Management Report

for

Independent School District No. 831
Forest Lake, Minnesota
June 30, 2012

To the School Board 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, Forest Lake, Minnesota's (the District) financial statements for the year ended June 30, 2012. 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
- Accounting and Auditing Updates
- Legislative Summary

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.

This report is intended solely for the information and use of management, those charged with governance of the District, and those who have responsibility for oversight of the financial reporting process. It is not intended to be, and should not be, used by anyone other than these specified parties.

INSERT DATE

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, 2012. 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, 2012:

- We have issued an unqualified 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 that are required to be reported under *Government Auditing Standards*.

- 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 compliance requirements that could have a direct and material effect on major federal programs.

- We noted one matter involving the internal control over compliance and its operation that we consider to be a material weakness in our testing of major federal programs. This matter relates to the completion of personal activity reports and is further detailed in the Schedule of Findings and Question Costs.

- We have 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 recorded cash transactions of these accounts for the year ended June 30, 2012.

We reported one deficiency involving internal control over financial reporting for the District's extracurricular student activities that we consider to be a material weakness. The District reports student activities on a cash basis, and has not established procedures to assure that all cash collections are recorded in the accounting records. Procedures such as the use and reconciliation of 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.

- 2012-1 Improper Accounts and Activity
- 2012-2 Activity Purpose Forms
- 2012-3 Untimely Deposits
- 2012-4 Disbursement Activity
- 2012-5 Inactive Accounts

SIGNIFICANT ACCOUNTING POLICIES

Management is responsible for the selection and use of appropriate accounting policies. The significant accounting policies used by the District are described in Note 1 of the notes to basic financial statements. No new accounting policies were adopted and the application of existing policies was not changed during the year ended June 30, 2012.

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

CORRECTED AND UNCORRECTED MISSTATEMENTS

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

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 fiscal year 2012 is not finalized until well into fiscal year 2013. 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 MDE. Because of the timing of the calculations, this adjustment for fiscal 2012 is not finalized until after the District has closed its financial records for the fiscal period. 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 Assets 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). These obligations are calculated using actuarial methodologies described in GASB Statement No. 45. These actuarial calculations include significant assumptions, including projected changes, healthcare insurance costs, investment returns, retirement ages, and employee turnover.

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

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

Management expects any differences between estimates and actual amounts of these estimates to be insignificant. We evaluated the key factors and assumptions used by management in the areas discussed above in determining that they are reasonable in relation to the financial statements taken as a whole.

DIFFICULTIES ENCOUNTERED IN PERFORMING THE AUDIT

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

DISAGREEMENTS WITH MANAGEMENT

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

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.

MANAGEMENT REPRESENTATIONS

We have requested certain representations from management that are included in the management representation letter dated INSERT DATE.

OTHER INFORMATION IN DOCUMENTS CONTAINING AUDITED FINANCIAL STATEMENTS

Our audit was conducted for the purpose of forming opinions on the financial statements that collectively comprise the District's basic financial statements. Other information, including the introductory section, supplemental information section, other district information section, Schedule of Expenditures of Federal Awards, and Uniform Financial Accounting and Reporting Standards (UFARS) compliance table accompanying the basic financial statements, are presented for purposes of additional analysis and are not required parts of the basic financial statements.

With respect to the supplemental information, Schedule of Expenditures of Federal Awards, and UFARS compliance table accompanying the financial statements, 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 supplemental information to the underlying accounting records used to prepare the basic financial statements or to the basic financial statements themselves.

With respect to the introductory section and other district information section accompanying the financial statements, our procedures were limited to reading this other information, and in doing so we did not identify any material inconsistencies with the audited financial statements.

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. The last section of this report, which contains a summary of legislative changes affecting school districts, gives an indication of how complicated the funding system is. The following section provides some state-wide funding and financial trend information.

STATE FINANCIAL OUTLOOK

The 2011 legislative session began with a projected budget deficit of $6.2 billion (later revised down to $5.0 billion in the February 2011 economic forecast) and strong disagreement between the Democratic Governor and Republican controlled Legislature on how to address the deficit. As the 2011 regular legislative session ended, the Governor vetoed eight major state appropriation bills and the omnibus tax bill passed by the Legislature, leaving the majority of state agencies without a budget for the next fiscal year. This resulted in the longest government shutdown in Minnesota history, with all "nonessential" state agencies closed from July 1, 2011 until the passing of appropriation bills in a special session on July 19th and 20th. As was the case in the last biennium, the state budget finally adopted for 2012–2013 utilized several large "accounting shifts" in an attempt to minimize the need for tax increases or state aid cuts to balance the budget. The accounting shifts included delaying an even higher percentage of estimated state aid payments to school districts and charter schools than was already being delayed, and a small expansion of the "tax shift," which accelerates the recognition of district tax levy revenue with an off-setting reduction in state aid. Both of these types of shifts significantly reduce the amount of operating cash available to Minnesota school districts and charter schools, but were intended to be revenue neutral, thereby sparing districts from deeper funding cuts.

The 2012 legislative session began on a much more positive note, with the November 2011 economic forecast projecting an unexpected surplus of $876 million for the remainder of the biennium. Even year legislative sessions are not typically budget years, but recently the Legislature has often had to adopt supplemental budgets in even year sessions to address large projected shortfalls. The projected surplus, which had increased another $323 million by the February 2012 economic forecast, eliminated any need for a supplemental budget and allowed legislators to pay down some state borrowing. This resulted in Minnesota school districts receiving a slightly higher percentage of their estimated state aid entitlements by June 30, 2012 than anticipated. Unfortunately, this short-term improvement in the state's financial condition is not expected to continue. The same February 2012 economic forecast that projected a surplus for the remainder of current biennium anticipates a $1.1 billion deficit for the 2014–2015 biennium.

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.

