

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

COMMUNICATIONS LETTER

For the Year Ended June 30, 2013

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 and Management
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, 2013, in accordance with auditing standards generally accepted in the United States of America, 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 was not designed to identify all deficiencies in internal control that might be material weaknesses or significant deficiencies and, therefore, material weaknesses or significant deficiencies may exist that were not identified. However, as discussed below, we identified a certain deficiency in internal control that we consider to be a material weakness.

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 a 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. The material weakness identified is stated within this letter.

A significant deficiency is a deficiency, or a 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 also includes financial analysis provided as a basis for discussion. The matters discussed herein were considered by us during our audit and they do not modify the opinion expressed in our Independent Auditor's Report dated October 15, 2013, 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
October 15, 2013

INDEPENDENT SCHOOL DISTRICT NO. 877

**MATERIAL WEAKNESS
June 30, 2013**

MATERIAL AUDIT ADJUSTMENT

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

In order to ensure financial statements were free from material misstatement, an audit adjustment was required to reclassify a portion of the other financing use, bond refunding payments as principal and interest expenditures.

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

INDEPENDENT SCHOOL DISTRICT NO. 877

REQUIRED COMMUNICATION

June 30, 2013

We have audited the financial statements of the District for the year ended June 30, 2013, and have issued our report dated October 15, 2013. Professional standards require that we provide you with the following information related to our audit.

OUR RESPONSIBILITY UNDER AUDITING STANDARDS GENERALLY ACCEPTED IN THE UNITED STATES OF AMERICA, *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 accounting principles generally accepted in the United States of America. Our audit of the financial statements does not relieve you or management of your responsibilities. .

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 internal control.

As part of obtaining reasonable assurance about whether the financial statements are free of material misstatement, we performed tests of the District's compliance with certain provisions of laws, regulations, contracts and grant agreements. However, the objective of our tests was not to provide an opinion on compliance with such provisions.

In planning and performing our audit, we considered the District's internal control over financial reporting in order to determine our auditing procedures for the purpose of expressing an opinion on the financial statements and not to provide assurance on the internal control over financial reporting. 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*.

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 grants, 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. 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 each of its major federal programs for the purpose of expressing an opinion on the District's compliance with those requirements. While our audit provided a reasonable basis for our opinion, it did not provide a legal determination on the District's compliance with those requirements.

Our responsibility for the supplementary information accompanying the financial statements, as described by professional standards, is to evaluate the presentation of the supplementary information in relation to the financial statements as a whole and to report on whether the supplementary information is fairly stated, in all material respects, in relation to the financial statements taken as a whole.

INDEPENDENT SCHOOL DISTRICT NO. 877

REQUIRED COMMUNICATION June 30, 2013

PLANNED SCOPE AND TIMING OF THE AUDIT

An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements; therefore, our audit involved judgment about the number of transactions to be examined and the areas to be tested.

Our audit included obtaining an understanding of the District and its environment, including internal control, sufficient to assess the risks of material misstatement of the financial statements and to design the nature, timing and extent of further audit procedures. Material misstatements may result from (1) errors, (2) fraudulent financial reporting, (3) misappropriation of assets, or (4) violations of laws or governmental regulations that are attributable to the District or to acts by management or employees acting on behalf of the District.

QUALITATIVE ASPECTS OF ACCOUNTING PRACTICES

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 to the financial statements. No new accounting policies were adopted and the application of existing policies was not changed during the year ended June 30, 2013. 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 proper period.

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 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.

The financial statement disclosures are neutral, consistent and clear.

DIFFICULTIES ENCOUNTERED IN PERFORMING THE AUDIT

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

INDEPENDENT SCHOOL DISTRICT NO. 877

REQUIRED COMMUNICATION

June 30, 2013

CORRECTED AND UNCORRECTED MISSTATEMENTS

Professional standards require us to accumulate all misstatements identified during the audit, other than those that are clearly trivial, and communicate them to the appropriate level of management. We identified the following uncorrected misstatement of the financial statements. Management has determined its effect is immaterial, both individually and in the aggregate, to the financial statements taken as a whole.

- Property taxes receivable and the related revenue are overstated
- State aids receivable and the related revenues are understated
- Interest receivable not booked in the OPEB Trust Fund
- Issue costs on debt issuance not capitalized

The following material misstatement detected as a result of audit procedures was corrected by management.

- Reclassifying a portion of the other financing use, bond refunding payments as principal and interest expenditures.

DISAGREEMENTS WITH MANAGEMENT

For purposes of this letter, a disagreement with management is 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 that are included 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 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.

INDEPENDENT SCHOOL DISTRICT NO. 877

REQUIRED COMMUNICATION

June 30, 2013

OTHER MATTERS

With respect to the supplementary information 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 United States of America, the method of preparing it has not changed from the prior period, and the information is appropriate and complete in relation to our audit of the financial statements. We compared and reconciled the supplementary information to the underlying accounting records used to prepare the financial statements or to the financial statements themselves.

