Management Report

for

Independent School District No. 16
Spring Lake Park, Minnesota

June 30, 2018

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MMKR
CERTIFIED PUBLIC ACCOUNTANTS

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To the School Board and Management of
Independent School District No. 16
Spring Lake Park, Minnesota

We have prepared this management report in conjunction with our audit of Independent School District No. 16's (the District) financial statements for the year ended June 30, 2018. We have organized this report into the following sections:

- Audit Summary
- Funding Public Education in Minnesota
- Financial Trends of Your District
- Legislative Summary
- Accounting and Auditing Updates

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.

The purpose of this report is solely to provide those charged with governance of the District, management, and those who have responsibility for oversight of the financial reporting process comments resulting from our audit process and information relevant to school district financing in Minnesota. Accordingly, this report is not suitable for any other purpose.

Malloy, Montague, Karnowski, Radosevich & Co., P.A.

Minneapolis, Minnesota
December 4, 2018

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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 TITLE 2 U.S. CODE OF FEDERAL REGULATIONS PART 200, *UNIFORM ADMINISTRATIVE REQUIREMENTS, COST PRINCIPLES, AND AUDIT REQUIREMENTS FOR FEDERAL AWARDS* (UNIFORM GUIDANCE)

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, 2018. 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 the Uniform Guidance, 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, 2018:

- We have issued an unmodified opinion on the District's basic financial statements.

- We reported no deficiencies in the District's internal control over financial reporting that we consider 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 required to be reported under *Government Auditing Standards.*

- We reported 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 types of compliance requirements that could have a direct and material effect on each of its major federal programs.

- We reported one significant deficiency in the District's internal controls over compliance and its operation based on our testing of major federal programs. The District's controls over allowable cost time and effort documentation were not sufficient to assure that timely and adequately detailed documentation was created and retained to support all employee salaries charged to its major federal program.

- We reported no findings based on our testing of the District's compliance with Minnesota laws and regulations.

FOLLOW-UP ON PRIOR YEAR FINDINGS AND RECOMMENDATIONS

As a part of our audit of the District's financial statements for the year ended June 30, 2018, we performed procedures to follow-up on any findings and recommendations that resulted from our prior year audit. We reported the following finding that was corrected by the District in the current year:

- During our audit of the year ended June 30, 2017, we noted that the District did not obtain the required IC134 Form or Contractor's Withholding Affidavit for one of three contracts selected for testing prior to making final settlement during fiscal 2017. Based on our testing in the current year, the District implemented adequate procedures to correct this prior year finding.

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 fiscal year ended June 30, 2018. However, the District implemented the following governmental accounting standards during the fiscal year ending June 30, 2018:

- Governmental Accounting Standards Board (GASB) Statement No. 85, *Omnibus 2017,* which addresses issues that have been identified during implementation and application of certain GASB statements.

- GASB Statement No. 86, *Certain Debt Extinguishment Issues*, which improves the consistency in accounting and financial reporting for in-substance defeasances of debt.

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.

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 the current fiscal year is not finalized until after the District has closed its financial records. 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 the Minnesota Department of Education (MDE). Because of the timing of the calculations, this adjustment for the current fiscal year is not finalized until after the District has closed its financial records. 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 Position 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) and pension benefits. These obligations are calculated using actuarial methodologies primarily described in GASB Statement Nos. 68, 74, and 75. These actuarial calculations include significant assumptions, including projected changes, healthcare insurance costs, investment returns, retirement ages, proportionate share, 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.

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

The financial statement disclosures are neutral, consistent, and clear.

DIFFICULTIES ENCOUNTERED IN PERFORMING THE AUDIT

We encountered no significant 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 clearly trivial, and communicate them to the appropriate level of management. There were no misstatements detected as a result of audit procedures that were material, either individually or in the aggregate, to each opinion unit's financial statements taken as a whole.

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 have requested certain representations from management that are included in the management representation letter dated December 4, 2018.

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.

OTHER MATTERS

We applied certain limited procedures to the management's discussion and analysis and the pension and OPEB-related required supplementary information (RSI) that supplements the basic financial statements. Our procedures consisted of inquiries of management regarding the methods of preparing the information and comparing the information for consistency with management's responses to our inquiries, the basic financial statements, and other knowledge we obtained during our audit of the basic financial statements. We did not audit the RSI and do not express an opinion or provide any assurance on the RSI.

We were engaged to report on the supplemental information accompanying the financial statements, and the separately issued Schedule of Expenditures of Federal Awards and the Uniform Financial Accounting and Reporting Standards (UFARS) Compliance Table, which are not RSI. With respect to this supplementary information, 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 supplementary information to the underlying accounting records used to prepare the financial statements or to the financial statements themselves.

We were not engaged to report on the introductory section and statistical section, which accompany the financial statements but are not RSI. Such information has not been subjected to the auditing procedures applied in the audit of the basic financial statements and, accordingly, we do not express an opinion or provide any assurance on it.

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. A summary of legislative changes affecting school districts and charter schools included later in this report gives an indication of how complicated the funding system is. This section provides some state-wide funding and financial trend information.

