

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

MANAGEMENT LETTER

For the Fiscal Year Ended June 30, 2012

INDEPENDENT SCHOOL DISTRICT NO. 877

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

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

In planning and performing our audit of the financial statements of Independent School District No. 877, Buffalo-Hanover-Montrose, Minnesota, as of and for the fiscal year ended June 30, 2012, in accordance with U.S. generally accepted auditing standards, we considered the District's internal control over financial reporting (internal control) as a basis for designing our auditing procedures for the purpose of expressing our opinions on the financial statements, but not for the purpose of expressing an opinion on the effectiveness of the District's internal control. Accordingly, we do not express an opinion on the effectiveness of the District's internal control.

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

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

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

The accompanying memorandum includes financial analysis and recommendations for improvement of accounting procedures and internal control measures that came to our attention as a result of our audit of the financial statements of the District for the fiscal year ended June 30, 2012. 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 3, 2012, on such statements.

KDV

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, Vice Ad

KERN, DEWENTER, VIERE, LTD.
Bloomington, Minnesota
October 3, 2012

INDEPENDENT SCHOOL DISTRICT NO. 877

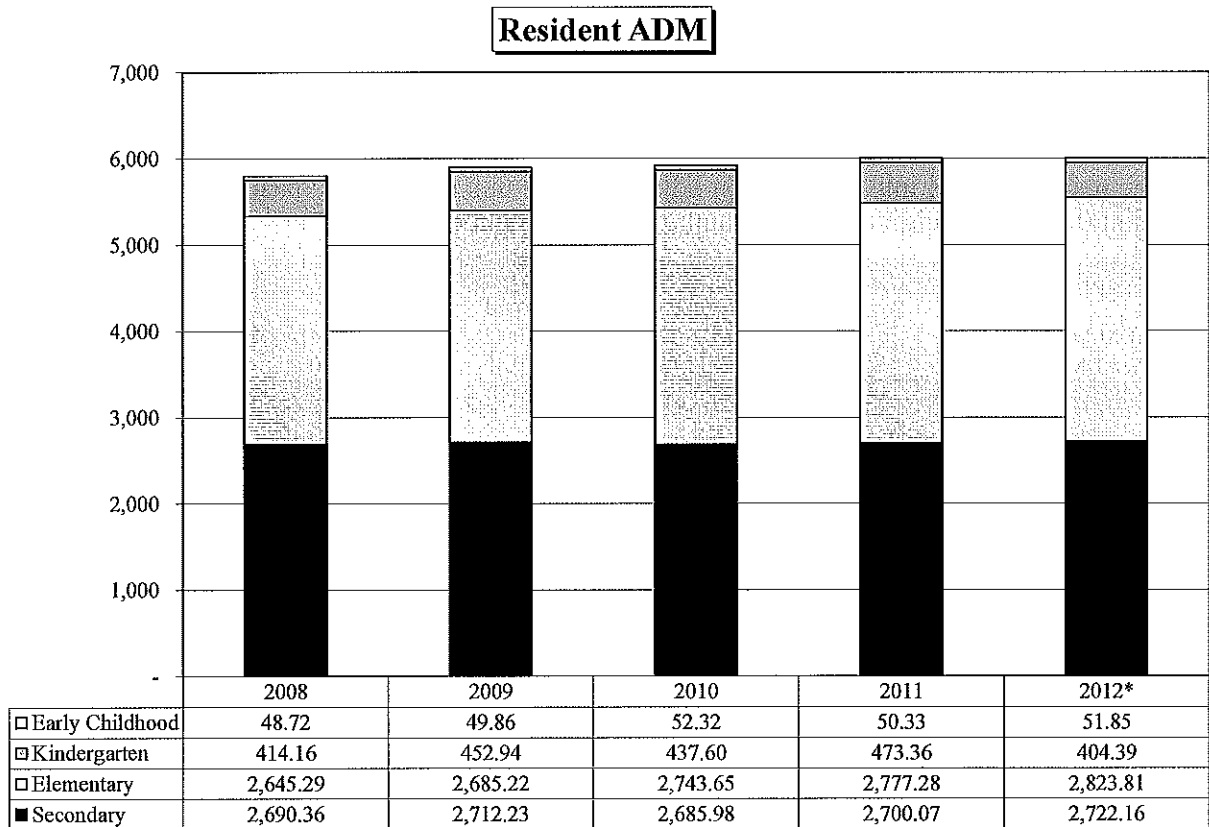
FINANCIAL ANALYSIS June 30, 2012

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 80% 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 fiscal years ended June 30.

ADM	2008	2009	2010	2011	2012*
Early Childhood	48.72	49.86	52.32	50.33	51.85
Kindergarten	414.16	452.94	437.60	473.36	404.39
Elementary	2,645.29	2,685.22	2,743.65	2,777.28	2,823.81
Secondary	2,690.36	2,712.23	2,685.98	2,700.07	2,722.16
Total Resident ADM	5,798.53	5,900.25	5,919.55	6,001.04	6,002.21



* Estimate as of August 13, 2012

INDEPENDENT SCHOOL DISTRICT NO. 877

**FINANCIAL ANALYSIS
June 30, 2012**

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 3.5% since 2008 and remained consistent from 2011 to 2012, increasing only 0.02%.