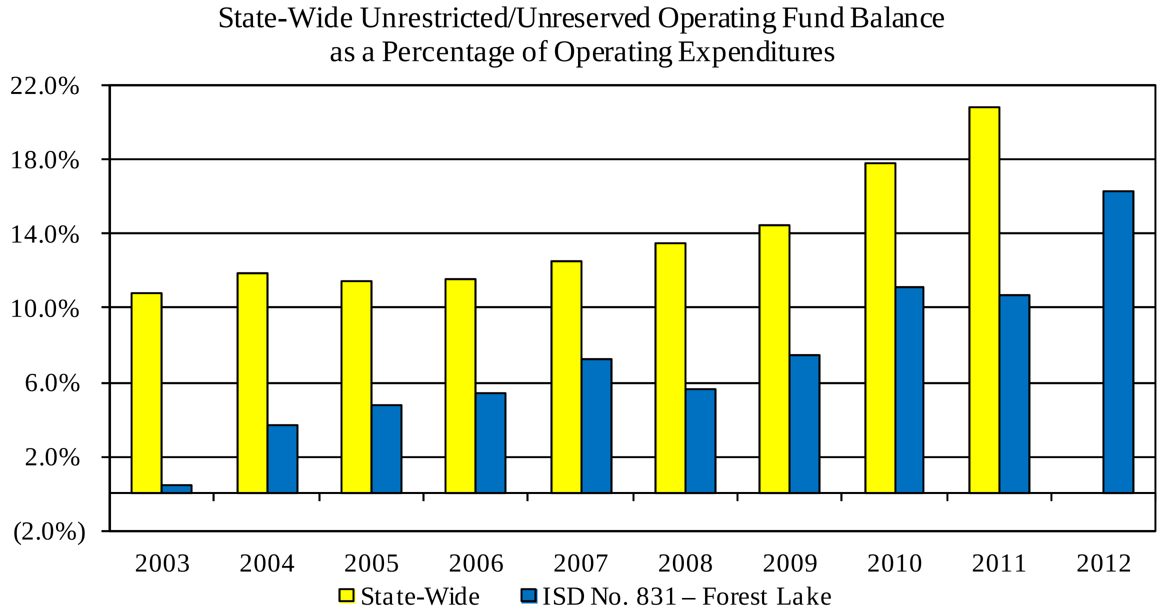
The table below presents a summary of the formula allowance for the past decade and as approved for the next fiscal year. The amount of the formula allowance and the percentage change from year to year excludes non-comparable changes such as temporary funding increases, the "roll-in" of aids that were previously funded separately, 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
2003	$ 4,601	2.6 %
2004	$ 4,601	– %
2005	$ 4,601	– %
2006	$ 4,783	4.0 %
2007	$ 4,974	4.0 %
2008	$ 5,074	2.0 %
2009	$ 5,124	1.0 %
2010	$ 5,124	– %
2011	$ 5,124	– %
2012	$ 5,174	1.0 %
2013	$ 5,224	1.0 %

As noted in the table above, after having been frozen at the same level for the last three years, the Legislature added $50 to the basic formula allowance for both fiscal 2012 and 2013. In recent years, the limited increases, if any, 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 (formerly unreserved) operating fund balance as a percentage of operating expenditures.



Note: State-wide information is not available for fiscal 2012.

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

Even with limited funding increases, school district unrestricted/unreserved fund balance has been increasing as a percentage of operating expenditures on a state-wide basis in recent years. This trend is the result of many factors, including districts reducing operating expenditures, adapting to funding restrictions, efforts to maintain fund balance for cash flow purposes, and in some cases community support in the form of operating referendums.

As of June 30, 2011, this ratio was 10.7 percent for the District, as compared to a state-wide average of 20.8 percent. The District's percentage of operating expenditures was 16.3 percent at the end of the current year.

The table below shows a comparison of governmental fund revenue per ADM received by Minnesota school districts and your district. Revenues for all governmental funds are included, except for the Capital Projects – Building Construction Fund and the OPEB 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		
	2010	2011	2010	2011	2010	2011	2012
General Fund							
Property taxes	$ 1,473	$ 2,130	$ 1,968	$ 2,811	$ 1,506	$ 2,223	$ 1,519
Other local sources	435	432	372	358	241	251	224
State	7,119	7,213	7,143	7,063	6,287	6,388	7,417
Federal	1,233	720	1,274	755	1,065	478	436
Total General Fund	10,260	10,495	10,757	10,987	9,099	9,340	9,596
Special revenue funds							
Food Service	469	474	465	470	537	534	543
Community Service	503	513	604	619	570	603	616
Debt Service Fund	1,040	1,053	1,137	1,131	556	577	554
Total revenue	$ 12,272	$ 12,535	$ 12,963	$ 13,207	$ 10,762	$ 11,054	$ 11,309
ADM served per MDE School District Profiles Report (current year estimated)					6,925	6,899	6,823

Note: Excludes the Capital Projects – Building Construction and OPEB Debt Service Funds.

Source of state-wide and seven-county metro area data: School District Profiles Report published by the MDE

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

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

The District earned approximately $77.2 million in the governmental funds reflected above in fiscal 2012, an increase of $0.9 million (1.2 percent) from the prior year. Total revenue per ADM served increased by $255 per student. Increases in the basic formula allowance as discussed earlier and improved funding for special education programming contributed to the overall revenue growth.

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 table below reflects similar comparative data available from the MDE for all governmental fund expenditures, excluding the Capital Projects – Building Construction Fund and the OPEB Debt Service Fund. Other financing uses, such as bond refunding and transfers, are also excluded.