BASIC GENERAL EDUCATION REVENUE

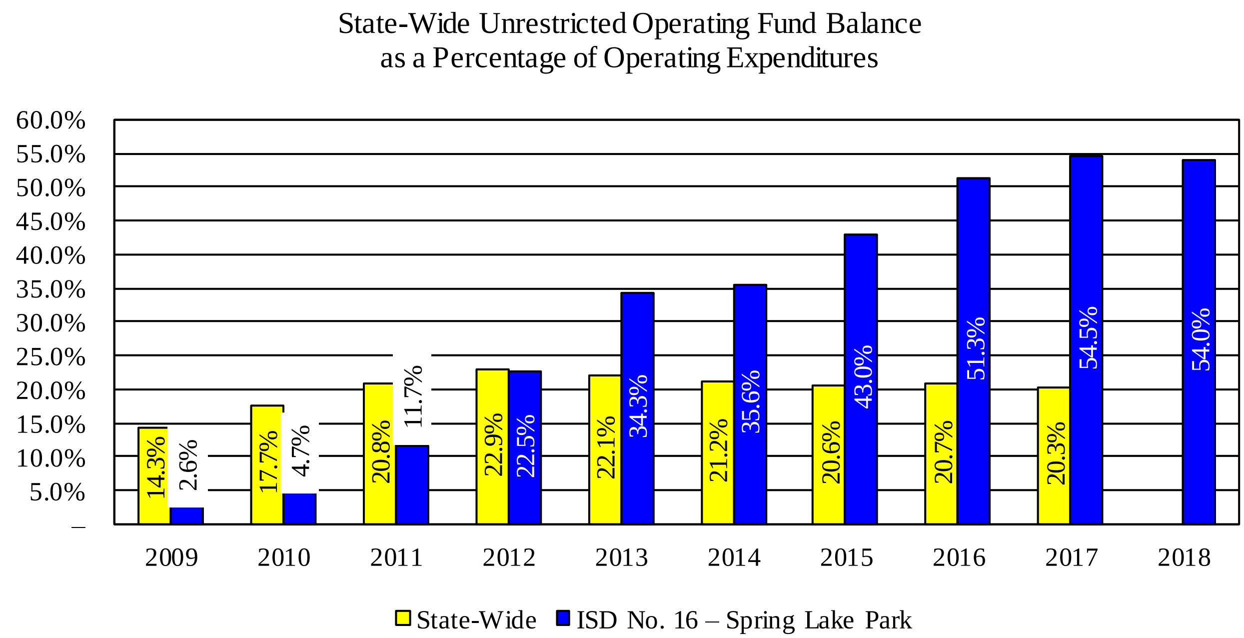
The largest single funding source for Minnesota school districts is basic general education aid. Each year, the Legislature sets a basic formula allowance. Total basic general education revenue is calculated by multiplying the formula allowance by the number of pupil units for which a district is entitled 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 2019 fiscal year. The amount of the formula allowance and the percentage change from year-to-year excludes temporary funding changes, the "roll-in" of aids that were previously funded separately, and changes that may vary dependent on actions taken by individual districts. The $529 increase in 2015 was offset by changes to pupil weightings and the general education aid formula that resulted in an increase equivalent to approximately $105, or 2.0 percent, state-wide.

	Formula Allowance	
Fiscal Year Ended June 30,	Amount	Percent Increase
2009	$ 5,124	1.0 %
2010	$ 5,124	– %
2011	$ 5,124	– %
2012	$ 5,174	1.0 %
2013	$ 5,224	1.0 %
2014	$ 5,302	1.5 %
2015	$ 5,831	2.0 %
2016	$ 5,948	2.0 %
2017	$ 6,067	2.0 %
2018	$ 6,188	2.0 %
2019	$ 6,312	2.0 %

STATE-WIDE SCHOOL DISTRICT FINANCIAL HEALTH

One of the most common and comparable statistics used to evaluate school district financial health is the unrestricted operating fund balance as a percentage of operating expenditures.



Note: State-wide information is not available for fiscal 2018.

The calculation above reflects only the unrestricted 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. We have also included the comparable percentages for your district.

During the economic downturn that began in 2008, the average unrestricted fund balance as a percentage of operating expenditures maintained by Minnesota school districts increased, peaking at 22.9 percent at the end of fiscal 2012. This trend reflected districts' efforts to limit budget cuts, retain educational programs, and maintain adequate operating cash flow during a period of uncertain funding. As the state's economic condition improved in subsequent years, this ratio has gradually decreased to 20.3 percent at the end of fiscal 2017.

As of June 30, 2017, this ratio was 54.5 percent for the District, as compared to 54.0 percent at the end of the current year.

The graph above shows the District's significant improvement in this ratio over the fiscal years presented.

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 and Post-Employment Benefits Debt Service Funds. 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. 16 – Spring Lake Park		
	2016	2017	2016	2017	2016	2017	2018
General Fund							
Property taxes	$ 1,777	$ 1,933	$ 2,342	$ 2,516	$ 1,749	$ 1,749	$ 1,812
Other local sources	495	515	392	423	240	275	264
State	9,271	9,386	9,357	9,387	8,663	8,667	8,941
Federal	432	450	447	480	303	299	314
Total General Fund	11,975	12,284	12,538	12,806	10,955	10,990	11,331
Special revenue funds							
Food Service	548	561	545	557	521	515	490
Community Service	591	628	692	733	566	589	570
Debt Service Fund	1,053	1,119	1,084	1,118	1,748	1,578	1,885
Total revenue	$ 14,167	$ 14,592	$ 14,859	$ 15,214	$ 13,790	$ 13,672	$ 14,276
ADM served per MDE School District Profiles Report (current year estimated)					5,617	5,707	5,767

Note: Excludes the Capital Projects – Building Construction and Post-Employment Benefits 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.

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.

The District earned $82,323,459 in the governmental funds reflected above in fiscal 2018, an increase of $4,298,017 (5.5 percent) from the prior year. The increase in the basic formula allowance as discussed earlier, an increase in special education funding, and additional funding for long-term facilities maintenance contributed to the overall revenue growth. The Debt Service Fund increase was largely as planned with new bonds approved and issued in recent years.

The following table reflects similar comparative data available from the MDE for all governmental fund expenditures, excluding the Capital Projects – Building Construction and Post-Employment Benefits Debt Service Funds. Other financing uses, such as bond refundings and transfers, are also excluded.

