

Management Report

for

Independent School District No. 272
Eden Prairie, Minnesota
June 30, 2015

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PRINCIPALS

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To the School Board and Management of
Independent School District No. 272
Eden Prairie, Minnesota

We have prepared this management report in conjunction with our audit of Independent School District No. 272's (the District) financial statements for the year ended June 30, 2015. The purpose of this report is to communicate information relevant to the financing of public education in Minnesota and to provide comments resulting from our audit process. We have organized this report into the following sections:

- Audit Summary
- Funding Public Education in Minnesota
- Financial Trends of Your District
- 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
November 17, 2015

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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 THE U.S. OFFICE OF MANAGEMENT AND BUDGET (OMB) CIRCULAR A-133

We have audited the financial statements of the governmental activities, each major fund, and the aggregate remaining fund information of the District as of and for the year ended June 30, 2015, and the related notes to the financial statements. Professional standards require that we provide you with information about our responsibilities under auditing standards generally accepted in the United States of America, *Government Auditing Standards*, and OMB Circular A-133, as well as certain information related to the planned scope and timing of our audit. We have communicated such information to you verbally and in our audit engagement letter. Professional standards also require that we communicate to you the following information related to our audit.

PLANNED SCOPE AND TIMING OF THE AUDIT

We performed the audit according to the planned scope and timing previously discussed and coordinated in order to obtain sufficient audit evidence and complete an effective audit.

AUDIT OPINION AND FINDINGS

Based on our audit of the District's financial statements for the year ended June 30, 2015:

- We have issued an unmodified opinion on the District's annual financial statements.
- We reported no deficiencies in the District's internal control over financial reporting that we considered to be material weaknesses.
- 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 matter involving the internal control over compliance and its operation that we consider to be a significant deficiency in our testing of major federal programs:
 - For the Title I federal program, the District did not have adequate controls in place to assure that it was not contracting for goods or services with parties that are suspended or debarred.
- We reported one finding based on our testing of the District's compliance with Minnesota laws and regulations:
 - For three of four projects selected for testing that were completed during the 2015 fiscal year, the statutory requirement to obtain a Form IC134 or Contractor's Withholding Affidavit prior to making the final payment to a contractor, was not met.

EXTRACURRICULAR STUDENT ACTIVITY ACCOUNTS

In accordance with Minnesota Statutes, the District's School Board has elected not to exercise control over the transactions of the extracurricular student activity accounts maintained at various district sites. Consequently, the cash receipts and disbursements of the District's extracurricular student activity accounts are reported in a separate set of financial statements, rather than being reported within the District's General Fund. We have issued an opinion on these separate financial statements, stating that they fairly present the cash balances and cash receipts and disbursements of these accounts as of and for the year ended June 30, 2015 on the cash basis of accounting. Our opinion was qualified for a limitation related to the completeness of cash receipts reported.

We reported one deficiency involving internal control over financial reporting for the District's extracurricular student activities that we consider to be a material weakness:

- The District reports student activities on a cash basis, and has not established procedures to assure that all cash collections are recorded in the accounting records. Procedures such as the use and reconciliation of pre-numbered receipts, pre-numbered admission tickets for events, and inventory controls over items sold for fundraisers would help strengthen the controls in this area.

We also issued a report on compliance with the Minnesota Department of Education's (MDE) *Manual for Activity Fund Accounting*, in which we reported one finding:

- All student activity accounts were not supported by a Statement of Purpose form. This form must exist for each activity and be completed, signed by the advisor and principal, and kept on file.

FOLLOW-UP ON PRIOR YEAR FINDINGS AND RECOMMENDATIONS

As a part of the audit of the District's financial statements for the year ended June 30, 2015, we performed procedures to follow-up on any findings and recommendations that resulted from the prior year audit. We reported the following findings that were corrected by the District in the current year:

- Regarding the special education cluster of federal programs, payroll costs charged to federal programs must be for time devoted to the performance of the federal award, and be supported by personnel activity reports. This has since been corrected and is no longer a finding for the fiscal 2015 audit.
- School Board officials may not vote on a specific contract in which there is a conflict of interest. That member must abstain from voting on the approval of the contract. There were no contracts approved during the fiscal 2015 audit in which a member of the School Board had a direct interest in the employee class. Therefore, this is not a finding for the fiscal 2015 audit.