INDEPENDENT SCHOOL DISTRICT NO. 877

FINANCIAL ANALYSIS

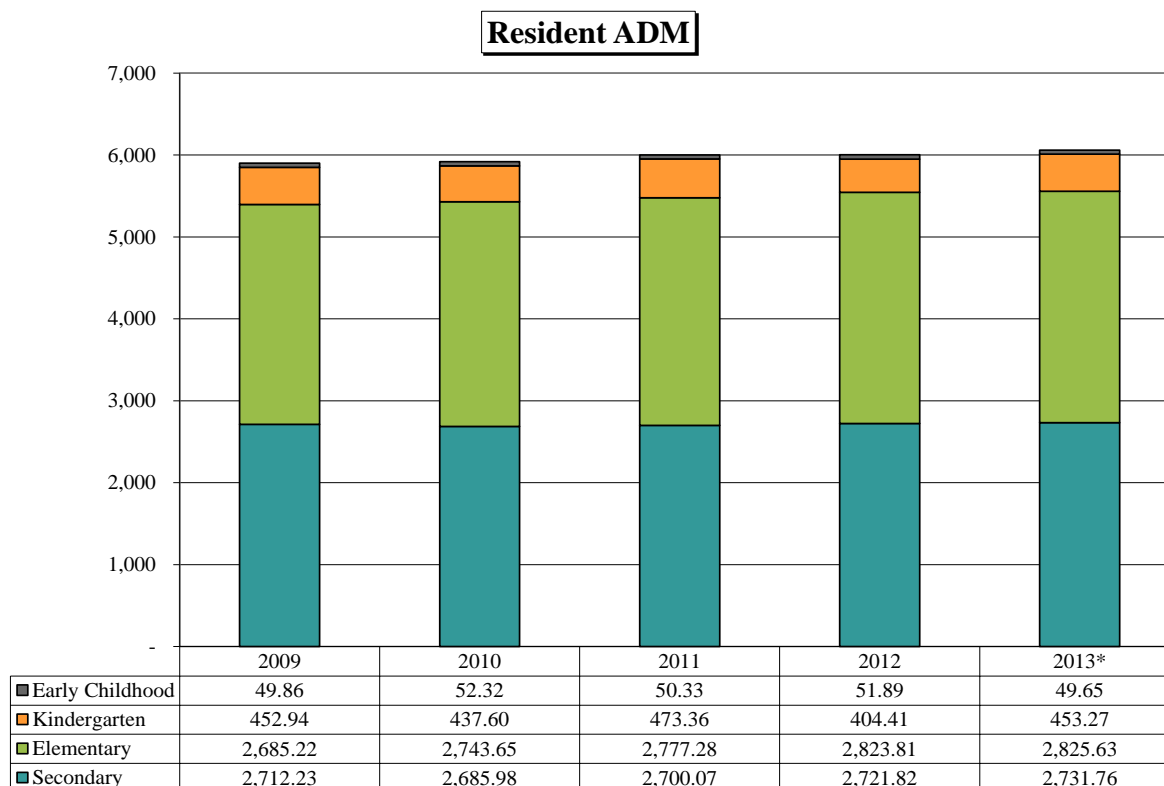
June 30, 2013

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 82% of the District's General Fund revenue is from the state. A majority of this funding is based on student counts, so an understanding of the District's population trends is critical to overall budgeting plans. The following table and graph summarizes resident average daily membership (ADM) of the District for the past five years ended June 30.

ADM	2009	2010	2011	2012	2013*
Early Childhood	49.86	52.32	50.33	51.89	49.65
Kindergarten	452.94	437.60	473.36	404.41	453.27
Elementary	2,685.22	2,743.65	2,777.28	2,823.81	2,825.63
Secondary	2,712.23	2,685.98	2,700.07	2,721.82	2,731.76
Total Resident ADM	5,900.25	5,919.55	6,001.04	6,001.93	6,060.31



* Estimate as of September 13, 2013

INDEPENDENT SCHOOL DISTRICT NO. 877

FINANCIAL ANALYSIS

June 30, 2013

RESIDENT AVERAGE DAILY MEMBERSHIP AND PUPIL UNITS

The chart and graph on the previous page illustrate the steady increase in resident ADM experienced by the District over the past five years. Total resident ADM increased 2.7% since 2009 and increased 1.0% from 2012 to 2013, a majority of this increase was in kindergarten ADM.

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				
	Pre-Kindergarten and Handicapped Kindergarten	Kindergarten	Elementary Grades 1-3/4-6	Secondary
2009-2013	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.

WADM	2009	2010	2011	2012	2013*
Residents	6,797.13	6,823.62	6,891.87	6,934.05	6,969.32
Resident WADM Loss	(530.42)	(571.14)	(617.96)	(678.76)	(693.49)
Nonresident WADM Gain	419.40	415.10	409.91	400.84	406.63
Total WADM Served	6,686.11	6,667.58	6,683.82	6,656.13	6,682.46

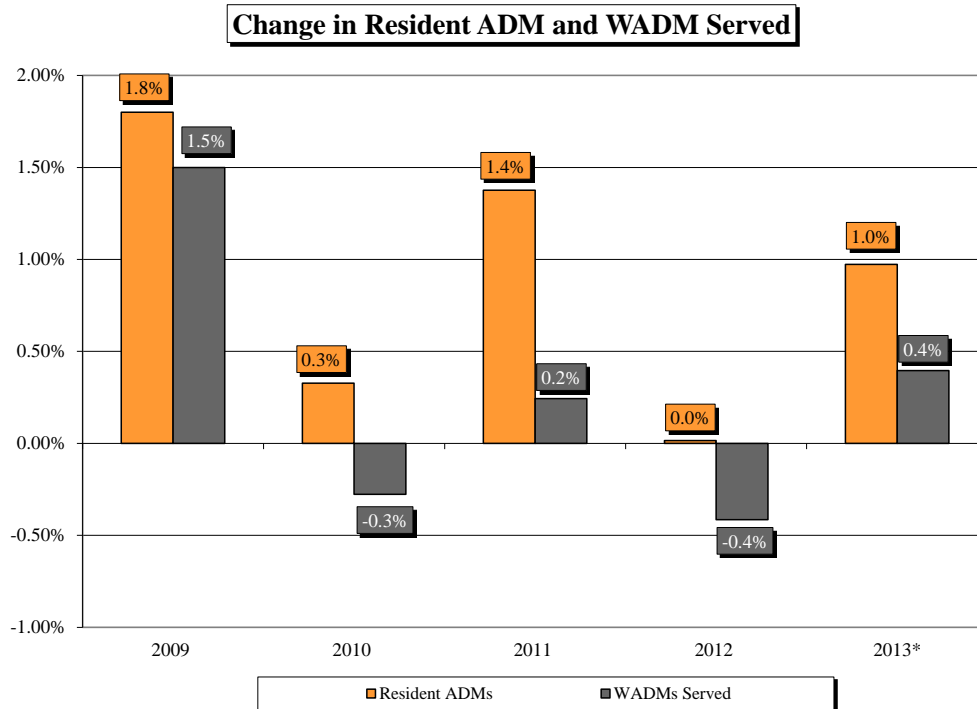
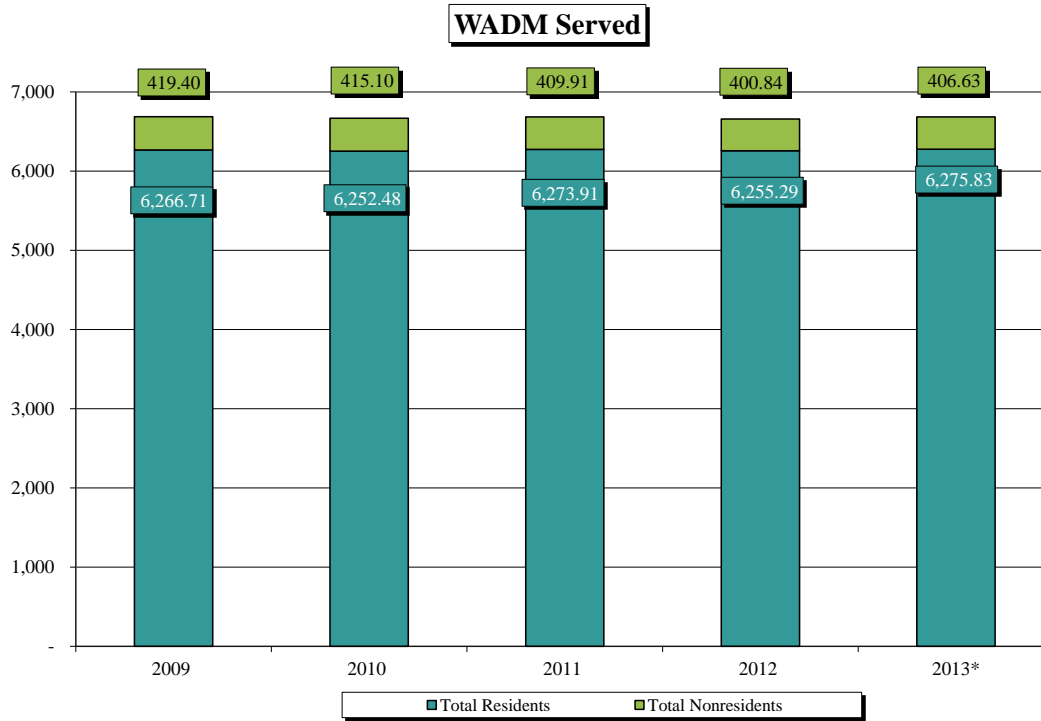
* Estimate as of September 13, 2013