Governmental Funds Expenditures per Student (ADM) Served

	State-Wide		Seven-County Metro Area		ISD No. 831 – Forest Lake		
	2010	2011	2010	2011	2010	2011	2012
General Fund							
Administration and district support	$ 807	$ 813	$ 781	$ 788	$ 683	$ 753	$ 775
Elementary and secondary regular instruction	4,885	4,829	5,069	5,107	4,193	4,315	3,854
Vocational education instruction	149	144	150	136	137	133	118
Special education instruction	1,832	1,904	1,992	2,015	1,370	1,491	1,543
Instructional support services	461	446	550	526	332	229	302
Pupil support services	861	874	937	937	1,067	1,255	1,375
Sites and buildings and other	794	811	755	765	1,042	978	938
Total General Fund expenditures (excluding capital)	9,789	9,821	10,234	10,274	8,824	9,154	8,905
General Fund capital expenditures	440	452	414	419	217	237	236
Special revenue funds							
Food Service	458	469	456	469	562	548	577
Community Service	513	515	618	623	571	589	598
Debt Service Fund	1,129	1,111	1,184	1,208	578	596	611
Total expenditures	$ 12,329	$ 12,368	$ 12,906	$ 12,993	$ 10,752	$ 11,124	$ 10,927
ADM served per MDE School District Profiles Report (current year estimated)					6,925	6,899	6,823

Note: Excludes the Capital Projects – Building Construction and OPEB Debt Service Funds.

Source of state-wide and seven-county metro area data: School District Profiles Report published by the MDE

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

The District spent approximately $74.5 million in the governmental funds reflected above in fiscal 2012, a decrease of $2.2 million (2.9 percent) from the prior year. On a per student basis, this represents a decrease of $197. Early retirement incentives and other cost containment measures implemented at the end of the prior fiscal year contributed to the overall decrease in the general fund. Savings on energy, fuel, and snow removal costs also reduced current year expenditures.

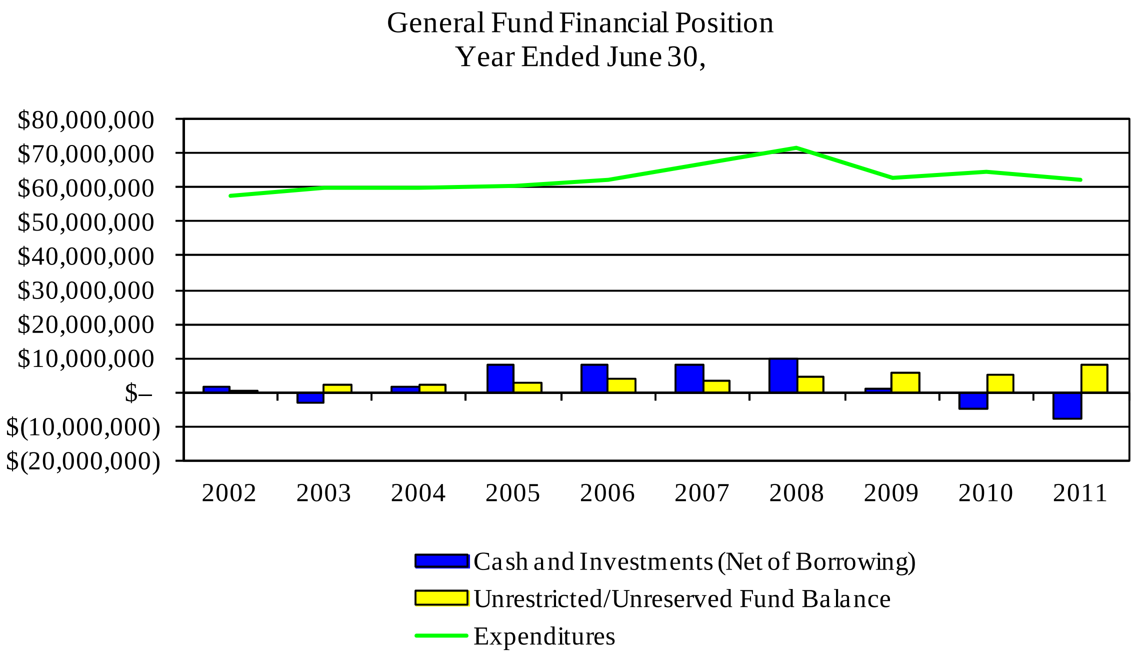
SUMMARY

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 (formerly unreserved) fund balance and cash balance are typically used as indicators of financial health, while annual expenditures are often used to measure the size of the operation.



The District ended fiscal year 2012 with a General Fund cash balance (net of borrowing) deficit of ($7,643,391) and an unrestricted fund balance of $8,576,415. The decrease in cash and investments in recent years reflects the change in metering of state aid payments to school districts as legislatively approved and an increase in the tax shift beginning in fiscal 2011.

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

	June 30, 2008	2009	2010	2011	2012
Nonspendable fund balances	$ –	$ –	$ –	$ 206,330	$ 237,671
Restricted (formerly reserved fund balances (1)	2,123,001	981,890	150,927	1,701	(96,844)
Unrestricted (formerly unreserved) fund balances					
Assigned (formerly designated)	–	1,226,524	1,258,590	823,777	1,002,121
Unassigned (formerly undesignated)	3,234,676	3,369,778	4,559,494	4,578,641	7,574,294
Total fund balance	$ 5,357,677	$ 5,578,192	$ 5,969,011	$ 5,610,449	$ 8,717,242
Unrestricted (formerly unreserved) fund balances as a percentage of expenditures	4.8%	6.4%	9.3%	8.3%	13.8%
Unassigned (formerly undesignated) fund balances as a percentage of expenditures	4.8%	4.7%	7.3%	7.1%	12.1%