GENERAL COMMENTS AND RECOMMENDATIONS

Disbursement Claims

Minnesota Statutes require that each claim made for payment from a Minnesota school district include a signed declaration that the claim is just and correct, and that no part of it has been paid. Districts have historically obtained this signed declaration by including it above the endorsement line on the back side of its checks. However, districts also have statutory authorization to make purchases using credit cards or pay claims through various forms of electronic fund transfers, which typically do not involve the issuance of a physical check. The statutes that authorized the use of these alternative purchasing methods specify that the transactions must comply with all applicable Minnesota Statutes, which include the requirement to obtain a signed declaration. There is no set guidance on how the claim declaration is to be obtained for these types of transactions, without completely defeating the purpose of paying claims electronically. We recommend that the District examine its purchasing process, and assure that Minnesota statutory requirements are being complied with for all vendor claims paid.

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.

The District implemented Governmental Accounting Standards Board (GASB) Statement No. 68, *Accounting and Financial Reporting for Pensions—an amendment of GASB Statement No. 27*. This statement provides new guidance on accounting and financial reporting for pensions accounted for in the financial statements of plan employers. This change required the District to report a change in accounting principle adjustment to beginning equity on the government-wide statements as described in Note 1 of the notes to basic financial statements.

The application of remaining policies was not changed during the fiscal year ended June 30, 2015. We noted no transactions entered into by the District during the year for which there is a lack of authoritative guidance or consensus. All significant transactions have been recognized in the financial statements in the proper period.

CORRECTED AND UNCORRECTED MISSTATEMENTS

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

ACCOUNTING ESTIMATES AND MANAGEMENT JUDGMENTS

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

General education revenue and certain other revenues are computed by applying an allowance per student to the number of students served by the District. Student attendance is accumulated in a state-wide database—MARSS. Because of the complexity of student accounting and because of certain enrollment options, student information is input by other school districts and the MARSS data for 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 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 compensated absences 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 described in GASB Statement Nos. 27, 45, and 68. 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.

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.

DIFFICULTIES ENCOUNTERED IN PERFORMING THE AUDIT

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

MANAGEMENT REPRESENTATIONS

We have requested certain representations from management that are included in the management representation letter dated November 17, 2015.

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 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 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 and statistical sections which accompany the financial statements but are not RSI. We did not audit or perform other procedures on this other information and 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 2016 and 2017 fiscal years. The amount of the formula allowance and the percentage change from year to year excludes non-comparable changes such as temporary funding increases, the “roll-in” of aids that were previously funded separately, potential reductions due to levying less than the maximum student achievement levy rate, and the one-time replacement of a portion of general education aid with federal fiscal stabilization funds in fiscal 2010.