Governmental Funds Expenditures per Student (ADM) Served

	State-Wide		Seven-County Metro Area		ISD No. 16 – Spring Lake Park		
	2016	2017	2016	2017	2016	2017	2018
General Fund							
Administration and district support	$ 960	$ 991	$ 958	$ 996	$ 710	$ 728	$ 753
Elementary and secondary regular instruction	5,466	5,539	5,849	5,887	4,446	4,437	4,724
Vocational education instruction	158	166	146	153	64	90	86
Special education instruction	2,182	2,225	2,330	2,334	1,483	1,489	1,580
Community service	–	–	–	–	24	3	11
Instructional support services	622	660	725	765	937	904	987
Pupil support services	1,019	1,074	1,104	1,165	1,021	1,042	1,139
Sites and buildings and other	890	906	847	870	854	900	1,181
Total General Fund – noncapital	11,297	11,561	11,959	12,170	9,539	9,593	10,461
General Fund capital expenditures	600	627	532	592	646	1,043	1,112
Total General Fund	11,897	12,188	12,491	12,762	10,185	10,636	11,573
Special revenue funds							
Food Service	542	550	539	545	510	487	521
Community Service	577	611	676	713	565	584	550
Debt Service Fund	1,522	1,359	1,453	1,323	2,069	1,903	1,775
Total expenditures	$ 14,538	$ 14,708	$ 15,159	$ 15,343	$ 13,329	$ 13,610	$ 14,419
ADM served per MDE School District Profiles Report (current year estimated)					5,617	5,707	5,767

Note: Excludes the Capital Projects – Building Construction and Post-Employment Benefits 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 District's expenditures per ADM have been below both the metro area and state-wide averages in recent years.

The District spent $83,149,900 in the governmental funds reflected above in fiscal 2018, an increase of $5,483,150 (7.1 percent) from the prior year. On a per-student basis, with growing enrollment, this represents an increase of $809 (5.9 percent). General Fund expenditures increased $937 per student, spread across nearly every program presented above, with the largest increase in elementary and secondary regular instruction. Debt Service Fund spending decreased $128 per student, with less debt issue costs in the current year and savings from debt refundings in recent years.

SUMMARY

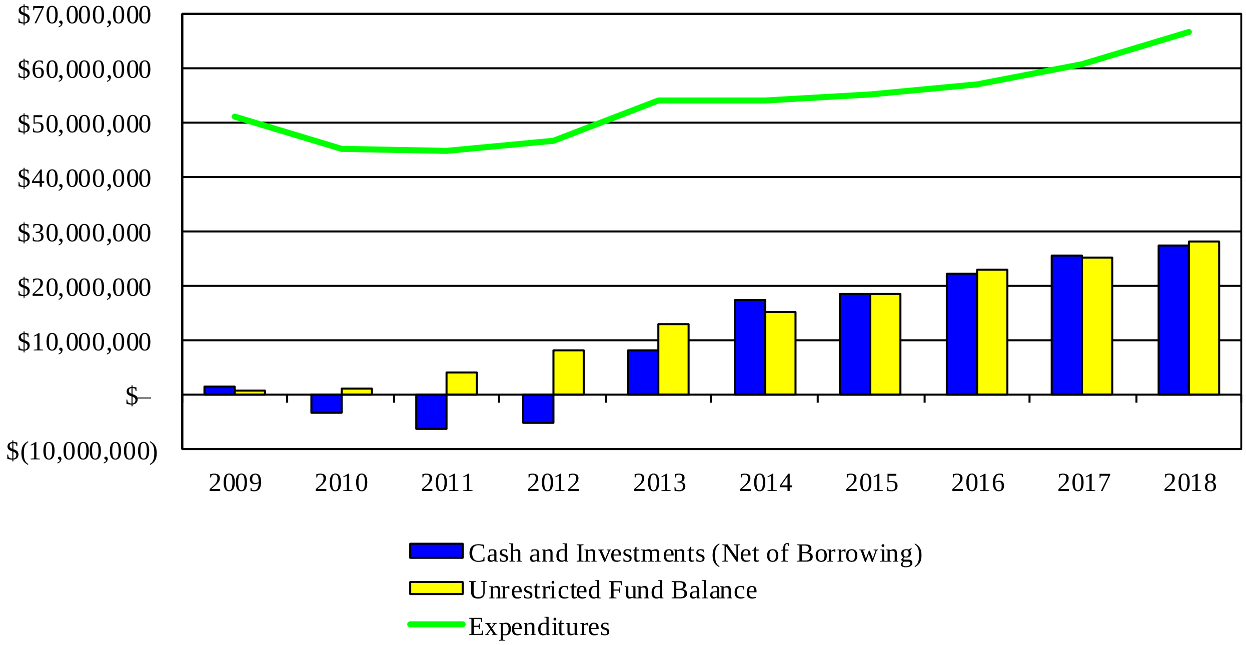
Funding for Minnesota school districts generally has not kept pace with inflation, despite recent enhancements to the basic general education state aid formula. This has often increased districts reliance on local revenue sources like voter-approved operating referenda and user fees to maintain programs. Many districts are also beginning to experience delays in collecting property tax revenues due to higher abatements, as more commercial property taxpayers are appealing the assessed values of brick-and-mortar facilities in light of the rapid evolution of e-commerce. School boards and district administrators continue to face many challenges in providing the best education within the limits of the resources available.

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 fund balance and cash balance are two indicators of financial health, while annual expenditures are often used to measure the size of the operation.

General Fund Financial Position
Year Ended June 30,



General Fund cash and investments (net of borrowing) totaled $27,575,058 at year-end, an increase of $2,046,709. The District's General Fund ended fiscal 2018 with an unrestricted fund balance (excluding restricted deficits) of $28,142,867, an increase of $2,716,520 from the comparable prior year balance. Total fund balance of the General Fund increased by $1,897,507, compared to a decrease of $748,579 approved in the final budget.

The improved financial position of the General Fund along with changes in the metering of state aid payments to school districts and in the tax shift, as legislatively-approved, has significantly impacted cash and investment balances in the years presented in the graph above.