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
Fiscal 2008-2012	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	2008	2009	2010	2011	2012*
Residents	6,702.95	6,797.13	6,823.62	6,891.87	6,934.42
Resident WADM Loss	(516.72)	(530.42)	(571.14)	(617.96)	(678.85)
Nonresident WADM Gain	403.13	419.40	415.10	409.91	400.87
Total WADM Served	6,589.36	6,686.11	6,667.58	6,683.82	6,656.44

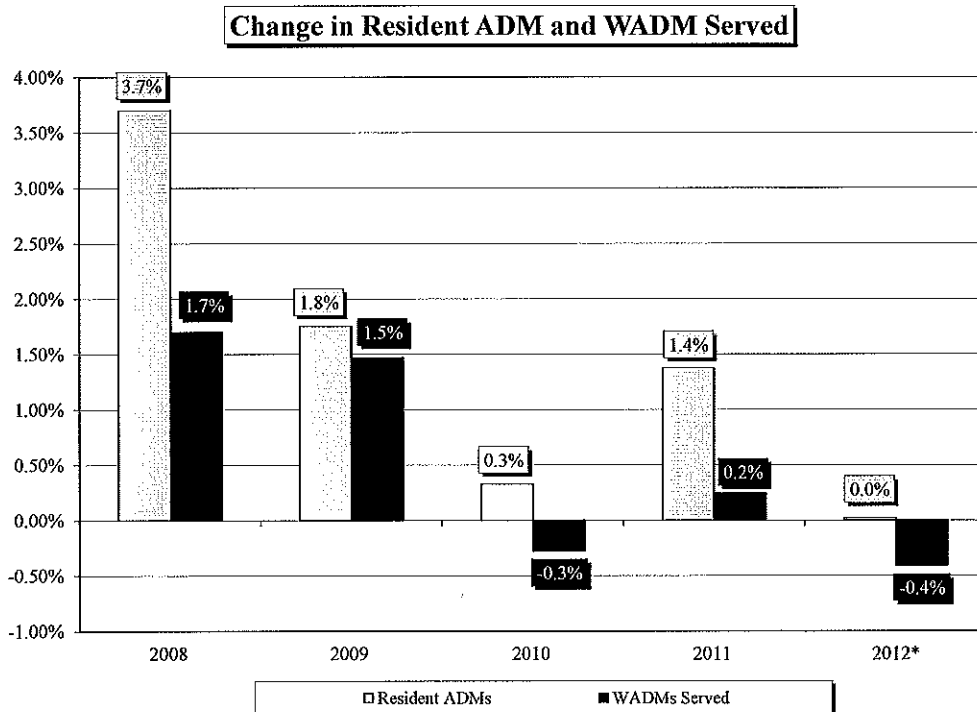
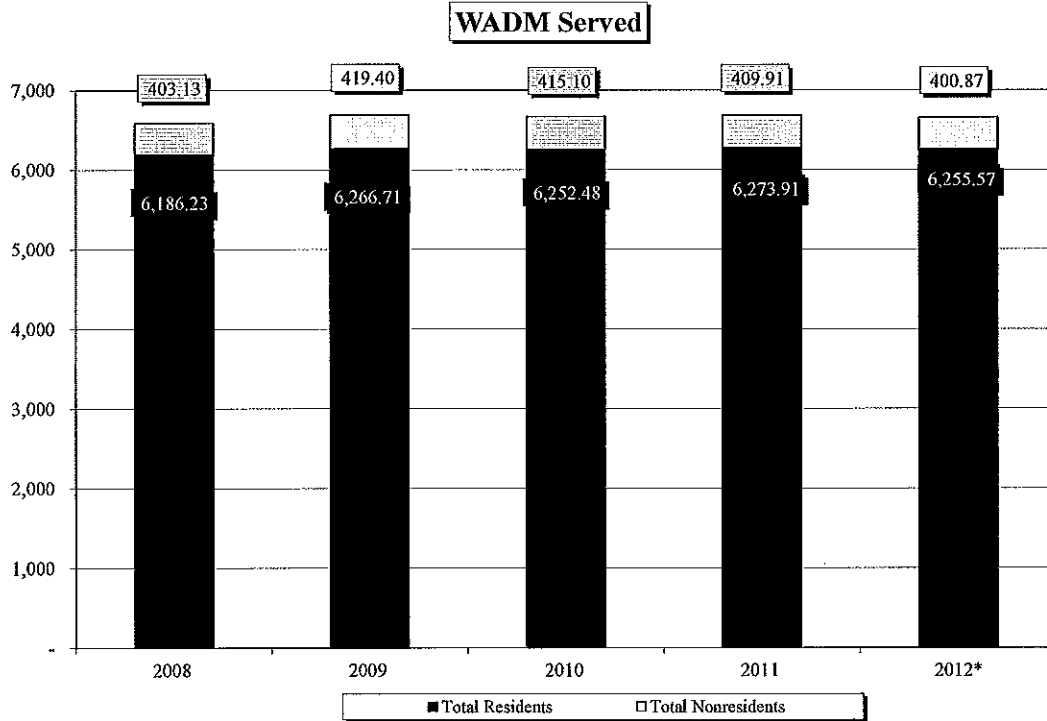
* Estimate as of August 13, 2012

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 2011 to 2012 there was a 27.4 decrease in WADM, due to an increase in resident WADM loss and a decrease in nonresident WADM gain. The District lost 9.8% of its resident WADM to neighboring districts, at the same time, 6.0% of WADM served are coming from outside the District.