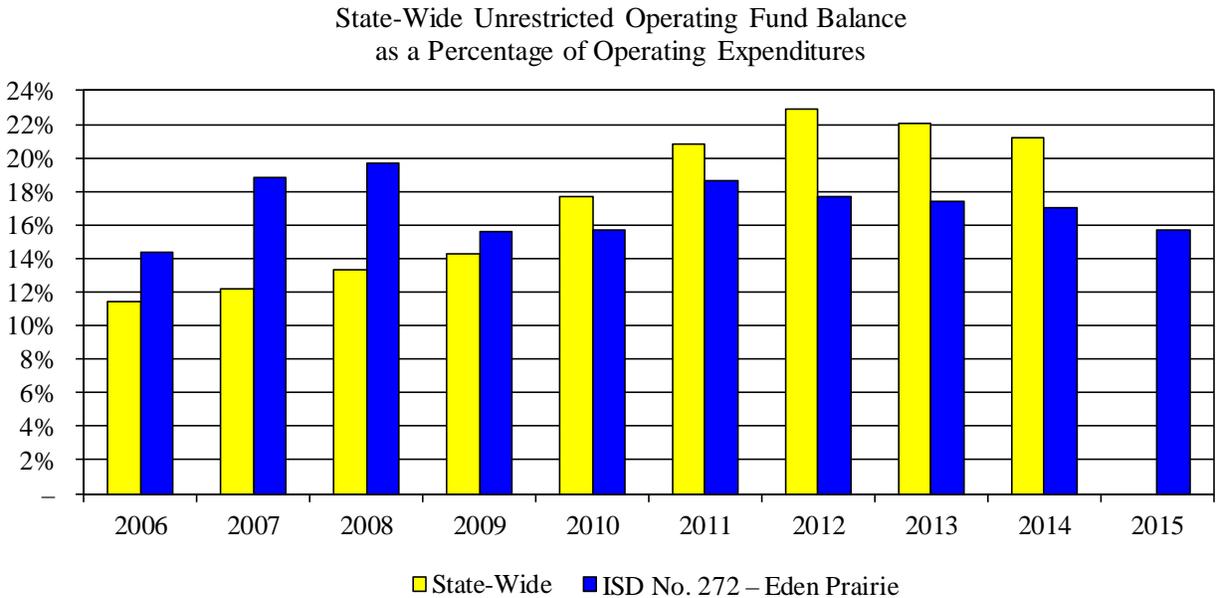
Fiscal Year Ended June 30,	Formula Allowance	
	Amount	Percent Increase
2006	\$ 4,783	4.0 %
2007	\$ 4,974	4.0 %
2008	\$ 5,074	2.0 %
2009	\$ 5,124	1.0 %
2010	\$ 5,124	– %
2011	\$ 5,124	– %
2012	\$ 5,174	1.0 %
2013	\$ 5,224	1.0 %
2014	\$ 5,302	1.5 %
2015	\$ 5,831	2.0 % *
2016	\$ 5,948	2.0 %
2017	\$ 6,067	2.0 %

* The \$529 increase in 2015 is offset by changes to pupil weightings and the general education aid formula that reduced the increase to the equivalent of \$105, or 2.0 percent, state-wide.

In recent years, modest increases in the formula allowance have forced many districts to continually cut expenditure budgets or seek increased referendum revenue in order to maintain programs.

STATE-WIDE SCHOOL DISTRICT FINANCIAL HEALTH

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



Note: State-wide information is not available for fiscal 2015.

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 (SOD). We have also included the comparable percentages for your district.

Since the financially turbulent 2008–2009 biennium, Minnesota school districts have generally been maintaining a higher unrestricted fund balance as a percentage of operating expenditures. This trend reflects districts' efforts to limit budget cuts, retain educational programs, and maintain adequate operating cash flow during a period of uncertain funding. It was accomplished by districts reducing or limiting operating expenditures, adapting to funding restrictions, and in some cases community support in the form of operating referendums. As the state's economic condition has stabilized the last few years, this trend appears to be gradually reversing, with the state average decreasing in 2013 and 2014.

As of June 30, 2014, this ratio was 17.0 percent for the District, as compared to a state-wide average of 21.2 percent. The District's unrestricted operating fund balance as a percentage of operating expenditures was 15.7 percent at the end of the current year.

The table below shows a comparison of governmental fund revenue per ADM received by Minnesota school districts and your district. Revenues for all governmental funds are included, except for the Capital Projects – Building Construction Fund and Post-Employment Benefits Debt Service Fund. Other financing sources, such as proceeds from sales of capital assets, insurance recoveries, bond sales, loans, and interfund transfers, are also excluded.