Resident ADM served has increased in all years presented as illustrated on the previous pages. WADM have varied from year-to-year based on open enrollment; from 2012 to 2013 there was a 26.3 WADM increase, due to an increase in resident WADM. The District lost 10.0% of its resident WADM to neighboring districts, at the same time, 6.1% of WADM served are coming from outside the District.

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**FINANCIAL ANALYSIS
June 30, 2013**

WEIGHTED AVERAGE DAILY MEMBERSHIP SERVED



INDEPENDENT SCHOOL DISTRICT NO. 877

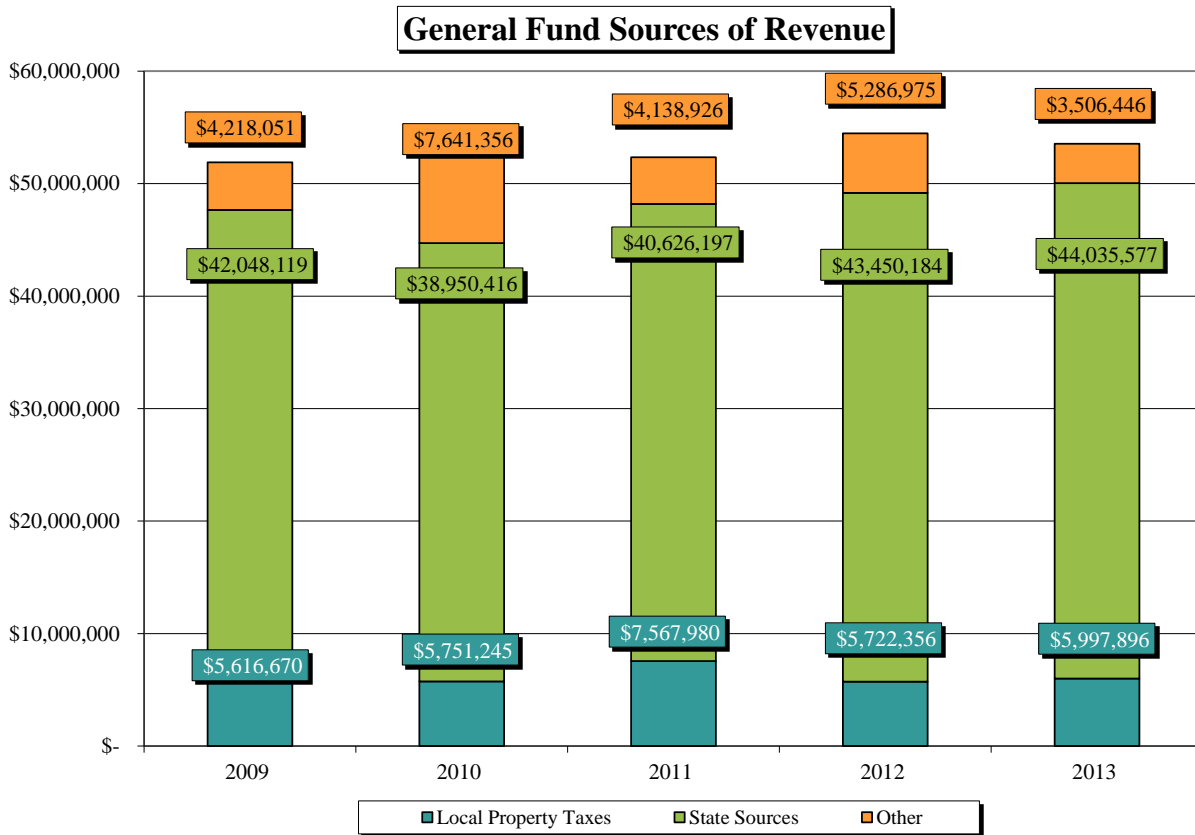
**FINANCIAL ANALYSIS
June 30, 2013**

GENERAL FUND SOURCES OF REVENUE

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

	2009	2010	2011	2012	2013
Local Property Taxes	\$ 5,616,670	\$ 5,751,245	\$ 7,567,980	\$ 5,722,356	\$ 5,997,896
State Sources	42,048,119	38,950,416	40,626,197	43,450,184	44,035,577
Other	4,218,051	7,641,356	4,138,926	5,286,975	3,506,446
Total	\$ 51,882,840	\$ 52,343,017	\$ 52,333,103	\$ 54,459,515	\$ 53,539,919

State revenue sources, which make up approximately 82.2% of total revenues, increased by \$ 585,393 for the year ended June 30, 2013, while local property taxes increased by \$ 275,540 and other sources decreased \$ 1,780,529. Included in other revenues are local, county and federal revenues. Factors contributing to these changes include effects of the tax shift for 2012, revenues were shifted from property taxes to state sources, the tax shift had a reverse affect in 2013. State revenues increased due to increased enrollment, changes to the general education aid formula and a new literacy aid in 2013. Other revenues decreased due to a decrease in medical assistance reimbursements which vary each year based on student needs decreased federal dollars most of which related to the Education Jobs Program, and the STEM Grant received through Northwest Suburban Integration District during 2012. General Fund revenue decreased 1.7% from 2012 to 2013.