GENERAL FUND COMPONENTS OF FUND BALANCE

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

	June 30,				
	2014	2015	2016	2017	2018
Nonspendable fund balances	$ 126,670	$ 240,909	$ 151,183	$ 520,147	$ 461,523
Restricted fund balances (1)	1,067,665	877,393	898,915	1,421,304	660,915
Unrestricted fund balances					
Assigned	3,078,505	3,048,575	5,467,187	6,799,600	8,523,970
Unassigned	12,121,794	15,664,846	17,646,475	18,626,747	19,618,897
Total fund balances	$ 16,394,634	$ 19,831,723	$ 24,163,760	$ 27,367,798	$ 29,265,305
Unrestricted fund balances as a percentage of total expenditures	28.1%	33.8%	40.4%	41.9%	42.2%
Unassigned fund balances as a percentage of total expenditures	22.4%	28.3%	30.8%	30.7%	29.4%

(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.

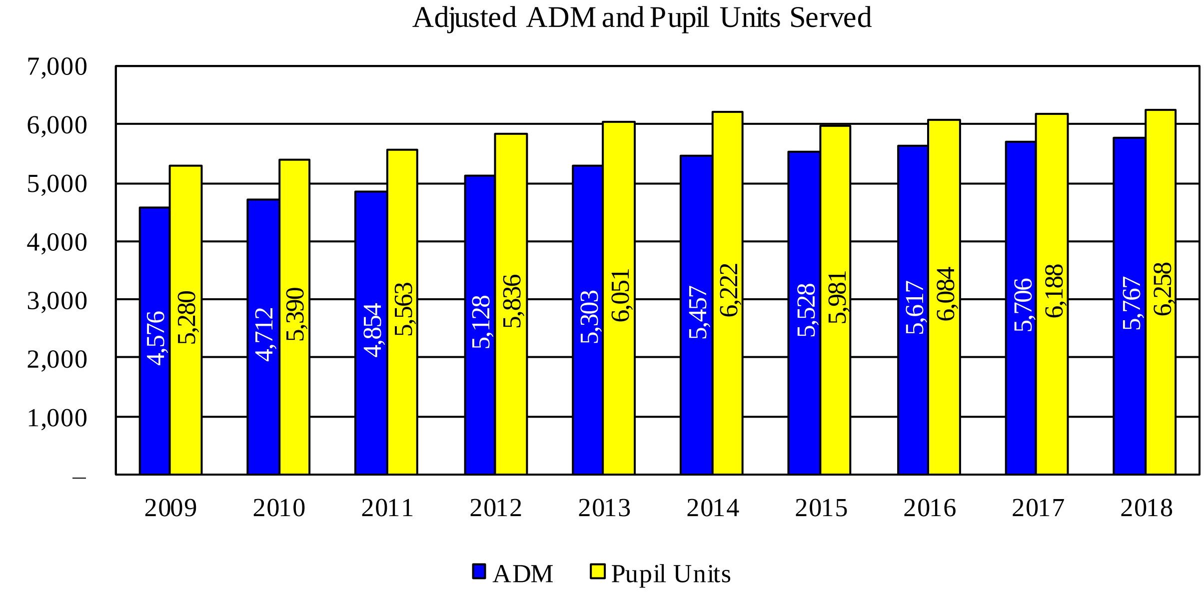
The table above reflects the total General Fund unrestricted fund balance and percentages, which differs from those used in the previous discussion of state-wide fund balances, which are based on a state formula.

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.

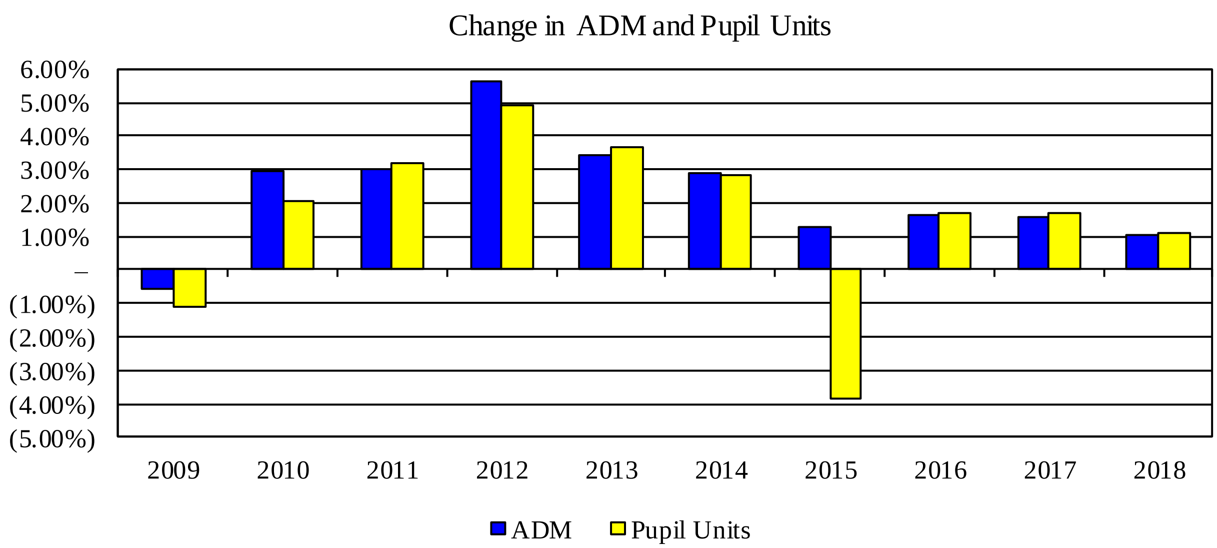
At June 30, 2018, unrestricted fund balance in the General Fund represented 42.2 percent of annual expenditures, or about 22 weeks of operations assuming level spending throughout the year.

AVERAGE DAILY MEMBERSHIP (ADM) AND PUPIL UNITS

The following graph presents the District's adjusted ADM and pupil units served for the past 10 years:



The following graph shows the rate of change in ADM served by the District from year to year, along with the change in the resulting pupil units:



Note: The change in pupil units for 2015 includes the effect of legislative reductions to pupil units.

