	-	341,200	273,509
Capital	-	-	327,355	327,355	327,355
Carryover	318,253	269,847	469,191	164,257	138,181
Dental Insurance	187,041	227,390	259,291	275,723	249,898
Total	\$ 7,231,447	\$ 7,496,270	\$ 8,936,401	\$ 11,216,560	\$ 12,059,364

As previously stated, total General Fund revenue decreased 0.2% from 2010 to 2011 as a result of an overall increase in General Education Aid for the slight increase in WADMs served, the tax shift from state revenues to local property taxes and a decrease in federal revenues.

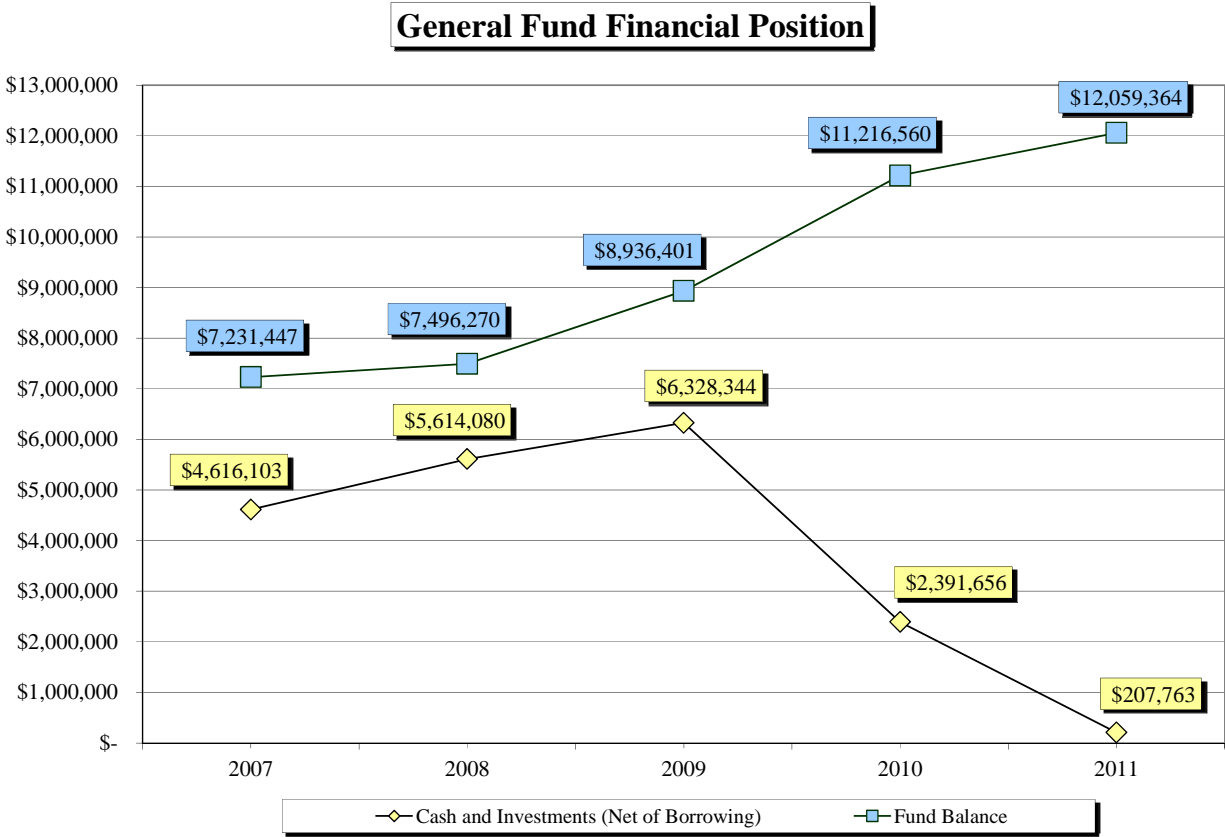
Total General Fund expenditures increased only 0.9% from 2010 to 2011, factoring out the OPEB expenses as result of bonding in 2010. Increases in salaries and benefits for step and lane changes and contract increases accounted for most of the increase from 2010 to 2011.

Revenues exceeded expenditures during 2011, and with the other financing sources, the fund balance increased \$ 842,804, or 7.5%, resulting in the increase in committed for separation benefits and increase in the unassigned fund balance.

INDEPENDENT SCHOOL DISTRICT NO. 877

FINANCIAL ANALYSIS
June 30, 2011

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%, and for 2011, further increased to 30%; this hold back will increase to 40% in fiscal year 2012. The state also reenacted the property tax shift in which property tax revenues were early recognized in place of state aids.