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FINANCIAL ANALYSIS
June 30, 2012

WEIGHTED AVERAGE DAILY MEMBERSHIP SERVED



* Estimate as of August 13, 2012

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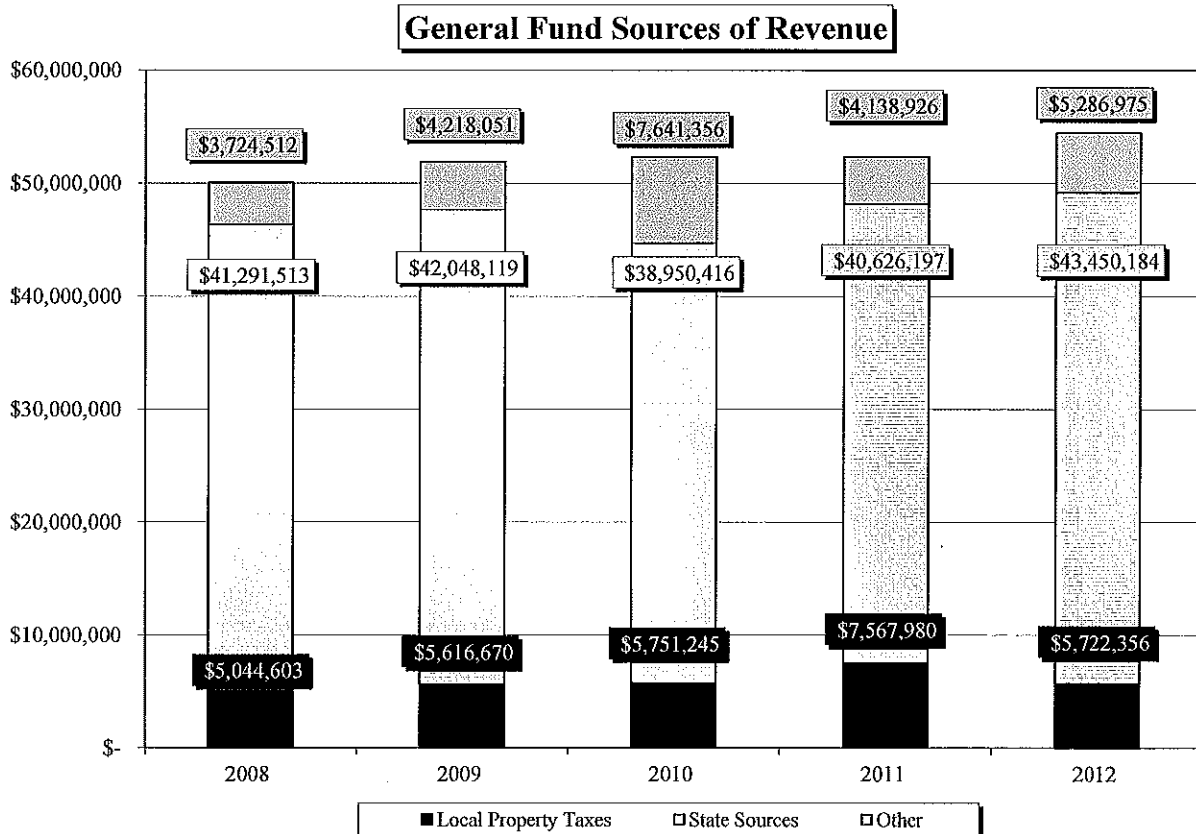
**FINANCIAL ANALYSIS
June 30, 2012**

GENERAL FUND SOURCES OF REVENUE

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

	2008	2009	2010	2011	2012
Local Property Taxes	\$ 5,044,603	\$ 5,616,670	\$ 5,751,245	\$ 7,567,980	\$ 5,722,356
State Sources	41,291,513	42,048,119	38,950,416	40,626,197	43,450,184
Other	3,724,512	4,218,051	7,641,356	4,138,926	5,286,975
Total	\$ 50,060,628	\$ 51,882,840	\$ 52,343,017	\$ 52,333,103	\$ 54,459,515

State revenue sources, which make up approximately 79.8% of total revenues, increased by \$ 2,823,987 for the fiscal year ended June 30, 2012, while local property taxes decreased by \$ 1,845,624 and other sources increased \$ 1,148,049. Included in other revenues are local, county and federal revenues. Factors contributing to these changes include a large tax shift for fiscal year 2011, where the state shifted revenue from state sources to property taxes and the District recognized a portion of next year's levy as current year revenue, an increase in the formula allowance also had some impact on the increase in state revenues. Other revenues increased due to the STEM Grant received through Northwest Suburban Integration District, an increase in medical assistance reimbursements which vary each year based on student needs and increased federal dollars most of which related to the Education Jobs Program, the increase in this Program was partially offset by decreases in American Reinvestment and Recovery Act (ARRA) for Title 1 and special education. General Fund revenue increased 4.1% from 2011 to 2012.



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**FINANCIAL ANALYSIS
June 30, 2012**