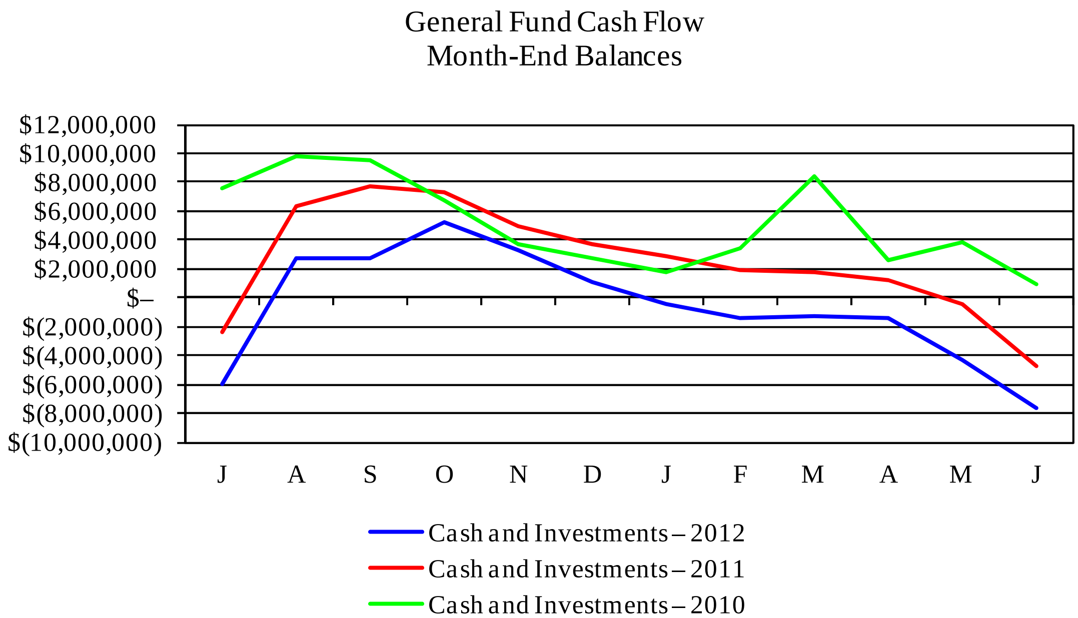
(1) Includes deficits in restricted fund balance accounts allowed to accumulate deficits under UFARS, which are part of unassigned fund balance on accounting standards generally accepted in the United States of America-based financial statements.

In the preceding table, General Fund unrestricted/unreserved fund balances and the related percentages of total General Fund expenditures differ from those used in the previous discussion of state-wide fund balances, which are based on the state SOD formula.

The resources represented by this fund balance are critical to a district's ability to maintain adequate cash flow throughout the year, to retain its programs, and to cushion against the impact of unexpected costs or funding shortfalls.

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:



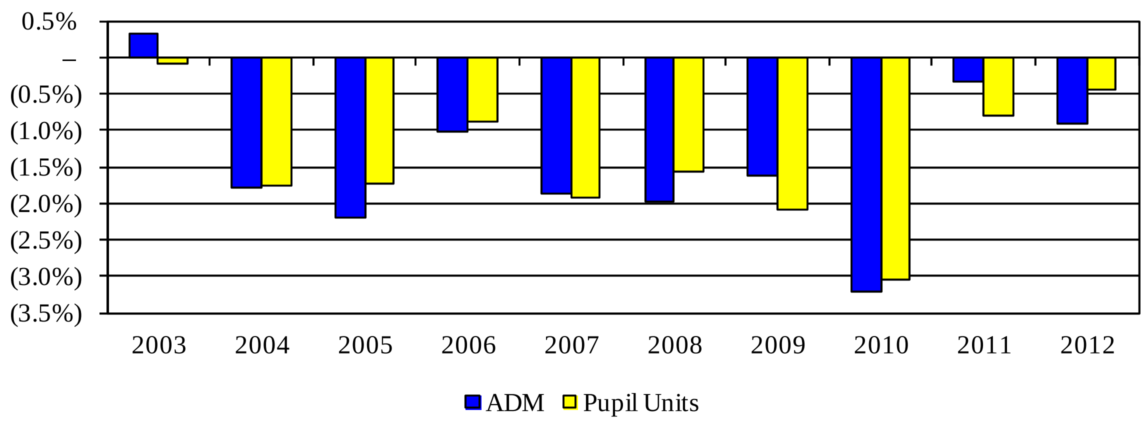
The graph above shows the peaks and valleys of the General Fund cash and investments balance (net of borrowing and interfund balances) on a monthly basis. The swing between its high and low month-end cash balances was about $12.9 million for fiscal 2012.

Changes in funding structure and state aid payment schedules significantly affect the cash flow of Minnesota school districts. As further described in the Legislative Summary section of this report, state aids normally paid on a 90–10 schedule were changed to a 73–27 schedule for fiscal 2010 and 70–30 for fiscal 2011, and 64.3–37.7 for fiscal 2012. Beginning in fiscal 2011, a further delay in aid payments occurred with a significant increase in the tax shift.

AVERAGE DAILY MEMBERSHIP AND PUPIL UNITS

The following graph shows the rate of ADM change from year to year, and the relationship of the resulting pupil units:

Change in ADM and Pupil Units

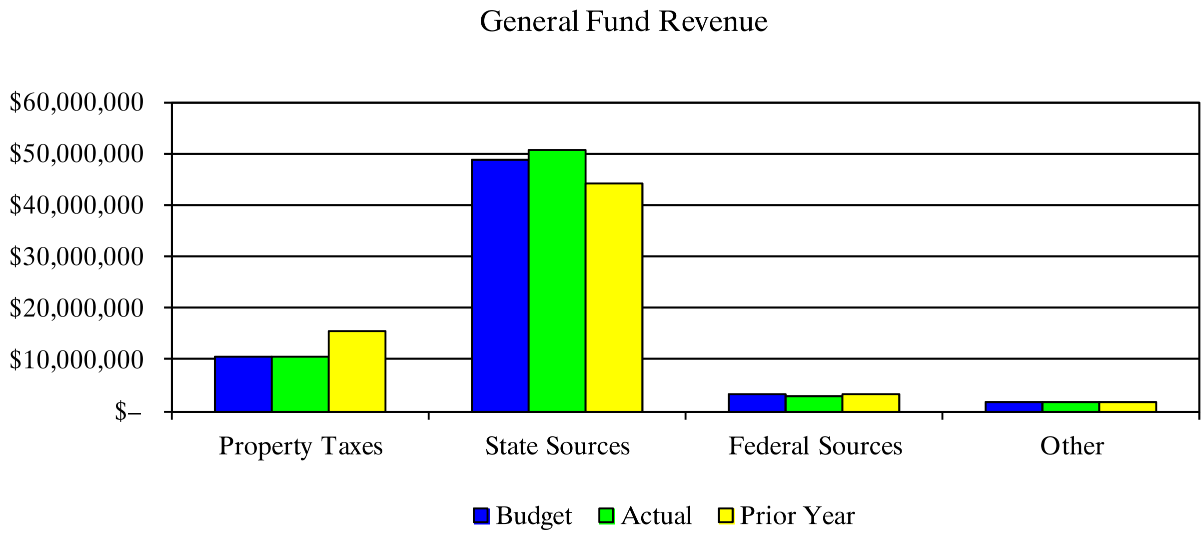


ADM is a measure of students attending class, which is then converted to pupil units (the base for determining revenue) using a statutory formula. Not only is the original budget based on ADM estimates, the final audited financial statements are based on updated, but still estimated, ADM since the counts 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.

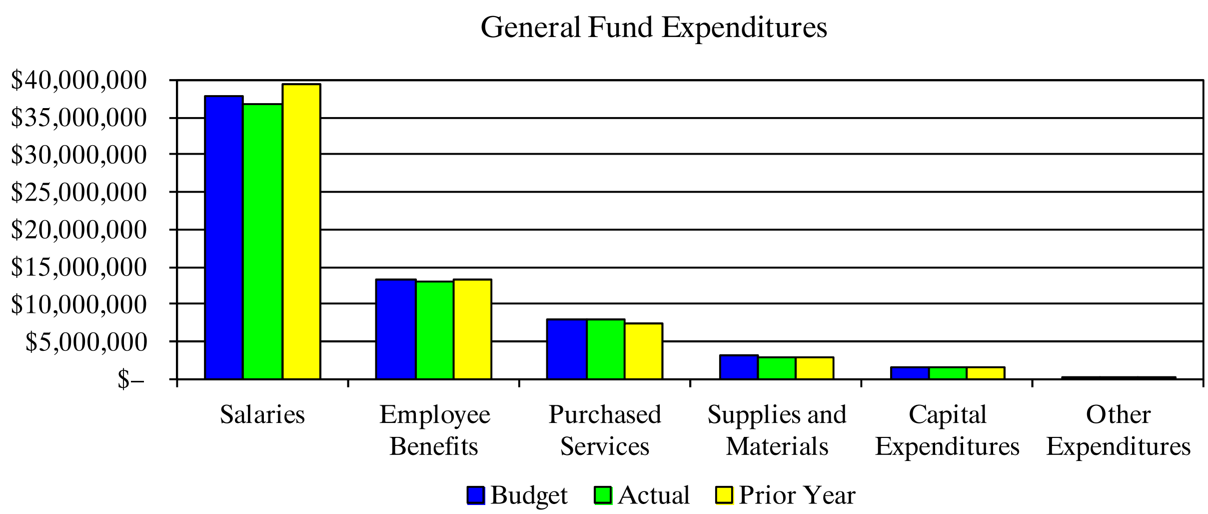
The District served an estimated ADM of 6,690 in 2012, a decrease of 61 ADM, or about 0.9 percent, from the prior year. The ADM served and resulting pupil units for the past 10 years, corresponding to the graph above, are presented as other District information within the District's financial statement.

GENERAL FUND REVENUE AND EXPENDITURES

The following graphs summarize the District's General Fund revenues and expenditures for 2012:



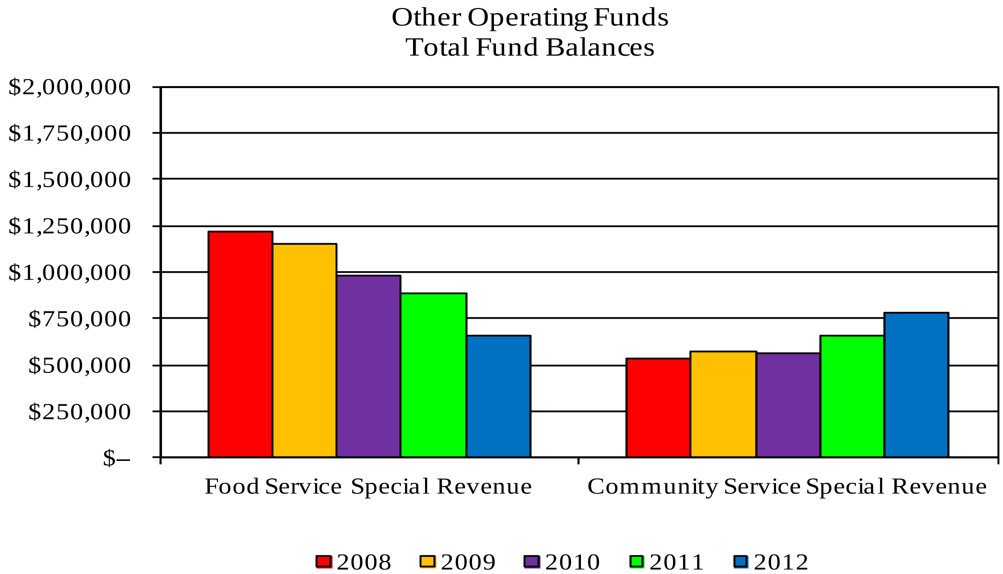
For 2012, revenues of $65,474,493 were over budget by $1,583,019, or 2.5 percent, and were $1,033,052 greater than the prior year. State sources were over budget by $2,016,250, which was partially offset by unfavorable variances in property taxes, federal and other local sources. The variance in state source was a result of the District serving more pupil units than anticipated in the current year budget, along with conservative estimates for special education funding formulas. This graph also reflects the tax shift between state aids and tax sources that offset dollar-for-dollar.