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**FINANCIAL ANALYSIS
June 30, 2013**

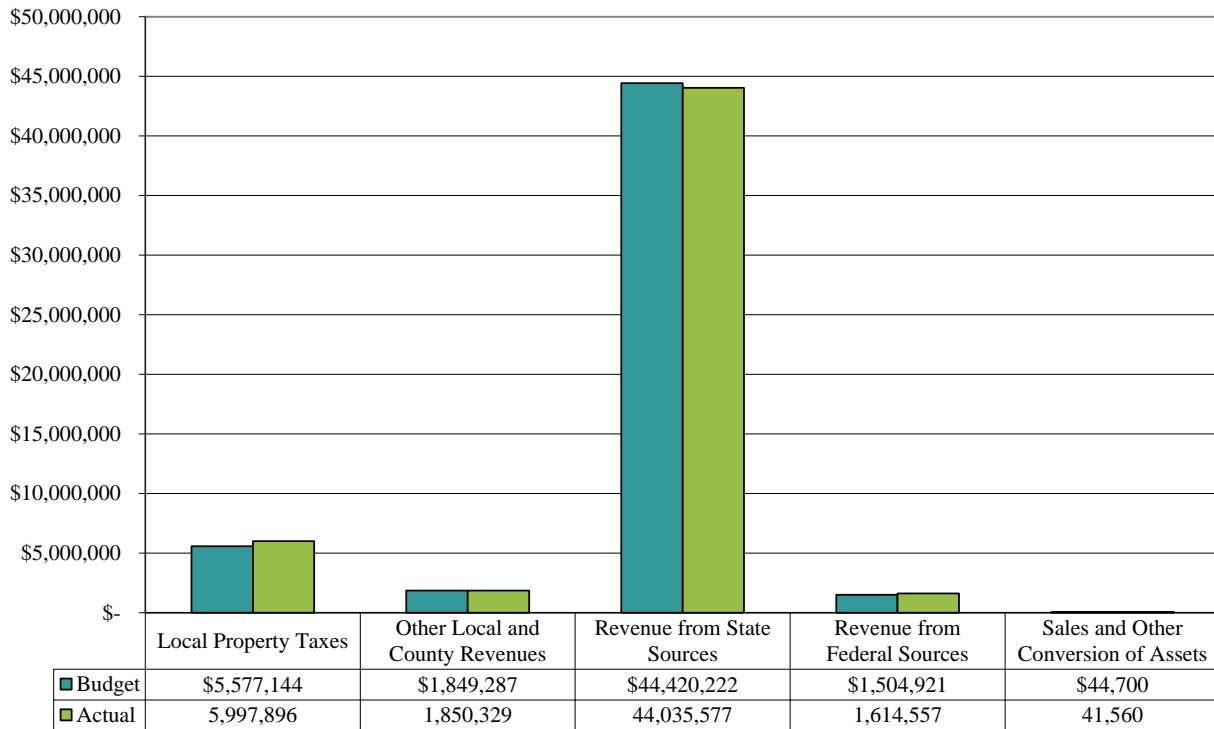
GENERAL FUND REVENUES BUDGET AND ACTUAL

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

The District approved a final General Fund revenue budget of \$ 53,396,274. With actual revenues coming in at \$ 53,539,919, the final budget produced a variance of \$ 143,645, or 0.3%.

The largest variances were in revenue from state sources and local property taxes, which were due to the District expecting another large tax shift adjustment by the state. All other revenue categories budgets were in line with actual revenue.

**General Fund Revenues
Budget and Actual**



INDEPENDENT SCHOOL DISTRICT NO. 877

FINANCIAL ANALYSIS

June 30, 2013

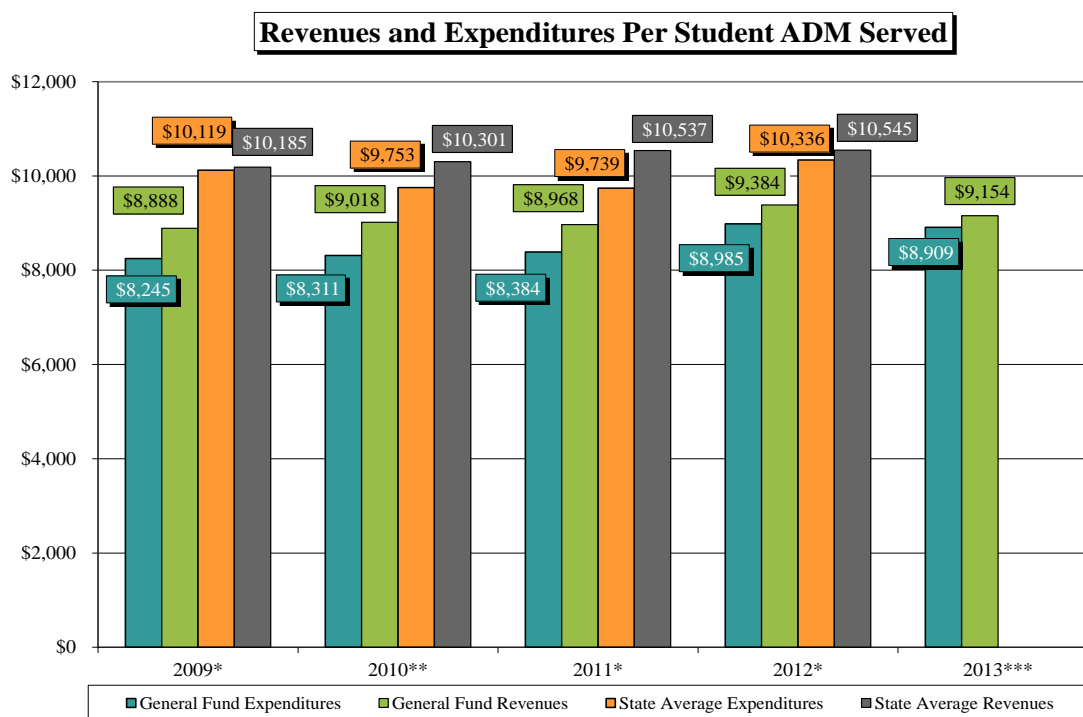
REVENUES AND EXPENDITURES PER ADM SERVED

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

	2009*	2010**	2011*	2012*	2013***
General Fund	\$ 8,888	\$ 9,018	\$ 8,968	\$ 9,384	\$ 9,154
General Fund State Average	10,185	10,301	10,537	10,545	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:

	2009*	2010**	2011*	2012*	2013***
General Fund	\$ 8,245	\$ 8,311	\$ 8,384	\$ 8,985	\$ 8,909
General Fund State Average	10,119	9,753	9,739	10,336	N/A



* Source: *School District Profiles*

** Estimate excluding OPEB costs in the General Fund

*** Estimate as of September 13, 2013; state-wide averages are not available

The District has seen a decrease in revenues and expenditures per student ADM served from 2012 to 2013. Revenues per ADM served decreased 2.4% from 2012 to 2013, while expenditures per ADM served decreased .8% over the same period. Revenues per ADM have consistently been below the state average, the largest variance is in property tax revenue per ADM, the District also receives less General Education Aid and federal aids per ADM. In relation to this, as a result of bringing in less revenue per ADM, the District is spending less per ADM than the state average.