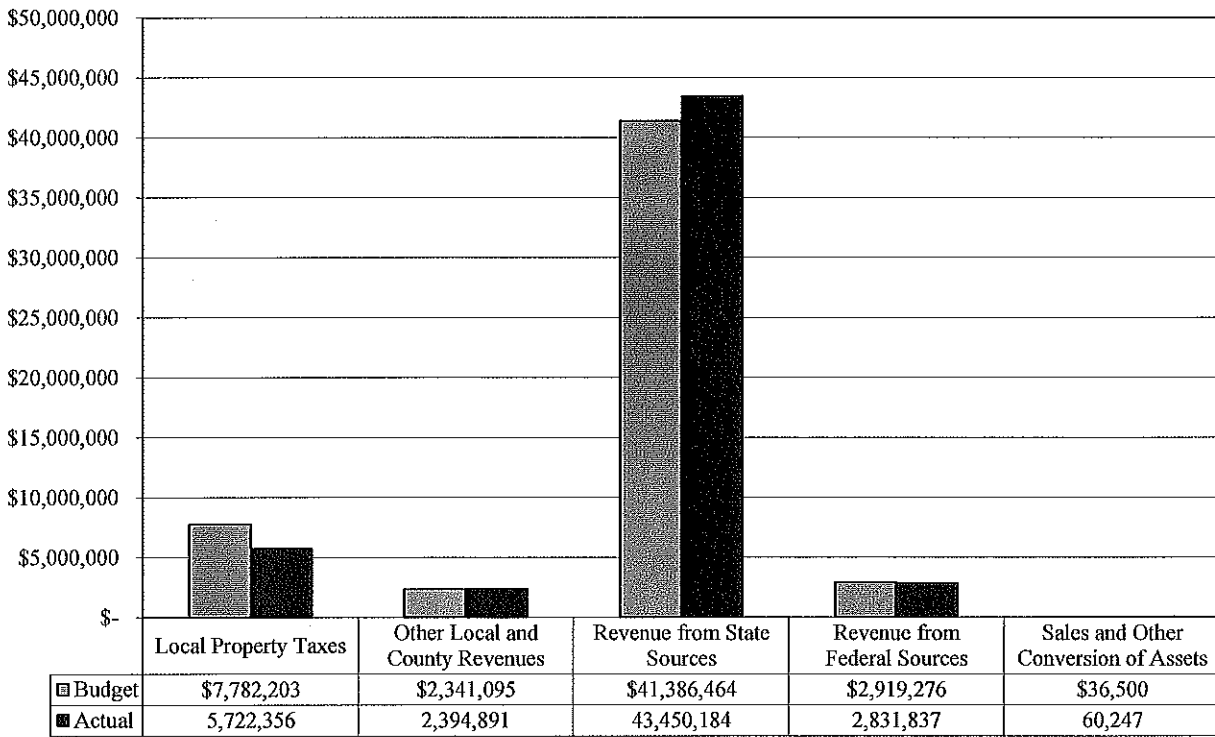
GENERAL FUND REVENUES BUDGET AND ACTUAL

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

In June 2011, the District approved a General Fund revenue budget of \$ 53,378,666. This was modified in May 2012 by \$ 1,086,872 to a final revenue budget of \$ 54,465,538. With actual revenues coming in at \$ 54,459,515, the final budget produced a variance of \$ (6,023), or 0.01%.

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.

**2012 General Fund Revenues
Budget and Actual**



INDEPENDENT SCHOOL DISTRICT NO. 877

**FINANCIAL ANALYSIS
June 30, 2012**

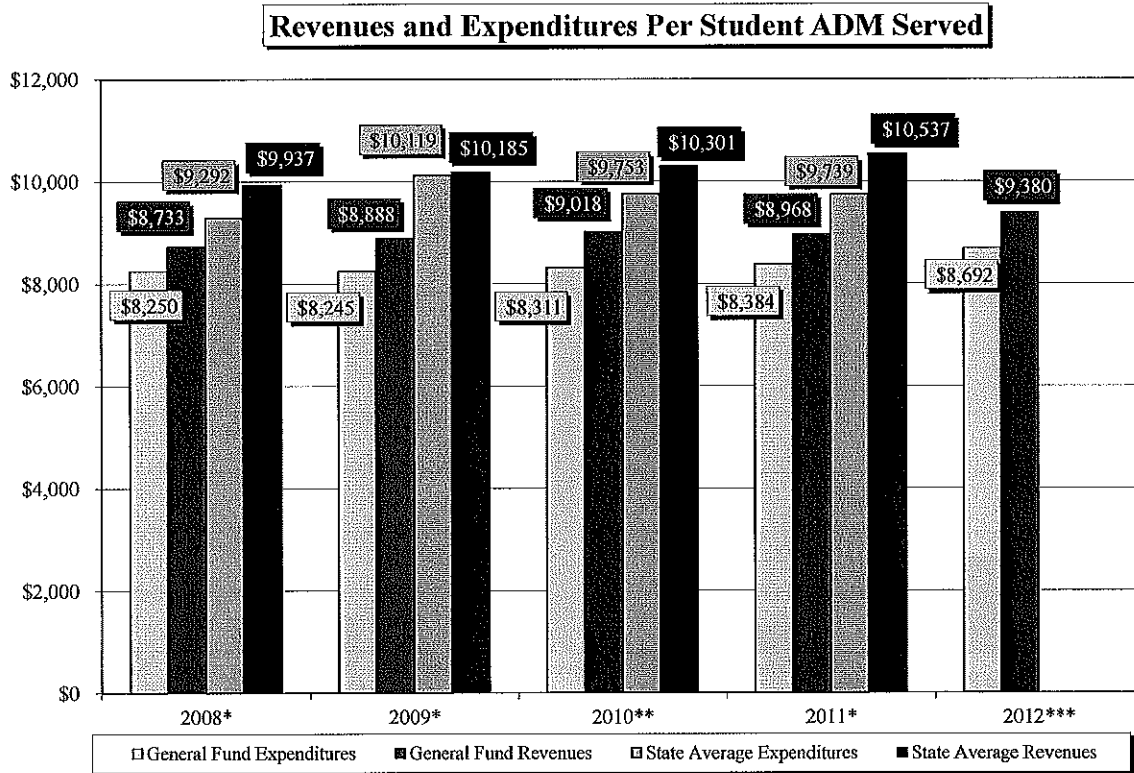
REVENUES AND EXPENDITURES PER ADM SERVED

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

	2008*	2009*	2010**	2011*	2012***
General Fund	\$ 8,733	\$ 8,888	\$ 9,018	\$ 8,968	\$ 9,380
General Fund State Average	9,937	10,185	10,301	10,537	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:

	2008*	2009*	2010**	2011*	2012***
General Fund	\$ 8,250	\$ 8,245	\$ 8,311	\$ 8,384	\$ 8,692
General Fund State Average	9,292	10,119	9,753	9,739	N/A



* Source: *School District Profiles*

** Estimate excluding OPEB costs in the General Fund

*** Estimate as of August 13, 2012; state-wide averages are not available

The District has seen an increase in revenues and expenditures per student ADM served from 2008 to 2012. Revenues per ADM served increased 4.6% from 2011 to 2012, while expenditures per ADM served increased 3.7% 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.