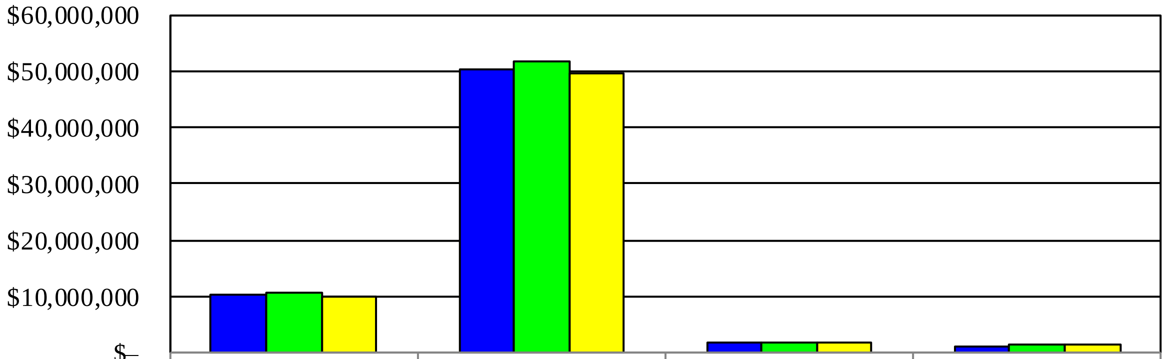
ADM is a measure of students attending class, which is then converted to pupil units (the base for determining revenue) using a statutory formula. Not only is the original budget based on ADM estimates, the final audited financial statements are based on updated, but still estimated, ADM since the counts 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 5,767 in 2018, an increase of 61 ADM (about 1.1 percent) from the prior year.

GENERAL FUND REVENUES

The following graph presents the District's General Fund revenues for 2018:

General Fund Revenue



	Property Taxes	State Sources	Federal Sources	Other
Budget	$10,342,476	$50,162,620	$1,736,000	$1,115,000
Actual	$10,449,849	$51,562,304	$1,808,151	$1,521,110
Prior Year	$9,982,763	$49,461,073	$1,708,418	$1,571,656

Total General Fund revenues were $65,341,414 for the year ended June 30, 2018, which was $1,985,318 (3.1 percent) over the final budget and $2,617,504 (4.2 percent) more than the prior year.

The variance to budget was mainly in state and other sources, which were $1,399,684 and $406,110 over budget, respectively. Conservative budgeting for students served, state special education, long-term facilities maintenance, and pension pass-through funding contributed to the favorable variance in state sources. Conservative budgeting for other sources, which includes investment earnings, donations, and fees, added to the favorable variance in this category presented above.

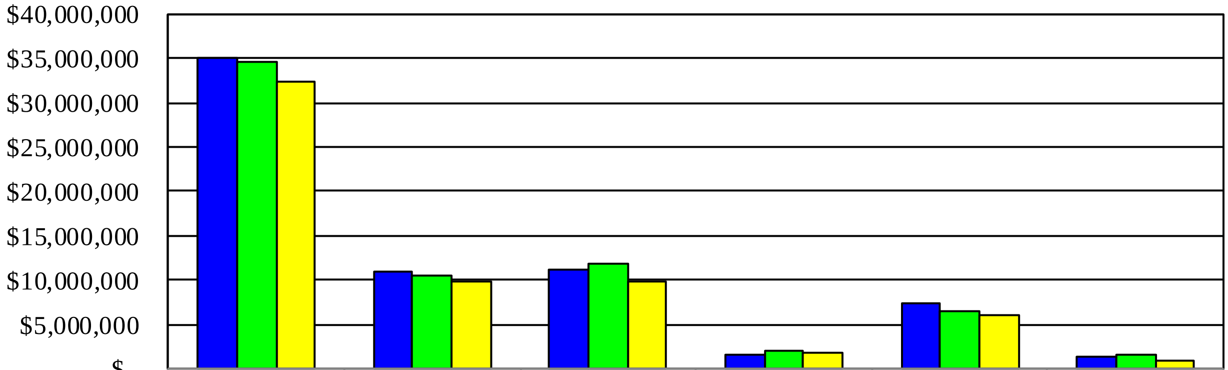
The increase from the prior year was spread across nearly all of the above sources. The largest increases were in state sources and property taxes. The increase in state sources was due to the District serving more students in the current year along with funding improvements in general education, special education, and long-term facilities maintenance funding formulas. Property taxes increased as anticipated with the increase in the adopted levy.

The graph above reflects the concentration of state sources (78.9 percent), followed by property taxes (16.0 percent) recognized to finance General Fund operations.

GENERAL FUND EXPENDITURES

The following graph presents the District’s General Fund expenditures for 2018:

General Fund Expenditures



	Salaries	Employee Benefits	Purchased Services	Supplies and Materials	Capital Expenditures	Other Expenditures
Budget	$35,007,810	$10,857,206	$11,098,390	$1,545,241	$7,483,788	$1,261,067
Actual	$34,505,833	$10,407,082	$11,845,448	$2,009,448	$6,413,712	$1,560,111
Prior Year	$32,347,366	$9,775,321	$9,910,375	$1,705,736	$5,953,766	$1,000,951

Total General Fund expenditures were $66,741,634 for the year ended June 30, 2018, which was $511,868 (0.8 percent) under the final budget and $6,048,119 (10.0 percent) more than the prior year.

As presented in the graph above, overall spending was close to the total amount projected in the final budget. Savings in salaries, employee benefits, and capital expenditures were partially offset by purchased services, supplies and materials, and other expenditures exceeding appropriations.