Governmental Funds Revenue per Student (ADM) Served							
	State-Wide		Seven-County Metro Area		ISD No. 272 – Eden Prairie		
	2013	2014	2013	2014	2013	2014	2015
General Fund							
Property taxes	\$ 1,608	\$ 972	\$ 2,101	\$ 1,285	\$ 2,688	\$ 1,783	\$ 2,842
Other local sources	444	480	372	397	270	600	525
State	8,112	9,036	8,138	9,257	7,625	8,727	8,068
Federal	489	458	519	480	305	290	295
Total General Fund	<u>10,653</u>	<u>10,946</u>	<u>11,130</u>	<u>11,419</u>	<u>10,888</u>	<u>11,400</u>	<u>11,730</u>
Special revenue funds							
Food Service	495	504	495	500	470	486	492
Community Service	535	553	647	667	547	611	436
Debt Service Fund	<u>1,079</u>	<u>1,090</u>	<u>1,172</u>	<u>1,187</u>	<u>1,324</u>	<u>1,193</u>	<u>1,261</u>
Total revenue	<u>\$ 12,762</u>	<u>\$ 13,093</u>	<u>\$ 13,444</u>	<u>\$ 13,773</u>	<u>\$ 13,229</u>	<u>\$ 13,690</u>	<u>\$ 13,919</u>
ADM served per MDE School District Profiles Report (current year estimated)					<u>9,422</u>	<u>9,320</u>	<u>9,121</u>
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 tables above and on the next page are based on enrollments consistent with those used in the MDE School District Profiles Report, which include extended time ADM, and may differ from ADM reported in other tables.

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

The District earned \$126,959,198 in the governmental funds reflected above in fiscal 2015, a decrease of \$640,983 (0.5 percent) from the prior year. Due to the decline in the ADM count served by the District, this represents an increase of \$229 per ADM. General Fund revenue increased \$330 per ADM, mainly from additional state general education funding. The mix of revenue in the General Fund was impacted by an \$8.7 million state buy-down of the tax shift in 2014, which shifted funding between taxes and state aids but was revenue neutral in total. Community Service Special Revenue Fund revenue was \$175 per ADM lower than last year due to the elimination of the fee-based all-day kindergarten program, as state funding for all-day kindergarten is now reported in the General Fund.

The following table reflects similar comparative data available from the MDE for all governmental fund expenditures, excluding the Capital Projects – Building Construction Fund and Post-Employment Benefits Debt Service Fund. 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. 272 – Eden Prairie			
	2013	2014	2013	2014	2013	2014	2015	
General Fund								
District and school administration	\$ 849	\$ 882	\$ 837	\$ 886	\$ 824	\$ 1,044	\$ 1,024	
Elementary and secondary regular instruction	4,982	5,091	5,273	5,408	5,122	5,148	5,378	
Vocational education instruction	138	140	132	130	185	198	205	
Special education instruction	1,909	1,987	2,055	2,144	1,808	1,879	2,066	
Instructional support services	477	536	562	630	590	813	788	
Pupil support services	919	950	991	1,019	837	882	912	
Sites and buildings and other	850	881	800	843	1,355	1,118	1,405	
Total General Fund – noncapital	10,124	10,467	10,650	11,060	10,721	11,082	11,778	
General Fund capital expenditures	509	512	469	442	690	701	508	
Total General Fund	10,633	10,979	11,119	11,502	11,411	11,783	12,286	
Special revenue funds								
Food Service	500	513	500	512	498	545	550	
Community Service	535	556	646	674	572	618	444	
Debt Service Fund	1,234	1,469	1,322	1,636	1,361	1,272	1,288	
Total expenditures	<u>\$ 12,902</u>	<u>\$ 13,517</u>	<u>\$ 13,587</u>	<u>\$ 14,324</u>	<u>\$ 13,842</u>	<u>\$ 14,218</u>	<u>\$ 14,568</u>	
ADM served per MDE School District Profiles Report (current year estimated)					<u>9,422</u>	<u>9,320</u>	<u>9,121</u>	
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 differences from program to program reflect the District’s particular character, such as its community service programs, as well as the fluctuations from year to year for such things as capital expenditures.

The District spent \$132,885,227 in the governmental funds reflected above in fiscal 2015, an increase of \$364,638 from the prior year. On a per student basis, this represents an increase of \$350. General Fund expenditures increased \$503 per ADM overall, with higher expenditures for regular instruction, special education instruction, and site operations offset by a decrease in General Fund capital expenditures. Community Service Special Revenue Fund expenditures were \$174 per ADM lower than last year due to the transition of the all-day kindergarten program to the General Fund.