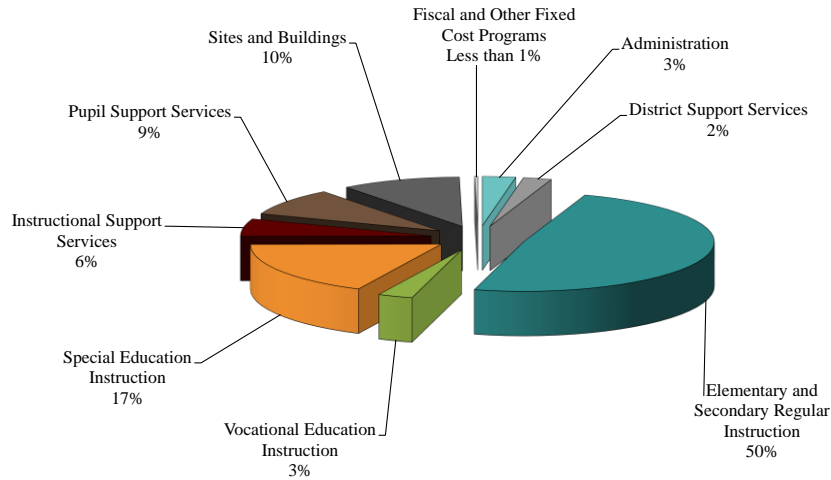
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**FINANCIAL ANALYSIS
June 30, 2013**

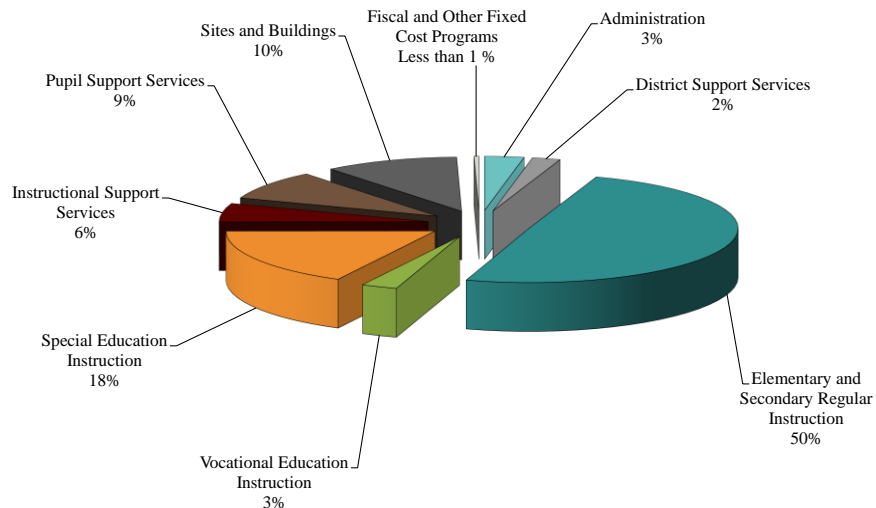
GENERAL FUND EXPENDITURES

The graphs below depict the percentage of expenditures by function in the General Fund for years 2012 and 2013. Expenditures decreased by \$ 149,157, or 0.3%, from 2012 to 2013, and the allocation of expenditures remained very consistent. Education programs and instructional support made up approximately 76% of the District’s expenditures, and only 3% and 2% were attributable to administration and District support services for 2012 and 2013, respectively.

General Fund Expenditures 2013



General Fund Expenditures 2012



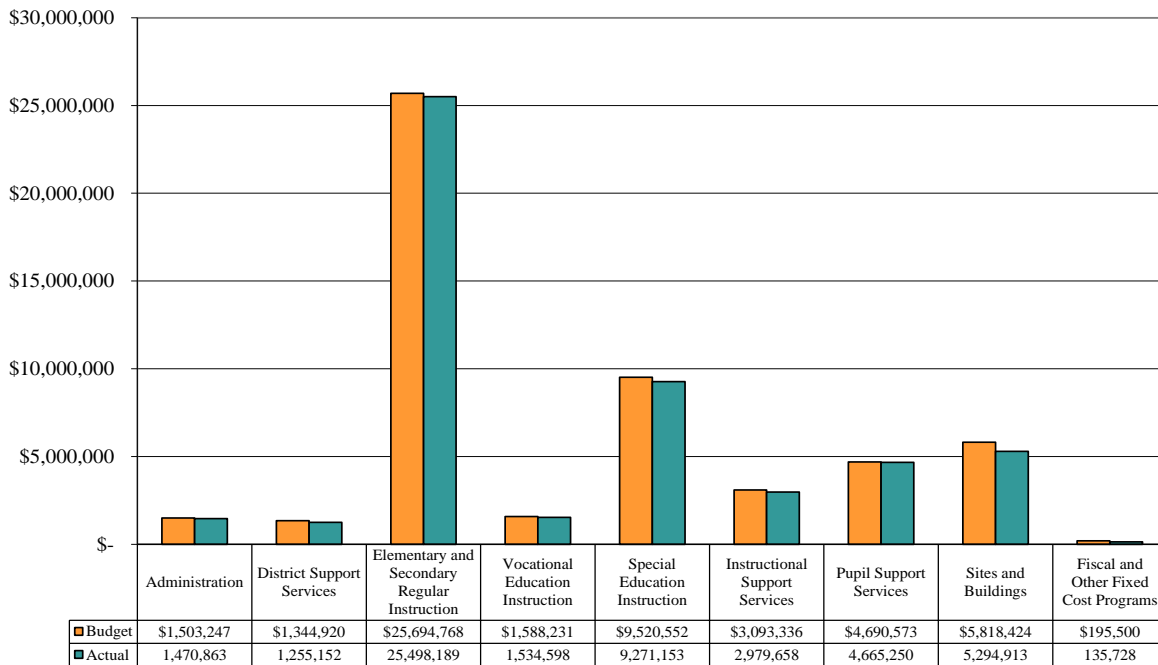
INDEPENDENT SCHOOL DISTRICT NO. 877

FINANCIAL ANALYSIS June 30, 2013

GENERAL FUND BUDGET AND ACTUAL

In total, General Fund expenditures were \$ 1,344,047 under budget. As noted in the graph below, every category was under budget. The largest variance occurred in sites and buildings due to lower than expected costs for utilities and less capital expenditures than budgeted.