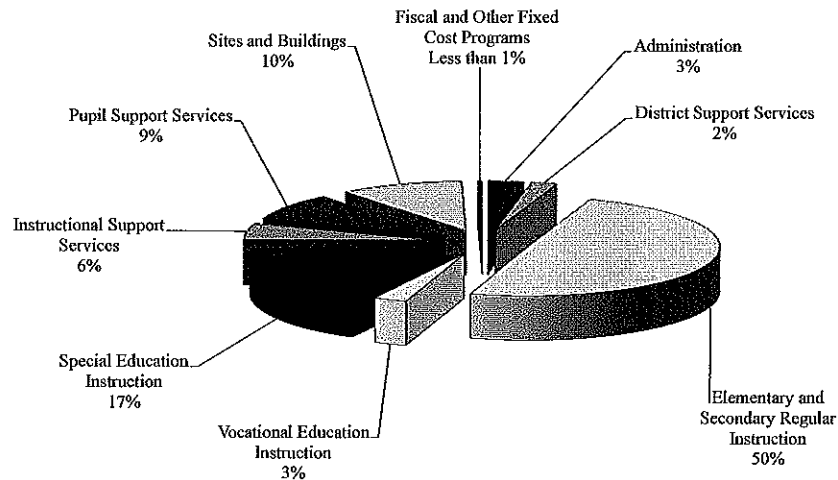
INDEPENDENT SCHOOL DISTRICT NO. 877

FINANCIAL ANALYSIS June 30, 2012

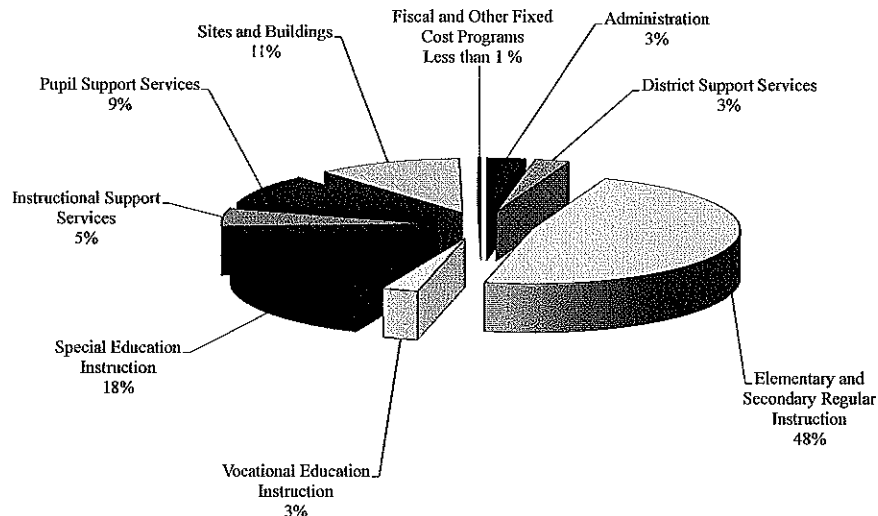
GENERAL FUND EXPENDITURES

The graphs below depict the percentage of expenditures by function in the General Fund for fiscal years 2011 and 2012. Expenditures increased by \$ 367,452, or 0.7%, from 2011 to 2012, and the allocation of expenditures remained very consistent. Education programs made up approximately 69% and 70% of the District's expenditures, and only 6% and 5% were attributable to administration and District support services for 2011 and 2012, respectively.

General Fund Expenditures 2012



General Fund Expenditures 2011



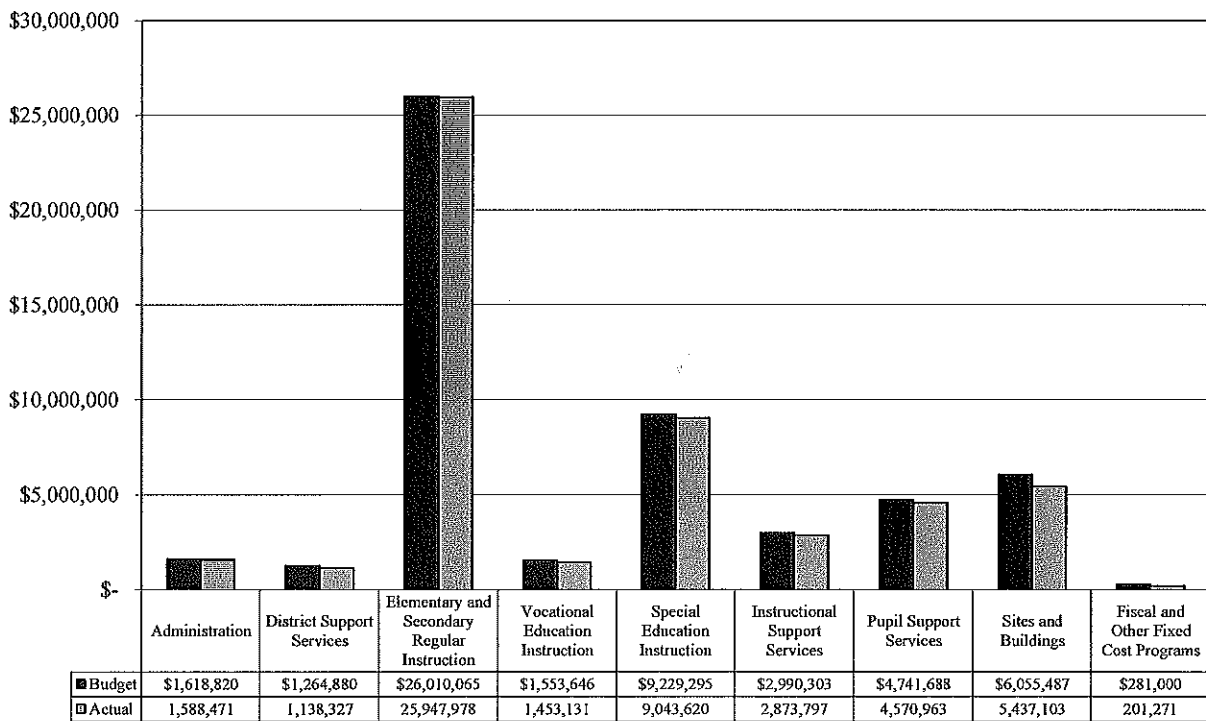
INDEPENDENT SCHOOL DISTRICT NO. 877

**FINANCIAL ANALYSIS
June 30, 2012**

GENERAL FUND BUDGET AND ACTUAL

In total, General Fund expenditures were \$ 1,490,523 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 snow removal and fuel costs for heating with a mild winter.