In 2012, expenditures of $62,367,700 were $1,523,774, or 2.4 percent, under budget and were $2,432,303 less than the prior year. Salaries and related benefits, which comprise 80% of General Fund spending, accounted for the majority of the decrease and variance to budget. Conservative budgeting along with early incentive retirement benefits offered near the end of the prior year contributed to this decrease in spending and expenditure variance.

Other Funds of the District

The following graph shows what is referred to as the other operating funds. The remaining non-operating 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 experienced a decrease in fund balance of $225,798 in 2012, compared to a budgeted decrease of $43,468. Revenues were $139,074 under budget. Meal sales decreased slightly from the prior year, but were projected to increase by $113,848, accounting for $141,339 of the total revenue variance. Expenditures were over budget by $43,256. Salary and benefit costs, which were $15,722 over prior year costs, were $275,689 over amounts approved in the budget. Saving in the remaining object categories of purchased services, supplies and materials, capital outlay, and other expenditures, partially offset the salary and benefit variance. The Food Service Special Revenue Fund had a year-end fund balance of $661,538, representing 16.8 percent of annual expenditures totaling $3,933,673.

This operation has maintained a healthy fund balance for several years and has also been able to assist in funding a portion of several capital improvements to food service facilities in recent years. The District should review upcoming capital needs of the child nutrition operation and incorporate that information in establishing an optimal level of fund balance that is also within state and federal fund balance limits.

Community Service Special Revenue Fund

The District's Community Service Special Revenue Fund experienced a fund balance increase of $123,269 in 2012, compared to a budgeted increase of $202,470. Revenues were $217,897 under budget, mainly in other tuition and fees. Expenditures were under projected levels, ending $138,696 under budget largely in salary and related benefit costs. The Community Service Special Revenue Fund had a year-end fund balance of $776,518, representing 19.0 percent of annual expenditures totaling $4,077,026.

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.

GOVERNMENT-WIDE FINANCIAL STATEMENTS

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

Theoretically, net assets represent the resources the District has leftover to use 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, the statement divides the net assets into three components: net assets invested in capital assets, net of related debt; restricted net assets; and unrestricted net assets. The following table presents a summarized conversion of the District's governmental fund balances (as discussed earlier) to net assets and the separate components for the last three years:

	June 30, 2010	June 30, 2011	June 30, 2012
Net assets – governmental activities			
Total fund balances – governmental funds	$ 8,806,673	$ 8,327,007	$ 10,967,188
Negative net OPEB obligation	5,040,521	4,575,041	4,095,577
Total capital assets, net of depreciation	50,860,841	49,183,495	47,754,044
Total long-term debt	(42,842,514)	(40,434,206)	(36,168,594)
Other adjustments	(278,221)	(190,251)	(185,784)
Total net assets – governmental activities	$ 21,587,300	$ 21,461,086	$ 26,462,431
Net assets			
Invested in capital assets, net of related debt	$ 19,466,942	$ 20,670,293	$ 22,301,539
Restricted	2,382,628	2,292,972	1,979,589
Unrestricted	(262,270)	(1,502,179)	2,181,303
Total net assets	$ 21,587,300	$ 21,461,086	$ 26,462,431

Some of the District's fund balances translate into restricted net assets 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 assets category consists mainly of the General Fund unrestricted fund balances, offset against non-capital long-term obligations such as vacation or severance payable. Consequently, many Minnesota school districts have accumulated deficits in this component of net assets.

Total net assets increased by $5,001,345 during fiscal 2012. This is partially due to the relationship between the rate of depreciation on capital assets and the repayment rate of related debt, as well as the general operating results of the District as a whole. The improved financial position of the General Fund as discussed earlier in this report significantly contributed to the increase in unrestricted net assets presented in the table above.

GASB STATEMENT NO. 60 – ACCOUNTING AND FINANCIAL REPORTING FOR SERVICE CONCESSION ARRANGEMENTS

This statement provides accounting and financial reporting guidance for governments that participate as either a transferor or an operator in a service concession arrangement (SCA). SCAs are arrangements whereby a government transfers the rights to operate one of its capital assets to a third party operator (either a private party or another government) for consideration, with the operator then being compensated from the fees or charges collected in connection with the operation of the asset. To qualify as an SCA, an arrangement must meet all of the following criteria: 1) the transferor must convey to the operator both the right and the obligation to use one of its capital assets to provide services to the public; 2) the operator must provide significant consideration to the transferor; 3) the operator must be compensated from the fees or charges it collects from third parties; 4) the transferor must have the ability to either determine, modify, or approve what services are to be provided to whom at what price; and 5) the transferor must retain a significant residual interest in the service utility of the asset. This statement provides guidance to governments that are party to an SCA for reporting the assets, obligations, and flow of revenues that result from the arrangement; along with the required financial statement disclosures. The requirements of this statement must be implemented for periods beginning after December 15, 2011, with earlier implementation encouraged.

GASB STATEMENT NO. 61 – THE FINANCIAL REPORTING ENTITY: OMNIBUS

This statement amends the current guidance in GASB Statement No. 14, "The Financial Reporting Entity," for identifying and presenting component units. This statement changes the fiscal dependency criterion for determining component units. Potential component units that meet the fiscal dependency criterion for inclusion in the financial reporting entity under existing guidance will only be included if there is also "financial interdependency" (an ongoing relationship of potential financial benefit or burden) with the primary government. This statement also clarifies the types of relationships that are considered to meet the "misleading to exclude" criterion for inclusion as a component unit; changes the criteria for blending component units; gives direction for the determination and disclosure of major component units; and adds a requirement to report an explicit, measurable equity interest in a discretely presented component unit in a statement of position prepared using the economic resources measurement focus. The requirements of this statement must be implemented for periods beginning after June 15, 2012, with earlier implementation encouraged.