**General Fund Expenditures
Budget and Actual**



INDEPENDENT SCHOOL DISTRICT NO. 877

**FINANCIAL ANALYSIS
June 30, 2013**

GENERAL FUND OPERATIONS

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

	2009	2010	2011	2012	2013
Revenues	\$ 51,882,840	\$ 52,343,017	\$ 52,333,103	\$ 54,459,515	\$ 53,539,919
Expenditures, Excluding OPEB	50,444,182	51,433,583	51,887,209	52,254,661	52,105,504
OPEB Expenditures	-	9,712,136	-	-	-
Excess of Revenues Over (Under) Expenditures	1,438,658	(8,802,702)	445,894	2,204,854	1,434,415
Transfers/Other Financing Sources	1,473	11,082,861	396,910	109,046	(13,556)
Fund Balance, July 1	7,496,270	8,936,401	11,216,560	12,059,364	14,373,264
Fund Balance, June 30	\$ 8,936,401	\$ 11,216,560	\$ 12,059,364	\$ 14,373,264	\$ 15,794,123
Components:					
Unreserved/Unassigned Nonspendable	\$ 4,255,850	\$ 6,151,513	\$ 6,277,042	\$ 7,719,781	\$ 8,361,633
Reserved/Restricted for:	-	-	398,695	417,092	312,765
Staff Development	74,801	74,801	74,801	74,801	74,801
Severance Pay	658,484	-	-	-	-
Deferred Maintenance	-	18,871	11,890	981	13
Operating Capital	390,331	38,273	61,415	111,840	368,212
Health and Safety	128,458	147,396	(77,456)	(112,811)	(65,661)
Designated/Committed/Assigned for:					
Separation Benefits	1,834,523	3,474,913	3,965,750	4,118,869	4,689,661
Student Activities	278,117	202,258	171,444	134,880	143,576
3rd Party Special Education	260,000	-	186,840	422,029	501,964
Stimulus	-	341,200	273,509	66,543	66,543
Capital	327,355	327,355	327,355	1,000,000	775,750
Carryover	469,191	164,257	138,181	171,929	341,646
Dental Insurance	259,291	275,723	249,898	247,330	223,220
Total	\$ 8,936,401	\$ 11,216,560	\$ 12,059,364	\$ 14,373,264	\$ 15,794,123

As previously stated, total General Fund revenue decreased 1.7% from 2012 to 2013 as a result of decreases in federal funding received, medical assistance reimbursements and the STEM Grant received in 2012, these decreases were partially offset by an increase in General Education Aid due to increased enrollment and changes in the formula allowance.

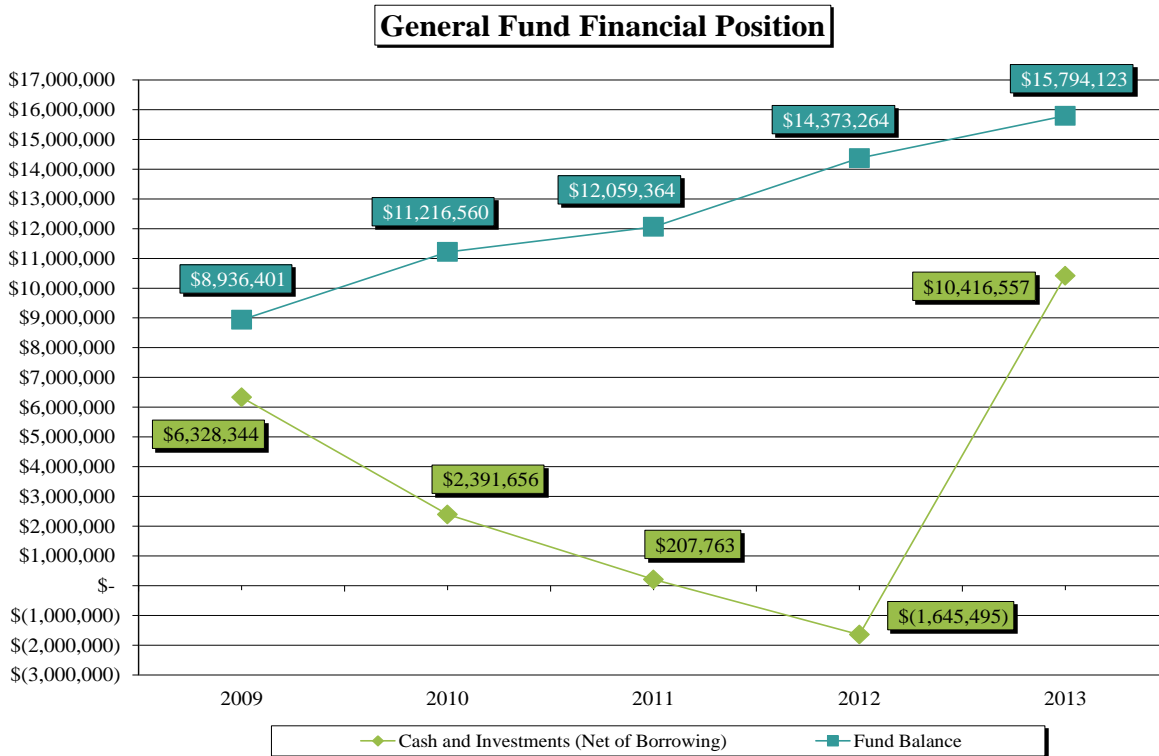
Total General Fund expenditures decreased 0.3% from 2012 to 2013.

Revenues exceeded expenditures during 2013, and with the other financing sources, the fund balance increased \$ 1,420,859, or 9.9%, resulting in an increase in the unassigned fund balance.

INDEPENDENT SCHOOL DISTRICT NO. 877

FINANCIAL ANALYSIS June 30, 2013

GENERAL FUND OPERATIONS



This graph outlines the cash and investments (net of borrowing) and the fund balance for the General Fund for the past five years. A healthy fund balance allows the District to maintain a positive operating cash position when expenditures are timed prior to the receipt of significant revenues, including state aid and local property tax levies. At year-end when expenditure needs are significant and revenue receipts are delayed until subsequent to year-end, an increased positive fund balance position reduces the reliance on short-term borrowing.

The state had previously been metering state aids at 90%; this dropped to 73% in 2010, 70% in 2011 and 64.3% in 2012. The state also reenacted the property tax shift in which property tax revenues were early recognized in place of state aids during year 2011. In 2013, the state metered payments at 85%. This change caused a significant improvement in the cash and investment position.

INDEPENDENT SCHOOL DISTRICT NO. 877

FINANCIAL ANALYSIS

June 30, 2013

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,	2009	2010	2011	2012	2013
Revenues	\$ 2,701,594	\$ 2,757,354	\$ 2,859,338	\$ 2,884,441	\$ 2,842,939
Expenditures, Excluding OPEB	2,788,100	2,693,406	2,825,861	2,993,198	2,887,006
OPEB Expenditures	-	352,780	-	-	-
Excess of Revenues Over (Under) Expenditures	(86,506)	(288,832)	33,477	(108,757)	(44,067)
Transfers/Other Financing Sources	6,860	353,180	-	-	16,677
Fund Balance, July 1	117,968	38,322	102,670	136,147	27,390
Fund Balance, June 30	\$ 38,322	\$ 102,670	\$ 136,147	\$ 27,390	\$ -