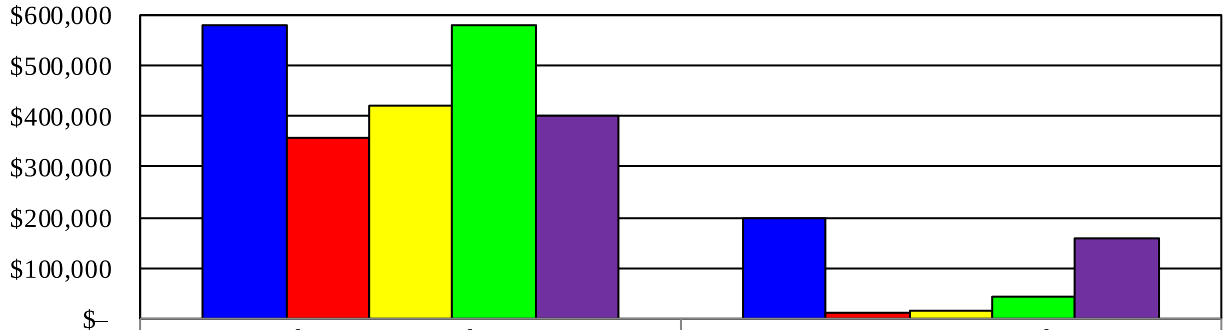
Expenditure increases were primarily due to planned program enhancements and contractual salary and benefit increases. The District recognized an increase in purchased services with more repairs and maintenance and site planning in the current year.

Salaries and employee benefits, which account for 67.3 percent of General Fund spending, were $2,790,228 (6.6 percent) over the prior year and $952,101 (2.1 percent) under budget.

OTHER FUNDS OF THE DISTRICT

The following graph shows what is referred to as the other operating funds. The remaining nonoperating 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 is 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.

Other Operating Funds
Total Fund Balances



	Food Service Special Revenue	Community Service Special Revenue
2014	$581,773	$200,281
2015	$358,445	$10,901
2016	$422,051	$16,062
2017	$579,437	$41,612
2018	$399,499	$160,560

Food Service Special Revenue Fund

The District's Food Service Special Revenue Fund reported a decrease in fund balance of $179,938 in 2018, compared to a balanced budget adopted by the School Board. Revenues were below budget by $76,911, while expenditures were $103,027 over budget. The revenue variance was primarily in local meal sale sources. The expenditure variance was spread across most areas with the largest variance in purchased services. The Food Service Special Revenue Fund had a year-end fund balance of $399,499, representing 13.3 percent of annual expenditures totaling $3,003,027.

Community Service Special Revenue Fund

The District's Community Service Special Revenue Fund reported a fund balance increase of $118,948 in 2018, compared to a balanced budget adopted by the School Board. Revenues exceeded budget by $89,815, while expenditures were $29,133 under budget. Conservative budgeting for participation fees and state sources contributed to the favorable variance. The Community Service Special Revenue Fund had a year-end fund balance of $160,560, representing 5.1 percent of annual expenditures totaling $3,170,867.

Over the years, we have emphasized to our clients that food service and community service operations should be self-sustaining, and should not become an additional burden on general education funds.

Capital Projects – Building Construction Fund

The Capital Projects – Building Construction Fund ended the year with a fund balance decrease of $30,595,462, compared to a $34,650,000 decrease anticipated in the budget. Capital outlay expenditures were less than budget, due to the timing of project costs. At year-end, $13,611,716 of fund balance remains for completing projects.

Debt Service Fund

Total Debt Service Fund revenues exceeded expenditures by $653,678 in the current year as anticipated with an increase of $664,235 approved in the final budget.

The funding of debt service is controlled in accordance with each outstanding debt issue's financing plan. It is important to remember that resources of the Debt Service Fund are dedicated to payment of outstanding debt obligations of the District. The District has actively reviewed outstanding debt, issuing refunding bonds in recent years. These refunding transactions were completed in order to reduce future debt levies to taxpayers of the District.

Proprietary Funds – Internal Service Funds

The District uses internal service funds to account for health and dental insurance offered by the District to its employees as self-insured plans. The following table presents the combined activity reported for the past three fiscal years for the internal service funds:

	June 30,		
	2016	2017	2018
Operating revenue			
Charges for services	$ 4,953,289	$ 5,133,616	$ 5,574,330
Operating expenses			
Health benefit claims	4,093,567	4,348,325	3,935,803
Dental benefit claims	340,627	381,437	403,967
Total operating expenses	4,434,194	4,729,762	4,339,770
Operating income	519,095	403,854	1,234,560
Nonoperating revenue			
Investment earnings	1,006	7,241	20,594
Change in net position	520,101	411,095	1,255,154
Net position			
Beginning of year	636,885	1,156,986	1,568,081
End of year	$ 1,156,986	$ 1,568,081	$ 2,823,235

Post-Employment Benefits Trust Fund

The District has established a Post-Employment Benefits Trust Fund to account for an irrevocable trust account established to finance the District's liability for post-employment healthcare benefits. At year-end, trust net position of $6,037,730 is available to pay these benefits.

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 governmental 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 financial statements provide information on the total cost of delivering educational services, including capital assets and long-term liabilities.

Theoretically, net position represents district resources available 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, this statement divides net position into three components: net investment in capital assets, restricted, and unrestricted. The following table presents a summarized reconciliation of the District's governmental fund balances to net position, and the separate components of net position for the last two years:

	June 30,		
	2018	2017	Change
Net position – governmental activities			
Total fund balances – governmental funds	$ 45,826,976	$ 73,932,243	$ (28,105,267)
Total capital assets, net of depreciation	144,313,752	115,032,704	29,281,048
Long-term liabilities excluding pensions	(140,873,240)	(148,042,795)	7,169,555
Pension adjustments	(63,765,824)	(49,035,116)	(14,730,708)
OPEB adjustments	942,127	1,168,650	(226,523)
Other adjustments	912,013	(207,552)	1,119,565
Total net position – governmental activities	$ (12,644,196)	$ (7,151,866)	$ (5,492,330)
Net position			
Net investment in capital assets	$ 23,079,326	$ 17,675,160	$ 5,404,166
Restricted	1,662,151	2,084,364	(422,213)
Unrestricted	(37,385,673)	(26,911,390)	(10,474,283)
Total net position	$ (12,644,196)	$ (7,151,866)	$ (5,492,330)

Some of the District's fund balances translate into restricted net position 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 position category consists mainly of the General Fund unrestricted fund balances, offset against noncapital long-term obligations such as severance payable and net pension liabilities.