INDEPENDENT SCHOOL DISTRICT NO. 877

FINANCIAL ANALYSIS

June 30, 2011

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,	2007	2008	2009	2010	2011
Revenues	\$ 2,425,265	\$ 2,553,237	\$ 2,701,594	\$ 2,757,354	\$ 2,859,338
Expenditures, Excluding OPEB	2,282,633	2,770,468	2,788,100	2,693,406	2,825,861
OPEB Expenditures	-	-	-	352,780	-
Excess of Revenues Over (Under) Expenditures	142,632	(217,231)	(86,506)	(288,832)	33,477
Transfers/Other Financing Sources	-	-	6,860	353,180	-
Fund Balance, July 1	192,567	335,199	117,968	38,322	102,670
Fund Balance, June 30	\$ 335,199	\$ 117,968	\$ 38,322	\$ 102,670	\$ 136,147

Revenues exceeded expenditures in the Food Service Fund for the first time in four years. Food service revenues increased 3.7% due to additional revenue received from the federal government for free and reduced meals, while expenditures increased 4.9% due to an increase in food commodities and supplies. The District issued OPEB Bonds 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,	2007	2008	2009	2010	2011
Revenues	\$ 2,498,143	\$ 2,787,017	\$ 2,826,137	\$ 2,794,718	\$ 2,998,587
Expenditures, Excluding OPEB	2,457,020	2,697,060	2,857,589	2,761,569	2,988,036
OPEB Expenditures	-	-	-	625,383	-
Excess of Revenues Over (Under) Expenditures	41,123	89,957	(31,452)	(592,234)	10,551
Transfers/Other Financing Sources	-	-	3,743	625,383	-
Fund Balance, July 1	141,329	182,452	272,409	244,700	277,849
Fund Balance, June 30	\$ 182,452	\$ 272,409	\$ 244,700	\$ 277,849	\$ 288,400

Components:

Unreserved/Unassigned	\$ 3,467	\$ 11,914	\$ 12,550	\$ 8	\$ -
Restricted/Reserved for:					
Community Service	-	-	-	-	7,860
ECFE	50,984	81,676	69,226	133,840	99,645
Community Education	107,270	136,853	107,205	83,107	129,672
School Readiness	11,425	20,553	44,430	48,587	40,554
Adult Basic Education	9,306	21,413	11,289	12,307	10,669
Total	\$ 182,452	\$ 272,409	\$ 244,700	\$ 277,849	\$ 288,400

INDEPENDENT SCHOOL DISTRICT NO. 877

**FINANCIAL ANALYSIS
June 30, 2011**

COMMUNITY SERVICE FUND

Revenues once again exceeded revenues in the Community Service Fund. During the year ended June 30, 2011, revenues increased 7.3% while expenditures, excluding OPEB, increased 8.2%; both increased as a result of an increase in the Kid Kare enrollment and a State Health Improvement Program Grant received. The District issued OPEB Bonds in 2010, resulting in OPEB expenditures of \$ 625,383, which was offset by the Bond proceeds.

INDEPENDENT SCHOOL DISTRICT NO. 877

LEGISLATIVE SUMMARY

June 30, 2011

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 MDE.

STATE AID APPROPRIATIONS

The formula allowance for fiscal years 2012 and 2013 General Education Aid was increased to \$ 5,174 and \$ 5,224, respectively. Linkages remain intact for compensatory, sparsity, transportation sparsity, nonpublic pupil/nonpublic transportation and tribal contract revenues.

For fiscal years 2012 and later, payments for state aids will be paid at 60% current and 40% final payment.

Small schools revenue, new for fiscal year 2013, will be included in General Education Aid. Districts, not including charter schools, with fewer than 1,000 students are eligible to receive small school revenue on a sliding scale. This revenue is equal to the 2013 formula allowance, divided by the district's adjusted marginal cost pupil units, times the greater of zero or the ratio of 1,000 less the district's adjusted marginal cost pupil units for that year divided by 1,000. Fiscal year 2013 appropriation for this program is \$ 9,617,000.

Beginning in fiscal year 2012, the Early Graduation Achievement Scholarship Program provides prorated scholarships, up to \$ 7,500, for students that graduate up to one or more semester(s) early. Students may use scholarships at any accredited higher education institutions. Scholarships are also provided for military service awards in the same dollar amounts for students who graduate early and enter the military.

A district may reallocate General Education Aid attributed to 12th grade students who have graduated early under section 120B.07 and who do not participate in the Early Graduation Achievement or Military Scholarship Programs.

The Integration Aid revenue statute is repealed for fiscal year 2014. A working group will be created to make recommendations for repurposing integration revenue funds to create and sustain opportunities for students to achieve improved educational outcomes. The working group will consist of six appointees by the Commissioner and six appointees by the State Legislature.