Expenditures once again exceeded revenues in the Food Service Fund. Food service revenues decreased 1.4% due to a decrease in sales or a reduction in meals served while expenditures decreased 3.6% due to the reduction in meals served. 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,	2009	2010	2011	2012	2013
Revenues	\$ 2,826,137	\$ 2,794,718	\$ 2,998,587	\$ 3,280,332	\$ 3,600,629
Expenditures, Excluding OPEB	2,857,589	2,761,569	2,988,036	3,222,834	3,757,184
OPEB Expenditures	-	625,383	-	-	-
Excess of Revenues Over (Under) Expenditures	(31,452)	(592,234)	10,551	57,498	(156,555)
Transfers/Other Financing Sources	3,743	625,383	-	-	-
Fund Balance, July 1	272,409	244,700	277,849	288,400	345,898
Fund Balance, June 30	\$ 244,700	\$ 277,849	\$ 288,400	\$ 345,898	\$ 189,343

Components:

Unreserved/Unassigned	\$ 12,550	\$ 8	\$ -	\$ -	\$ -
Restricted/Reserved for:					
Community Service	-	-	7,860	9,981	2
ECFE	69,226	133,840	99,645	78,951	28,276
Community Education	107,205	83,107	129,672	212,281	138,066
School Readiness	44,430	48,587	40,554	32,303	10,494
Adult Basic Education	11,289	12,307	10,669	12,382	12,505
Total	\$ 244,700	\$ 277,849	\$ 288,400	\$ 345,898	\$ 189,343

During the year ended June 30, 2013, expenditures exceeded revenues for the first time in three years. Revenues increased 9.8% while expenditures increased 16.6%; both increased as a result of the District adding a daycare program.

INDEPENDENT SCHOOL DISTRICT NO. 877

LEGISLATIVE SUMMARY June 30, 2013

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

STATE AID APPROPRIATIONS

Total appropriations from the state general fund for E-12 education, are \$ 7.6 billion for 2014 and \$ 8.0 billion for 2015, or a total of \$ 15.6 billion for the biennium. This includes the addition of funding for all-day kindergarten, beginning in 2015.

The formula allowance for 2013 General Education Aid was increased \$ 50 to \$ 5,224. For 2014, the formula allowance will increase \$ 78 (1.5%) to \$ 5,302. For 2015 and later, the formula allowance is set at \$ 5,806, which is an increase of \$ 80 (1.5%) over 2014 after adjusting for the change in pupil unit weights and the elimination of the aid subtraction for pension rate changes. Beginning in 2015, basic revenue is calculated using adjusted pupil units with the new pupil weights rather than adjusted marginal cost pupil units.

Given the February 2013 budget forecast for the state, education appropriations have been changed from 64.3% current funding at the beginning of 2013 to 86.4% current funding at the end of 2013.

The ability of school districts and charter schools to generate extended time revenue for programs designed to accelerate grade level advancement so that students graduate before their peers is eliminated.

In 2015 the extended time revenue allowance increases from \$ 4,601 to \$ 5,017 to adjust for the change in pupil weights. Also in 2015, the gifted and talented revenue increases from \$ 12 to \$ 13 to adjust for the change in pupil weights.

For 2015 and later, alternative teacher compensation revenue (Q Comp) will be changed from a component of general education revenue to a separate categorical revenue, and adds declining enrollment revenue, pension adjustment revenue and location equity revenue as new components of general education revenue. The funding amount did not change.

Beginning in 2014, small schools revenue is changed to include small high schools in geographically isolated school districts with more than one high school in the small schools revenue formula. The small schools revenue formula is adjusted for the new pupil weights by increasing the maximum allowance from \$ 522.40 to \$ 544.00 and reducing the maximum pupil units to qualify from 1,000 to 960.

Marginal cost calculations will be eliminated from the definition of pupil units. Beginning in 2015, a new component of general education revenue, "declining enrollment revenue," will be established to replace funding previously provided to districts with declining enrollment through marginal cost pupil units. The declining enrollment revenue is set to equal the decline in adjusted pupil units between the prior year and the current year times 28% of the formula allowance.

INDEPENDENT SCHOOL DISTRICT NO. 877

LEGISLATIVE SUMMARY

June 30, 2013

STATE AID APPROPRIATIONS

The compensatory revenue formula for 2015 and later is adjusted to neutralize the impact of the change in pupil unit weights by deducting \$ 839 from the formula allowance for compensatory revenue calculations instead of \$ 415. Districts will be allowed to use up to 5% of its compensatory revenue for programs designed to prepare children for entry into school including early education programs, parent-training programs, school readiness programs, early kindergarten programs for four-year olds, and voluntary home visits and other outreach. This is in addition to the 5% that districts currently have flexibility with. The remaining 90% of compensatory revenue must be spent at the site where the revenue is generated.

For 2015 and later, \$ 530 will be deducted from the formula allowance used in calculating elementary and secondary scarcity revenue to neutralize the impact of pupil unit weighting changes. The transportation scarcity formula was also adjusted to account for the removal of marginal cost pupil unit accounting and the new pupil weights.

Beginning in 2015, the operating capital allowances are adjusted to compensate for the elimination of marginal cost pupil units and the new pupil unit weights. The basic rate increases from \$ 73 to \$ 79; the sliding scale rate based on building age increases from \$ 100 to \$ 109; and the learning year rate increases from \$ 30 to \$ 31. Beginning in 2015, the equalizing factor for operating capital will increase from \$ 10,194 to \$ 14,500 to adjust for the change in pupil unit weights and reduce the property tax share of operating capital revenue to offset the new general education levy. The allowable uses of operating capital revenue are also clarified by including computer hardware, software, and annual licensing fees, and cross referencing the definition of textbooks in the nonpublic pupil aid statute.

Beginning in 2015, a new component of general education revenue for districts with below average reduction for changes in employer pension contributions is established. The revenue per pupil unit is set to equal the difference between the district's 2014 pension adjustment per pupil unit and the state average year 2014 aid reduction per pupil unit.

Beginning in 2015, location equity revenue is established as a new component of general education revenue. For a district with any of its area in the seven-county metropolitan area, the revenue equals \$ 424 times the adjusted pupil units (APU) for that school year. For all other school districts with more than 2,000 pupils in average daily membership, for the year ending in the year before the levy is certified (2012 for 2015 revenue), the revenue equals \$ 212 times the APU for the school year. Location equity is an equalized levy spread on referendum market value (RMV); the equalizing factor is \$ 510,000. If a district levies less than the maximum amount, the aid is reduced proportionately. A district may opt out of the revenue by adopting a board resolution prior to September 1 of the year prior to the year for which the decision to opt out becomes effective (September 1, 2013 for FY 2015 revenue). For participating districts, the location equity allowance is subtracted from the referendum allowance.

INDEPENDENT SCHOOL DISTRICT NO. 877

LEGISLATIVE SUMMARY

June 30, 2013

STATE AID APPROPRIATIONS

Beginning in 2015, school districts are allowed to use general education revenue generated for all-day kindergarten to meet the needs of three and four year olds in the district. This does not apply to a district with a fee-based all-day kindergarten.