GASB STATEMENT NO. 63 – FINANCIAL REPORTING OF DEFERRED OUTFLOWS OF RESOURCES, DEFERRED INFLOWS OF RESOURCES, AND NET POSITION

This statement provides financial reporting guidance for deferred outflows of resources and deferred inflows of resources; which are defined as the consumption or acquisition of net assets, respectively, applicable to a future reporting period. The statement amends certain reporting requirements in GASB Statement No. 34 and related pronouncements, providing a format for a new Statement of Net Position, which reports deferred outflows of resources and deferred inflows of resources separately from assets and liabilities. It also renames the residual of assets, deferred outflows of resources, liabilities, and deferred inflows of resources as net position, rather than net assets. The requirements of this statement must be implemented for periods beginning after December 15, 2011, with earlier implementation encouraged.

GASB STATEMENT NO. 65 – ITEMS PREVIOUSLY REPORTED AS ASSETS AND LIABILITIES

This statement establishes accounting and financial reporting standards that reclassify, as deferred outflows of resources or deferred inflows of resources, certain items that were previously reported as assets and liabilities and recognizes, as outflows of resources or inflows of resources, certain items that were previously reported as assets and liabilities. This statement also provides other financial reporting guidance related to the impact of the financial statement elements deferred outflows of resources and deferred inflows of resources, such as changes in the determination of the major fund calculations and limiting the use of the term *deferred* in financial statement presentations. The provisions of this statement are effective for financial statements for periods beginning after December 15, 2012. Earlier application is encouraged.

GASB STATEMENT NO. 67 – FINANCIAL REPORTING FOR PENSION PLANS – AN AMENDMENT OF GASB STATEMENT NO. 25

The primary objective of this statement is to improve financial reporting by state and local governmental pension plans. GASB Statement No. 67 replaces the requirements of GASB Statement Nos. 25 and 50 for pension plans that are administered through trusts or equivalent arrangements that meet the following criteria: contributions from employers and nonemployer contributing entities to the pension plan and earnings on those contributions are irrevocable; pension plan assets are dedicated to providing pensions to plan members in accordance with the benefit terms; and pension plan assets are legally protected from the creditors of employers, nonemployer contributing entities, and the pension plan administrator. If the plan is a defined benefit pension plan, plan assets also are legally protected from creditors of the plan members. The requirements of GASB Statement Nos. 25 and 50 remain applicable to pension plans that are not administered through trusts covered by the scope of this statement and to defined contribution plans that provide post-employment benefits other than pensions. The statement makes a number of changes in the financial statement presentation, measurement, and required disclosures relating to the reporting of these types pension plans. This statement is effective for financial statements for fiscal years beginning after June 15, 2013. Earlier application is encouraged.

GASB STATEMENT NO. 68 – ACCOUNTING AND FINANCIAL REPORTING FOR PENSIONS – AN AMENDMENT OF GASB STATEMENT NO. 27

The primary objective of this statement is to improve accounting and financial reporting by state and local governments for pensions. This statement replaces the requirements of GASB Statement Nos. 27 and 50, as they relate to pensions that are provided through pension plans administered as trusts or equivalent arrangements that meet certain criteria (as described above for GASB Statement No. 67). The requirements of GASB Statement Nos. 27 and 50 remain applicable for pensions that are not covered by the scope of this statement. This statement establishes standards for measuring and recognizing liabilities, deferred outflows of resources, deferred inflows of resources, and expense/expenditures. In addition, this statement details the recognition and disclosure requirements for employers with liabilities (payables) to a defined benefit pension plan and for employers whose employees are provided with defined contribution pensions. This statement also addresses circumstances in which a nonemployer entity has a legal requirement to make contributions directly to a pension plan. This statement is effective for financial statements for fiscal years beginning after June 15, 2014. Earlier application is encouraged.

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

LEGISLATIVE SUMMARY

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

Basic General Education Revenue – The per pupil basic general education formula allowance for fiscal year (FY) 2012 was $5,174. The allowance will increase $50 to $5,224 for FY 2013.

Small Schools Revenue – Small schools revenue will be added as a new component of general education revenue beginning in FY 2013. School districts with less than 1,000 adjusted marginal cost pupil units (AMCPU) will qualify for an additional revenue allowance per AMCPU of: $522.40 times (1,000 – AMCPU)/1,000. Charter schools are not eligible for this aid.

Temporary Suspension of Reserved Revenue for Staff Development – The temporary suspension of the requirement for school districts and charter schools to reserve 2 percent of their basic general education revenue for staff development, initially suspended for FY 2010 and FY 2011, was extended to include FY 2012 and FY 2013. The requirement for districts to allocate the reserved funds; 50 percent to sites on a per teacher basis, 25 percent for best practices, and 25 percent for district-wide staff development, has been repealed.

Training and Experience Revenue – Training and experience revenue was eliminated as a component of general education revenue effective FY 2012.

Homeless Students – For general education aid, the district where the parent or legal guardian of a homeless student resides is now considered their district of residence rather than the district where the homeless shelter is located, unless the parent or guardian lives outside the state, is imprisoned, or has had their parental rights terminated. If any of these three exceptions apply, the district of residence is the district in which the pupil resided when the qualifying event occurred. If the district of residence cannot otherwise be determined, it will be the district in which the pupil currently resides. Homeless students whose parent or legal guardian moves to another district are allowed to continue to enroll at the district they have been attending without the approval of either the resident or nonresident districts' boards. Transportation from the district of residence to and from the school of enrollment must be provided for homeless students by the serving district.

State Aid Payment Deferral – State aids normally paid on a 90–10 schedule were due to be paid on a 60–40 payment schedule beginning in FY 2012 for both school districts and charter schools. An exception was allowed for charter schools in which at least 90 percent of the enrollment receives special education services, accelerating regular special education aid payments only to a 90–10 payment schedule. Due to a projected budget surplus, the percentage of FY 2012 estimated state aids payable to districts and charter schools during the current year was increased to 64.3 percent, beginning with the March 15, 2012 payment. The March 15th payment was adjusted to catch districts and charter schools up to amount they would have received through that date had the current payment percentage been set at 64.3 percent throughout the year.