**2012 General Fund Expenditures
Budget and Actual**



INDEPENDENT SCHOOL DISTRICT NO. 877

**FINANCIAL ANALYSIS
June 30, 2012**

GENERAL FUND OPERATIONS

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

	2008	2009	2010	2011	2012
Revenues	\$ 50,060,628	\$ 51,882,840	\$ 52,343,017	\$ 52,333,103	\$ 54,459,515
Expenditures, Excluding OPEB	49,795,805	50,444,182	51,433,583	51,887,209	52,254,661
OPEB Expenditures	-	-	9,712,136	-	-
Excess of Revenues Over (Under) Expenditures	264,823	1,438,658	(8,802,702)	445,894	2,204,854
Transfers/Other Financing Sources	-	1,473	11,082,861	396,910	109,046
Fund Balance, July 1	7,231,447	7,496,270	8,936,401	11,216,560	12,059,364
Fund Balance, June 30	\$ 7,496,270	\$ 8,936,401	\$ 11,216,560	\$ 12,059,364	\$ 14,378,264
Components:					
Unreserved/Unassigned	\$ 4,233,226	\$ 4,255,850	\$ 6,151,513	\$ 6,277,042	\$ 7,719,781
Nonspendable	-	-	-	398,695	417,092
Reserved/Restricted for:					
Staff Development	-	74,801	74,801	74,801	74,801
Severance Pay	669,869	658,484	-	-	-
Deferred Maintenance	-	-	18,871	11,890	981
Operating Capital	412,851	390,331	38,273	61,415	111,840
Health and Safety	(25,350)	128,458	147,396	(77,456)	(112,811)
Designated/Committed/Assigned for:					
Separation Benefits	1,430,324	1,834,523	3,474,913	3,965,750	4,118,869
Student Activities	278,113	278,117	202,258	171,444	134,880
3rd Party Special Education	-	260,000	-	186,840	422,029
Stimulus	-	-	341,200	273,509	66,543
Capital	-	327,355	327,355	327,355	1,000,000
Carryover	269,847	469,191	164,257	138,181	171,929
Dental Insurance	227,390	259,291	275,723	249,898	247,330
Total	\$ 7,496,270	\$ 8,936,401	\$ 11,216,560	\$ 12,059,364	\$ 14,378,264

As previously stated, total General Fund revenue increased 4.1% from 2011 to 2012 as a result of increases in General Education Aid, increased federal funding received, increased medical assistance reimbursements and the STEM Grant.

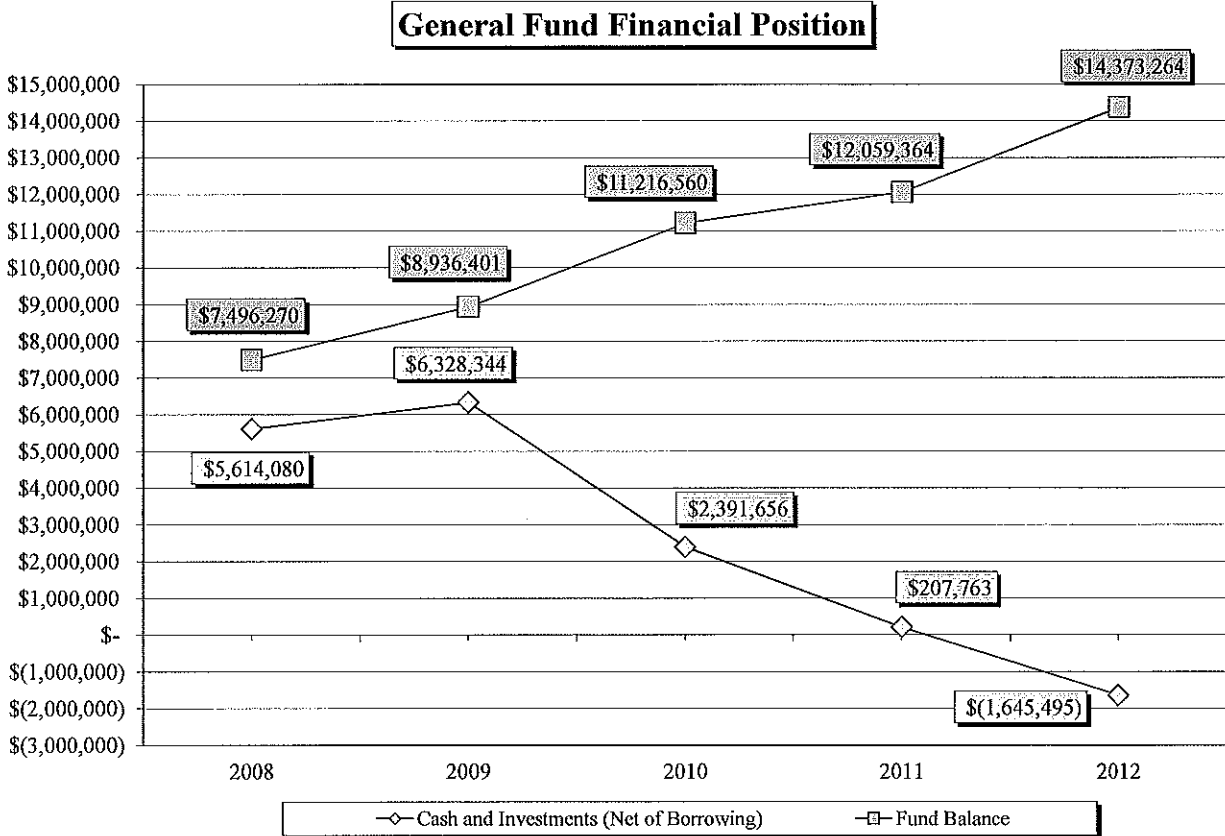
Total General Fund expenditures increased only 0.7% from 2011 to 2012. Increases in salaries and benefits for step and lane changes and contract increases accounted for most of the increase from 2011 to 2012.