The staff development set aside requirement is suspended for fiscal years 2012 and 2013. The reserve is equal to 2% of the district's basic general education revenue.

School districts are no longer subject to the January 15 teacher contract deadline.

Minnesota Statutes 127A.46 was repealed. The state is no longer allowed to delay state aid payments to school districts to avoid state short-term borrowing.

EDUCATION EXCELLENCE

School boards conducting meetings may use interactive technology with an audio and visual link to conduct the meeting if the school board complies with all requirements under *Minnesota Statutes* 13D.02.

INDEPENDENT SCHOOL DISTRICT NO. 877

LEGISLATIVE SUMMARY

June 30, 2011

EDUCATION EXCELLENCE

New Literacy Incentive Aid, beginning in fiscal year 2013, includes the new Proficiency Aid and Growth Aid. Proficiency Aid is the district's enrollment on October 1 of the previous year times \$ 85 times its proficiency index (percent of 3rd graders meeting or exceeding proficiency.) Growth Aid is the product of a district's enrollment on October 1 of the previous year times \$ 85 times the percent of 4th graders making medium or high growth on the reading MCA. Funding in 2013 is capped at \$ 48,585,000.

Beginning with taxes payable in 2012, the career and technical levy increases to the greater of \$ 80 times the district's ADM in grades 9-12, or 35% (instead of the fiscal year 2011 amount of 25%) of the approved expenditures.

SPECIAL EDUCATION

Regular and excess cost and growth factors remained as in current law (4.6% for regular and 2.0% for excess cost).

FACILITIES AND TECHNOLOGY

The process for districts to apply for health and safety revenue has been streamlined and the health and safety statute has been clarified.

Standing appropriations for Debt Service Equalization Aid are set at \$ 11,022,000 for fiscal year 2012 and at \$ 19,484,000 for fiscal year 2013.

Appropriations for Alternative Facilities Bonding Aid are set at \$ 17,359,000 for fiscal year 2012 and \$ 19,289,000 for fiscal year 2013.

Ballot language is modified for capital project levy referendum renewals with no change in tax rate, indicating that voting yes would renew the existing referendum that is scheduled to retire.

Districts with capital loans, received prior to July 1, 1997, are now authorized to repay the full outstanding principal on its capital loan prior to July 1, 2012 to satisfy its obligation to the state and discharge its maximum debt service levy effort.

NUTRITION AND ACCOUNTING

The tax shift calculation is changed to use gross levies before credits are deducted, enabling the MDE to calculate the final tax shift amounts much earlier.

Except where specifically authorized, state education payments shall be made only to the district or other education organizations earning state aid revenue as a result of providing education services.

INDEPENDENT SCHOOL DISTRICT NO. 877

LEGISLATIVE SUMMARY

June 30, 2011

NUTRITION AND ACCOUNTING

Funds Transfer: School districts are authorized to transfer money from one fund or account to another in fiscal years 2012 and 2013 as long as the transfer does not increase state aid obligations or increase local property taxes. Transfers are not allowed from the food service or community service funds. The school board must adopt a resolution stating the transfer will not diminish instructional opportunities for students and the district must apply to the Commissioner to make the transfer. The application must include the amount to be transferred and the funds/accounts involved. It must also be signed by the superintendent and approved by the school board.

PREVENTION AND SELF SUFFICIENCY AND LIFELONG LEARNING

Districts with less than 6,000 residents (instead of 2,000) are allowed to identify a Minnesota superintendent to serve as community education director instead of licensed community education director. This section also deletes the authority for a person with a principal's license to serve as a community education director but grandfathers-in principals serving prior to June 1, 2011.

Adult Basic Education Revenue: The growth factor of this program, originally at 3%, is reduced to a 2% growth factor.

STATE AGENCIES

Due to the current economic condition of the state, the MDE budget has been reduced by 5% for fiscal year 2012 and 2013 to \$ 18,820,000.

INDEPENDENT SCHOOL DISTRICT NO. 877

OTHER DEFICIENCY
June 30, 2011

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 tracked. We noted 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 and provide detailed descriptions. 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.

INDEPENDENT SCHOOL DISTRICT NO. 877

REQUIRED COMMUNICATION

June 30, 2011

We have audited the financial statements of the District for the year ended June 30, 2011, and have issued our report dated September 30, 2011. 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 U.S. Office of Management and Budget (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

REQUIRED COMMUNICATION

June 30, 2011

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. The District implemented GASB Statement No. 54, *Fund Balance Reporting and Governmental Fund Type Definitions* during 2011. 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.

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.

INDEPENDENT SCHOOL DISTRICT NO. 877

REQUIRED COMMUNICATION

June 30, 2011

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.