Total net position decreased by $5,492,330 during fiscal 2018. The District's net investment in capital assets increased $5,404,166 this year. The change in this category of net position typically depends on the relationship between the rate at which the District is adding additional capital assets, the rate capital assets are being depreciated, and how that compares to the rate at which the District is repaying the debt issued to purchase or construct those assets. The District reported a decrease in amounts restricted for capital asset acquisition, food service, and other state funding restrictions as of year-end compared to the prior year.

Unrestricted net position decreased largely due to changes in the District's proportionate share of the Public Employees Retirement Association (PERA) and the Teachers Retirement Association (TRA) pension plan obligations.

LEGISLATIVE SUMMARY

The 2018 legislative session, falling in the second half of the state's fiscal biennium, was a short session in which only two major finance-related bills were passed, an omnibus bonding bill and an omnibus pensions bill. The following is a brief summary of specific legislative changes from the 2018 session or previous legislative sessions impacting Minnesota school districts in future years.

Basic General Education Revenue – The Legislature approved annual increases of 2 percent to the basic general education formula allowance for the 2018–2019 biennium. The per pupil allowance will increase $124 to $6,312 for fiscal year (FY) 2019.

Compensatory Revenue – The $5 million previously allocated for compensatory pilot grants was permanently added to the allocation for regular compensatory revenue beginning in FY 2018. The portion of compensatory revenue required to be used for extended time activities will increase from 1.7 percent of total compensatory revenue for FY 2018 to 3.5 percent in FY 2019, and 3.5 percent plus the percentage change in the basic formula for FY 2020 and beyond.

Early Learning – The Legislature made a number of changes to early learning programs, including appropriating funding of $71.75 million for the 2018–2019 biennium. Other changes include:

- The creation of a new School Readiness Plus (SR+) program for FY 2018 and FY 2019 only, with the following student eligibility requirements:
    - A child who is four years of age as of September 1, and who demonstrates one or more risk factors is eligible to participate in the program free of charge,
    - A child who is four years of age as of September 1, and who does not demonstrate any risk factors is eligible to participate on a fee-for-service basis, and
    - A district must adopt a sliding fee schedule for students not demonstrating risk factors, but must waive the fee for students unable to pay.

- Changing the Voluntary Pre-Kindergarten (VPK) cap from a limit on the total state aid entitlement to a limit on the number of participants, as follows:
    - A combined cap of 7,160 participants for VPK and SR+ for FY 2019, and
    - A cap of 3,160 participants for VPK for FY 2020 and later (SR+ program sunsets).

- All applications submitted in January to renew an existing VPK program will be funded first (3,160 slots). Applications for expanded VPK programs, and new VPK or SR+ programs will be ranked and approved based on various criteria. The number of new participants allowed in each new or expanded program will depend on how the programs are ranked.

Long-Term Facilities Maintenance Revenue – Long-term facilities maintenance revenue will increase from $292 to $380 per adjusted pupil unit (APU); multiplied by the lessor of one, or the ratio of the district's average building age to 35 years for FY 2019 and thereafter.

School Building Bond Agricultural Tax Credit – Effective for taxes beginning with the payable 2018 levy (FY 2019), a tax credit on all property classified as agricultural (excluding the house, garage, and one acre of an agricultural homestead) is provided equal to 40 percent of the tax on the property attributable to school district building bond levies. The legislative appropriation for this tax credit is $34.8 million for FY 2019, $45.2 million for FY 2020, and $52.5 million for FY 2021.

School Safety Grants – The 2018 bonding bill included an appropriation of $25 million for school safety grants to be funded from the state's General Fund for FY 2019. These grants may be used to design, construct, furnish, or equip school facilities, including renovating or expanding existing facilities. Grants will be awarded by the MDE on a first come – first served basis, up to a limit of $500,000 for each qualifying school building. At least half the grants must be awarded to school districts outside of the metro area.

Pension Benefit Reforms – The 2018 pension bill included a number of reforms to the various defined benefit pension plans across the state, including the plans administered by the Teachers Retirement Association (TRA), St. Paul Teachers Retirement Fund Association (SPTRFA), and the Public Employees Retirement Association (PERA). The reforms include:

- Elimination of augmentation (annual percentage increases to pension benefits accrued by individuals leaving public service prior to retirement). For the TRA plan, augmentation is eliminated for all members after December 31, 2017, but does not eliminate augmentation previously credited to member accounts.

- Early retirement subsidies (augmentation an early retiree would have received had they waited until the normal retirement age to begin receiving the pension) are phased out.

- Post-retirement cost of living adjustments (COLAs) are reduced. For the TRA plan, the COLA was reduced from 2.0 percent to 1.0 percent for five years, with the rate increasing by 0.1 percent annually thereafter, to a maximum of 1.5 percent. For the SPTRFA plan, there will be no COLA increase for two years, and a 1.0 percent annual COLA thereafter. For the PERA plans, the COLA will be equal to 50.0 percent of the annual increase for Social Security, but not less than 0.5 percent and not more than 1.5 percent.

- For early retirees that retire on or after January 1, 2024, COLAs are deferred until the retiree reaches the normal retirement age.

- The rate of interest paid on refunds of employee contributions to former public employees was reduced from an annual rate of 4 percent to 3 percent.

- The actuarial assumption for investment rate of return was reduced to 7.5 percent for all plans.

- Employer contribution rates were increased for the TRA plan (a total increase of 1.25 percent phased in over a 6-year period beginning in FY 2019) and the SPTRFA plan (a total increase of 2.50 percent phased in over a 6-year period beginning in FY 2019). Employee contribution rates were also increased by 0.25 percent beginning in FY 2024 for the TRA plan and beginning in FY 2023 for the SPTRFA plan. The pension adjustment component of the general education aid formula was increased by an amount equal to the product of the salaries paid to members of these two plans times the district's pension adjustment rate for the fiscal year to help offset the cost of the employer contribution increases.