Revenues exceeded expenditures during 2012, and with the other financing sources, the fund balance increased \$ 2,313,900, or 19.2%, resulting in an increase in the unassigned fund balance.

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FINANCIAL ANALYSIS
June 30, 2012

GENERAL FUND OPERATIONS



The decrease in cash and investments balance from 2009 to 2012 is a result of state hold-backs in aid. During 2009, the District saw approximately 10% of General Education Aid held back by the state; during 2010, that amount increased to 27%, for 2011, further increased to 30%; and finally in 2012 increased to 35.7%. The state also reenacted the property tax shift in which property tax revenues were early recognized in place of state aids during fiscal year 2011.

INDEPENDENT SCHOOL DISTRICT NO. 877

FINANCIAL ANALYSIS June 30, 2012

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,	2008	2009	2010	2011	2012
Revenues	\$ 2,553,237	\$ 2,701,594	\$ 2,757,354	\$ 2,859,338	\$ 2,884,441
Expenditures, Excluding OPEB	2,770,468	2,788,100	2,693,406	2,825,861	2,993,198
OPEB Expenditures	-	-	352,780	-	-
Excess of Revenues Over (Under) Expenditures	(217,231)	(86,506)	(288,832)	33,477	(108,757)
Transfers/Other Financing Sources	-	6,860	353,180	-	-
Fund Balance, July 1	335,199	117,968	38,322	102,670	136,147
Fund Balance, June 30	\$ 117,968	\$ 38,322	\$ 102,670	\$ 136,147	\$ 27,390

Expenditures once again exceeded revenues in the Food Service Fund after positive operations in the prior year. Food service revenues increased 0.9% due to additional revenue received from the federal government for free and reduced meals, while expenditures increased 5.9% due to an increase in food costs and increases in salaries and benefits. 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,	2008	2009	2010	2011	2012
Revenues	\$ 2,787,017	\$ 2,826,137	\$ 2,794,718	\$ 2,998,587	\$ 3,280,332
Expenditures, Excluding OPEB	2,697,060	2,857,589	2,761,569	2,988,036	3,222,834
OPEB Expenditures	-	-	625,383	-	-
Excess of Revenues Over (Under) Expenditures	89,957	(31,452)	(592,234)	10,551	57,498
Transfers/Other Financing Sources	-	3,743	625,383	-	-
Fund Balance, July 1	182,452	272,409	244,700	277,849	288,400
Fund Balance, June 30	\$ 272,409	\$ 244,700	\$ 277,849	\$ 288,400	\$ 345,898

Components:					
Unreserved/Unassigned	\$ 11,914	\$ 12,550	\$ 8	\$ -	\$ -
Restricted/Reserved for:					
Community Service	-	-	-	7,860	9,981
ECFE	81,676	69,226	133,840	99,645	78,951
Community Education	136,853	107,205	83,107	129,672	212,281
School Readiness	20,553	44,430	48,587	40,554	32,303
Adult Basic Education	21,413	11,289	12,307	10,669	12,382
Total	\$ 272,409	\$ 244,700	\$ 277,849	\$ 288,400	\$ 345,898

Revenues once again exceeded expenditures in the Community Service Fund. During the fiscal year ended June 30, 2012, revenues increased 9.4% while expenditures increased 7.9%; both increased as a result of the District providing all-day Kindergarten programming.

INDEPENDENT SCHOOL DISTRICT NO. 877

LEGISLATIVE SUMMARY June 30, 2012

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

STATE AID APPROPRIATIONS

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

Given the February 2012 budget forecast for the state, education appropriations have been changed from 60% current funding to 64.3% current funding.

Residency and transportation rules for students experiencing homelessness has been clarified, making the district where the parent or legal guardian resides, the district of residence, with certain exceptions. Transportation from the district of residence to the school of enrollment must be provided by the serving district. If the parent or legal guardian moves out of the district where the student is enrolled, the student may continue to enroll in the nonresident district without approval from the resident or nonresident district. If the student is enrolled in an intermediate or cooperative, the General Education Aid is paid to the district of residence.

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

The Early Graduation Achievement Scholarship Program and Military Awards Program have been updated, resulting in a reduction in the General Education Aid received for any student who graduates early, regardless of participation in these Programs.

Beginning fiscal year 2013, the MDE will pay mileage reimbursements for Post-Secondary Education Option (PSEO) alternative students from low income families directly to post-secondary institutions, instead of requiring these students to seek reimbursement from the district of residence.

Beginning fiscal year 2013, districts are required to pay teachers who are on military leave their full salary. Current law allows districts to reduce the teacher's leave pay by the direct costs of substitute teachers.

The staff development set aside requirement is suspended for fiscal year 2013. Districts are also no longer required to allocate staff development 50% to sites on a per teacher basis, 25% for grants to sites for best practices and 25% for district-wide staff development.

The Integration Aid revenue statute is repealed for fiscal year 2014. A working group was created to make recommendations for repurposing integration revenue funds to create and sustain opportunities for students to achieve improved educational outcomes. A report was adopted for consideration for the House Education Finance hearing, but absent any legislative action, Integration Aid will sunset after the next legislative session.