The early graduation scholarships and military service awards programs were repealed and will be removed from the general education appropriation beginning in 2014.

Beginning in 2014, the career and technical education (CTE) levy is converted to an equalized aid and levy, with an equalizing factor of \$ 7,612. The statewide revenue limit for CTE revenue is increased for 2014 from \$ 15,393,000 to \$ 20,657,000. Revenue for 2014 continues to be based on the old CTE formula, with the proration factor adjusted to hit the statewide revenue target. Beginning in 2015, the statewide revenue limit expires and revenue is computed using the new formula enacted in 2012 that bases funding on 35% of approved program expenditures.

The staff development set aside requirement is reinstated for 2014. However, districts will no longer be required to allocate 50% of staff development revenue to sites on a per teacher basis, 25% to sites for best practices and 25% for district-wide staff development.

PUPIL ACCOUNTING REFORM

Beginning in 2015, pupil accounting reform will occur and pupil unit weights will change as follows:

Prekindergarten and Disabled	From 1.25	To 1.0
Part-time Kindergarten	From .612	To .55
All-Day Kindergarten	From .612	To 1.0
Grades 1-3	From 1.115	To 1.0
Grades 4-6	From 1.06	To 1.0
Grades 7-12	From 1.3	To 1.2

To qualify for all-day kindergarten weight, a pupil must be enrolled in a free all-day every day kindergarten program that is available to all kindergarten students at the pupil's school and must include at least 850 hours of instruction.

INDEPENDENT SCHOOL DISTRICT NO. 877

LEGISLATIVE SUMMARY June 30, 2013

GENERAL EDUCATION LEVY REFORM

Beginning in 2015, a district is allowed to convert up to \$ 300 per APU of voter-approved referendum revenue to board-approved referendum revenue by board vote. For a district with less than \$ 300 per APU of referendum revenue after the location equity revenue subtraction, the school board is allowed to authorize new referendum revenue up to the difference between \$ 300 per APU and the district's net referendum allowance after the location equity revenue subtraction.

There is an operating referendum freeze that prohibits a district from conducting a referendum election to increase its referendum allowance for 2015.

A new uniform general education levy called the "Student Achievement Levy" is established. All districts may levy up to the general education rate. If a district levies less than the permitted rate, its general education aid is reduced proportionally.

MISCELLANEOUS LEVIES

The maximum rate for the building lease levy is changed from \$ 150 to \$ 162 per pupil unit for districts and from \$ 43 to \$ 46 for intermediate district members to adjust for the pupil unit weighting changes.

The safe school levy for taxes payable in 2014 and later was increased from \$ 30 to \$ 36 per pupil unit. \$ 4 of the increase is new revenue while the other \$ 2 is to adjust for pupil unit weighting changes. The uses of the levy are also expanded to include facility security enhancements, efforts to improve the school climate and costs associate with mental health services.

EARLY CHILDHOOD AND COMMUNITY EDUCATION

An early learning scholarship program was established. For a family to receive a scholarship, it must have a child age 3 or 4 on September 1 of the current year and have income equal to or less than 185% of the federal poverty level. Scholarships may be awarded up to \$ 5,000 per child per year.

The growth factor for adult basic education increased from 1.02 to 1.025 for 2015 and later.

Beginning in 2014, there will no longer be reserve account limits and associated aid and levy penalties for community education, early childhood family education (ECFE) and school readiness.

EDUCATION EXCELLENCE

District may now use the 2% of basic revenue set aside for staff development for teacher evaluation.

A new formula for achievement and integration is established for 2014. An eligible district's achievement and integration revenue equals the sum of the district's initial integration revenue and incentive revenue. At least 80% of a district's revenue is required to be used for innovative and integrated learning environments. Up to 20% is allowed to be used for professional and staff development. Administration expenditures can be no more than 10%.

INDEPENDENT SCHOOL DISTRICT NO. 877

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SPECIAL EDUCATION

A new special education formula is enacted beginning in 2016. To provide for a transition to the new formula, the current special education regular formula remains in place for 2014 and 2015, but a new cross subsidy reduction aid is added for 2014 and 2015. The cross subsidy reduction aid entitlement is \$ 13 million for 2014 and \$ 30 million for 2015.

For 2014 and 2015, special education aid equals the sum of the capped regular special education aid under the old law formula, plus the cross subsidy reduction aid, plus the capped excess cost aid. Beginning in 2016, special education aid equals the sum of the new formula aid plus the new formula excess cost aid.

State total special education aid is increased by \$ 39 million for 2016 and by \$ 41 million for 2017.

Beginning in 2015, tuition billing is changed so that the resident district is responsible for 90% of unfunded costs (vs. 100% currently) and the serving district/charter school is responsible for 10% of unfunded costs for open-enrolled students. Intermediate districts, cooperatives and charter schools where at least 70% of students are eligible for special education are exempt from this provision and continue to be able to recover 100% of unfunded special education costs from the resident district. This also does not apply to students placed by the resident district (e.g. at an intermediate district), or served at a charter school with very high special education concentration.

Beginning in 2016, special education aid will be paid directly to cooperatives and intermediate districts, rather than having those aids flow through the resident district. Tuition bills will be reduced to offset the aid paid to the cooperative and intermediaries.

Special education excess cost aid will be calculated using prior year data beginning in 2014. Special education tuition receipts and expenditures will not be taken into account in excess cost aid calculations to expedite the excess cost aid calculations and eliminate circularity between tuition billing and excess cost aid.

FACILITIES AND TECHNOLOGY

The health and safety levy, deferred maintenance revenue and telecommunications aid were all adjusted to conform to the new pupil weights.

INDEPENDENT SCHOOL DISTRICT NO. 877

LEGISLATIVE SUMMARY June 30, 2013

PERSONNEL AND ACCOUNTING

For 2014, all districts are required to adopt and maintain an annual principal evaluation process consistent with provisions in state statutes. Principal evaluations will be a required duty of the superintendent. The MDE developed a model for this evaluation which is piloted in certain districts for the 2013 school year.

For 2015, all districts are required to adopt and maintain a teacher evaluation process consistent with provisions in state statutes. The MDE is in the process of developing a model for this evaluation, which will be piloted in certain districts for the 2014 school year.

The authority for districts to make unlimited fund transfers that do not increase state aid or levy obligations is extended to 2014 and 2015. Districts will follow the same procedures outlined for 2012 and 2013, with one change:

- 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. The application must also be signed by the superintendent and approved by the school board. The change in requirements for 2014 and 2015 is that a transfer cannot be made from the reserved account for staff development revenue as the 2% set aside requirement has been reinstated for those years.

SCHOOL NUTRITION

The rate for each school lunch served increased from 12 to 12.5 cents beginning July 1, 2013.