Endowment/Permanent School Fund Payments – Effective March 1, 2012, the distribution of endowment/permanent school fund revenue will be based on the adjusted average daily membership (ADM) pupils served by each school district rather than resident ADM pupils. Also, charter schools will qualify to receive endowment/permanent school fund payments beginning that same date.

Compensatory Pilot Project Formula Aid – The 20 largest school districts in the state in terms of adjusted pupil units may be eligible for this one-time aid for FY 2013. To be eligible, the district's compensatory revenue per compensatory pupil unit (free + 1/2 of reduced price lunch count) must be less than $1,400. The aid, which can only be used for basic skills purposes, will equal the amount needed to bring the district's compensatory aid up to $1,400 per compensatory pupil unit.

Literacy Incentive Aid – For FY 2013 and later, a new literacy incentive aid is available to school districts and charter schools. Only school sites that enroll students in Grades 3 and 4, with reading Minnesota Comprehensive Assessments (MCA) test results from the prior year, generate revenue. There is no requirement for the funds to be spent at the school generating the revenue. The aid may be used for any General Fund purpose.

Literacy incentive aid is the sum of two components, proficiency aid and growth aid. Proficiency aid equals the number of the school's third grade enrollment from October 1 of the previous year times the school's proficiency allowance ($530 times the percent of third graders meeting or exceeding proficiency on the reading MCA test, averaged across the previous three test administrations). Growth aid equals the school's fourth grade enrollment on the previous October 1 times the school's growth allowance ($530 times the percentage of students making medium or high growth on the fourth grade reading MCA, averaged across the previous three test administrations).

Integration Aid – The current integration rule remains in effect with no sunset. However, the current integration aid funding formula remains in place only through FY 2013. The integration revenue statute is repealed for FY 2014, and the base appropriation for a new program is established for FY 2014 and FY 2015. A 12-member Integration Revenue Replacement Advisory Task Force convened by the Commissioner of Education will develop recommendations for repurposing integration revenue funds to create and sustain opportunities for students to achieve improved educational outcomes.

Homestead Market Value Credit (HMVC) – The HMVC, which reduces the property taxes spread to homestead property based on net tax capacity and replaces it with state aid, is repealed effective for taxes payable in 2012. To help neutralize the impact of the credit repeal on homeowners, a portion of each homestead taxpayer's market value will be excluded in determining the property's net tax capacity for determining net tax capacity-based taxes. The exclusion starts at 40 percent of the value for homes valued up to $76,000, and is gradually reduced as the home value increases, phasing out completely for homes valued over $413,800.

Career and Technical Levy – Beginning with taxes payable in 2012, this levy is increased to the greater of $80 times the district's ADM in Grades 9 through 12, or 35 percent of approved expenditures (simply 35 percent of approved expenditures for taxes payable in 2015 or later), rather than the old formula of the lesser of $80 times the district's ADM in Grades 10 through 12, or 25 percent of approved expenditures.

Early Graduation Programs – Two programs were created that provide students that graduate early with awards between $2,500 and $7,500, depending on how many semesters early they graduate. Students qualifying for the Early Graduation Achievement Scholarship Program receive a scholarship award that may be used at any accredited higher education institution, and students qualifying for the Early Graduation Military Service Award Program receive a cash award equivalent to the scholarship program award amounts. Students are required to apply for these programs within two years of graduation. General education aid to school districts and charter schools is reduced for all early graduates, regardless of whether they participate in one of these programs.

Post-Secondary Enrollment Options (PSEO) – Eligibility to participate in PSEO programs has been expanded to include 10th graders who have passed the 8th grade reading MCA. Post-secondary institutions are now allowed to advertise and recruit students on educational and programmatic grounds only. The deadline for students to notify districts of plans to participate in PSEO was moved from March 30 to May 30, with the notification now binding on the student. Students will now receive both high school and college credit for PSEO courses. Parents or guardians can receive reimbursement for transportation from the post-secondary institution for travel between the secondary and post-secondary institutions.

Innovation Zones Pilot Project – A five-year pilot project (FY 2014–FY 2018) has been established to allow groups of school districts to collaborate in providing innovative education programs and activities and sharing district resources. Applications must be made to the MDE Commissioner by February 1, 2013.

Fund Transfers – For FY 2012 through FY 2015, school districts are authorized to transfer any money from one fund or account to another, excluding transfers from the food service or community service funds, as long as the transfer does not increase state aid obligations or increase local property taxes. School boards may only approve such transfers after they have adopted a resolution stating that the transfer will not diminish instructional opportunities for students.

Purchase of Food Service Equipment – The requirement for the MDE to approve capital expenditures from the food service fund is eliminated for food service equipment purchases made on or after July 1, 2012. However, the requirement remains that the cost of equipment purchased from the food service fund in any year cannot exceed the unreserved fund balance in the food service fund at the end of the previous fiscal year.

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

PERA and TRA Rates – Contribution rates for employers and employees of the PERA Coordinated Plan increased by 0.25 percent effective January 1, 2011. Contribution rates for employers and employees for both the TRA Basic and Coordinated Plans increase by 0.5 percent each year through FY 2015. There is no additional aid to help fund these increases.

Military Leave – Effective July 1, 2012, school districts are required to pay the full salary for employees on active duty military leave that would have been paid to the employee during their leave for military service into a special service member’s aggregate salary savings account. The district must use the combined proceeds in the account to pay the full salary differentials (the difference between the employee’s base active duty military pay and the salary they would have been paid as an active district employee, including any adjustments they would have received) of all eligible deployed employees of the district. Districts are no longer allowed to reduce the salaries paid to employees on military leave by the costs of substitute teachers used to replace them.

Minnesota Department of Education Budget – The MDE budget has been reduced by 5.0 percent annually for FY 2012 and FY 2013.