INDEPENDENT SCHOOL DISTRICT NO. 877

LEGISLATIVE SUMMARY June 30, 2012

EARLY CHILDHOOD AND COMMUNITY EDUCATION

Beginning in fiscal year 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.

The early childhood education scholarship state appropriations have been reduced from \$ 4 million in fiscal year 2013 and \$ 2 million in the ongoing base, to \$ 2 million in fiscal year 2013 \$ 3 million in the ongoing base.

Early childhood screening notices printed after March 27, 2012 must include the following statement: "Early childhood development screening helps a school district identify children who may benefit from district and community resources available to help in their development. Early childhood development screening includes a vision screening that helps detect potential eye problems but is not a substitute for a comprehensive eye exam".

EDUCATION EXCELLENCE

New Literacy Incentive Aid, beginning in fiscal year 2013, includes the new Proficiency Aid and Growth Aid. Proficiency Aid is the district's 3rd grade enrollment on October 1 of the previous year times \$ 530, times its proficiency index (percent of 3rd graders meeting or exceeding proficiency.) Growth Aid is the product of a district's 4th grade enrollment on October 1 of the previous year, times \$ 530 times the percent of 4th graders making medium or high growth on the reading MCA. Funding in 2013 is capped at \$ 45,585,000 and the estimated aid proration factor is 97.8%.

Beginning with taxes payable in 2012, the career and technical levy increases to the greater of \$ 80 times the district's ADM in grades 9-12, or 35% of the approved expenditures. For taxes payable in 2015 and later, the new levy formula will simply be 35% of the approved expenditures. State-wide levy maximums for 2013 and 2014 will be \$ 15.5 million and \$ 15.4 million, respectively. With the new formula and no state-wide levy maximum for taxes payable in 2015, the levy is projected to increase to approximately \$ 23.4 million for taxes payable in 2015.

SPECIAL EDUCATION

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

FACILITIES AND TECHNOLOGY

Purchases of food service equipment made out of the food service fund on or after July 1, 2012 are no longer required to have MDE approval; however, the fund balance in the food service fund at the end of the last fiscal year must be greater than the costs of the equipment to be purchased from the fund.

The use of nonpublic pupil textbook aid has been expanded to include software or other education technology. However, software or other educational technology must not be used in religious courses, devotional exercises, religious training or any other religious activities.

Districts may now use lease levy dollars for administrative space. The district must demonstrate to the satisfaction of the commissioner that leasing the space would reduce its need to lease instructional space and the lease cost for the administrative space is no greater than the lease cost for instructional space the district would otherwise need

INDEPENDENT SCHOOL DISTRICT NO. 877

LEGISLATIVE SUMMARY

June 30, 2012

PERSONNEL AND ACCOUNTING

Beginning fiscal year 2013, districts are required to give written notice by July 1, instead of June 1, to probationary teachers whose contract it declines to renew for the following school year.

For fiscal year 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 will be piloted in certain districts for the 2013 school year.

For fiscal year 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 fiscal years 2014 and 2015. Districts will follow the same procedures outlined for fiscal years 2012 and 2013:

- 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.

INDEPENDENT SCHOOL DISTRICT NO. 877

REQUIRED COMMUNICATION

June 30, 2012

We have audited the financial statements of the District for the fiscal year ended June 30, 2012, and have issued our report dated October 3, 2012. Professional standards require that we provide you with the following information related to our audit.

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

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

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

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

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

PLANNED SCOPE AND TIMING OF THE AUDIT

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

INDEPENDENT SCHOOL DISTRICT NO. 877

**REQUIRED COMMUNICATION
June 30, 2012**

QUALITATIVE ASPECTS OF ACCOUNTING PRACTICES

Management is responsible for the selection and use of appropriate accounting policies. In accordance with the terms of our engagement letter, we will advise management about the appropriateness of accounting policies and their application. The significant accounting policies used by the District are described in Note 1 to the financial statements. No new accounting policies were adopted and the application of existing policies was not changed during fiscal year 2012. We noted no transactions entered into during the year for which there is a lack of authoritative guidance or consensus. There are no significant transactions that have been recognized in the financial statements in a different period than when the transaction occurred.

Accounting estimates are an integral part of the financial statements prepared by management and are based on management's knowledge and experience about past and current events and assumptions about future events. Certain accounting estimates are particularly sensitive because of their significance to the financial statements and because of the possibility that future events affecting them may differ significantly from those expected. The most sensitive estimates affecting the financial statements were:

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

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

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

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

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

DIFFICULTIES ENCOUNTERED IN PERFORMING THE AUDIT

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

CORRECTED AND UNCORRECTED MISSTATEMENTS

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

INDEPENDENT SCHOOL DISTRICT NO. 877

**REQUIRED COMMUNICATION
June 30, 2012**

DISAGREEMENTS WITH MANAGEMENT

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

MANAGEMENT REPRESENTATIONS

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

MANAGEMENT CONSULTATIONS WITH OTHER INDEPENDENT ACCOUNTANTS

In some cases, management may decide to consult with other accountants about auditing and accounting matters, similar to obtaining a "second opinion" on certain situations. If a consultation involves application of an accounting principle to the District's financial statements or a determination of the type of auditor's opinion that may be expressed on those statements, our professional standards require the consulting accountant to check with us to determine the consultant has all the relevant facts. We are not aware of any consultations by the District's management with other accountants during the course of our audit.

OTHER ISSUES

We generally discuss a variety of matters, including the application of accounting principles and auditing standards, with management each year prior to retention as the District's auditors. However, these discussions occurred in the normal course of our professional relationship and our responses were not a condition to our retention.

OTHER INFORMATION IN DOCUMENTS CONTAINING AUDITED FINANCIAL STATEMENTS

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