Competitive Bidding Threshold – Effective for contracts awarded on or after August 1, 2018, the dollar threshold at which Minnesota Statutes require the use of a sealed bidding process was raised from $100,000 to $175,000. This extends the dollar range for which contracts may be awarded using direct negotiation (obtaining two quotations) contracts between $25,000 and $175,000. By reference, this change also increased the dollar threshold at which public contractors' performance and payment bonds are required for contracts over $175,000.

ACCOUNTING AND AUDITING UPDATES

GASB Statement No. 83, *Certain Asset Retirement Obligations*

At times, state and local governments are required to take specific actions to retire certain tangible capital assets, such as the decommissioning of nuclear reactors, removal and disposal of wind turbines in wind farms, dismantling and removal of sewage treatment plants, and removal and disposal of x-ray machines. Obligations to retire certain tangible capital assets also arise from contracts or court judgments. Accounting and financial reporting standards exist for costs of the closure and post-closure care of municipal solid waste landfills, but those standards do not address retirement obligations associated with other types of tangible capital assets.

This statement addresses accounting and financial reporting for certain asset retirement obligations (AROs) that were not addressed in GASB standards by establishing uniform accounting and financial reporting requirements for these obligations. An ARO is a legally enforceable liability associated with the retirement of a tangible capital asset. A government that has legal obligations to perform future asset retirement activities related to its tangible capital assets should recognize a liability based on the guidance in this statement. The requirements of this statement are effective for reporting periods beginning after June 15, 2018.

GASB Statement No. 84, *Fiduciary Activities*

This statement is intended to enhance consistency and comparability of fiduciary activity reporting by state and local governments. It is also meant to improve the usefulness of fiduciary activity information primarily for assessing the accountability of governments in their roles as fiduciaries.

This statement establishes criteria for identifying fiduciary activities of all state and local governments. The focus of the criteria generally is on (1) whether a government is controlling the assets of the fiduciary activity and (2) the beneficiaries with whom a fiduciary relationship exists. An activity meeting the criteria should be reported in a fiduciary fund in the basic financial statements. This statement describes four fiduciary funds that should be reported, if applicable: (1) pension (and other employee benefit) trust funds, (2) investment trust funds, (3) private-purpose trust funds, and (4) custodial funds. Custodial funds generally should report fiduciary activities that are not held in a trust or equivalent arrangement that meets specific criteria. The requirements of this statement are effective for reporting periods beginning after December 15, 2018.

GASB Statement No. 87, *Leases*

A lease is a contract that transfers control of the right to use another entity’s nonfinancial asset as specified in the contract for a period of time in an exchange or exchange-like transaction. Examples of nonfinancial assets include buildings, land, vehicles, and equipment. Any contract that meets this definition should be accounted for under the leases guidance, unless specifically excluded in this statement.

Governments enter into leases for many types of assets. Under the previous guidance, leases were classified as either capital or operating depending on whether the lease met any of four tests. In many cases, the previous guidance resulted in reporting lease transactions differently than similar nonlease financing transactions.

The goal of this statement is to better meet the information needs of users by improving accounting and financial reporting for leases by governments. It establishes a single model for lease accounting based on the principle that leases are financings of the right to use an underlying asset. This statement increases the usefulness of financial statements by requiring recognition of certain lease assets and liabilities for leases that previously were classified as operating leases and recognized as inflows of resources or outflows of resources based on the payment provisions of the contract.

Under this statement, a lessee is required to recognize a lease liability and an intangible right-to-use lease asset, and a lessor is required to recognize a lease receivable and a deferred inflow of resources, thereby enhancing the relevance and consistency of information about governments' leasing activities.

To reduce the cost of implementation, this statement includes an exception for short-term leases, defined as a lease that, at the commencement of the lease term, has a maximum possible term under the lease contract of 12 months (or less), including any options to extend, regardless of their probability of being exercised. Lessees and lessors should recognize short-term lease payments as outflows of resources or inflows of resources, respectively, based on the payment provisions of the lease contract. The requirements of this statement are effective for reporting periods beginning after December 15, 2019.

GASB Statement No. 88, *Certain Disclosures Related to Debt, Including Direct Borrowings and Direct Placements*

The primary objective of this statement is to improve the information that is disclosed in notes to government financial statements related to debt, including direct borrowings and direct placements. It also clarifies which liabilities governments should include when disclosing information related to debt.

The requirements of this statement will improve financial reporting by providing users of financial statements with essential information that currently is not consistently provided. In addition, information about resources to liquidate debt and the risks associated with changes in terms associated with debt will be disclosed. As a result, users will have better information to understand the effects of debt on a government's future resource flows.

This statement defines debt for purposes of disclosure in notes to financial statements as a liability that arises from a contractual obligation to pay cash (or other assets that may be used in lieu of cash) in one or more payments to settle an amount that is fixed at the date the contractual obligation is established. The statement requires that additional essential information related to debt be disclosed in notes to financial statements, including unused lines of credit; assets pledged as collateral for the debt; and terms specified in debt agreements related to significant events of default with finance-related consequences, significant termination events with finance-related consequences, and significant subjective acceleration clauses. It also requires that existing and additional information be provided for direct borrowings and direct placements of debt separately from other debt. The requirements of this statement are effective for reporting periods beginning after June 15, 2018.

Uniform Guidance, Micro-Purchase Threshold

Under the Uniform Guidance for federal programs, a micro-purchase is one for goods or services that, due to its relatively low value, does not require the government to abide by many of its ordinary competitive procedures, including small business set-asides. Because the contract is theoretically, such a low amount, the contracting officer can pick virtually whatever company and product he or she wants to satisfy the procurement, so long as the price is reasonable. The standard micro-purchase threshold has been amended to increase the threshold to $10,000, effective June 20, 2018. Entities are not required to increase the micro-purchase and simplified acquisition thresholds but, if they wish to do so, they must update their procurement policies and procedures to reflect the change in thresholds. They cannot retroactively make these changes effective prior to June 20, 2018.