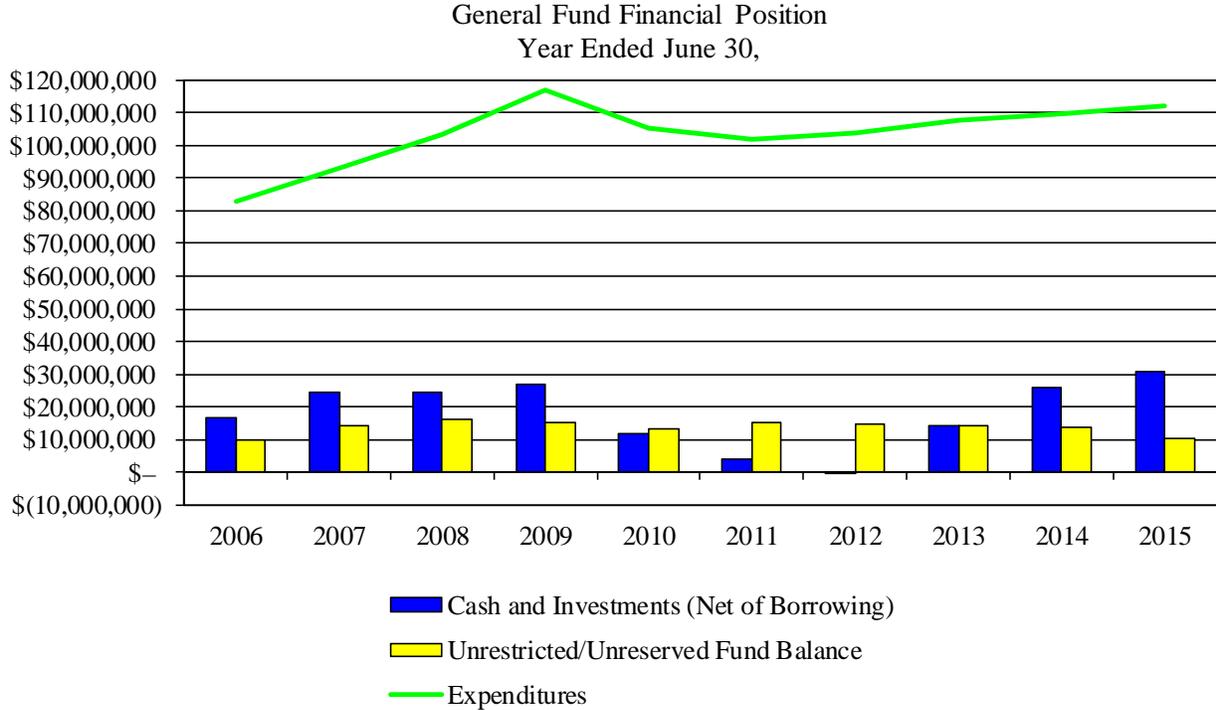
SUMMARY

The funding for and financial position of Minnesota school districts has fluctuated significantly over the past several years due to a number of factors, including those discussed above. This situation continues to present a challenge for school boards, administrators, and management of these districts in providing the best education with the limited resources available in a climate of unknown future funding levels.

FINANCIAL TRENDS OF YOUR DISTRICT

GENERAL FUND FINANCIAL POSITION

The following graph displays the District's General Fund trends of financial position and changes in the volume of financial activity. Unrestricted fund balance and cash balance are two indicators of financial health or equity, while annual expenditures are often used to measure the size of the operation.



The General Fund cash balance (adjusted for interfund borrowing) at the end of fiscal year 2015 was \$30,662,698, an increase of \$4,965,107 from the prior year.

Total fund balance at year-end was \$14,997,011, a decrease of \$426,032, as compared to a budgeted decrease of \$2,283,039. Year-end unassigned fund balance was \$10,301,993 (excluding restricted fund balance account deficits).

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

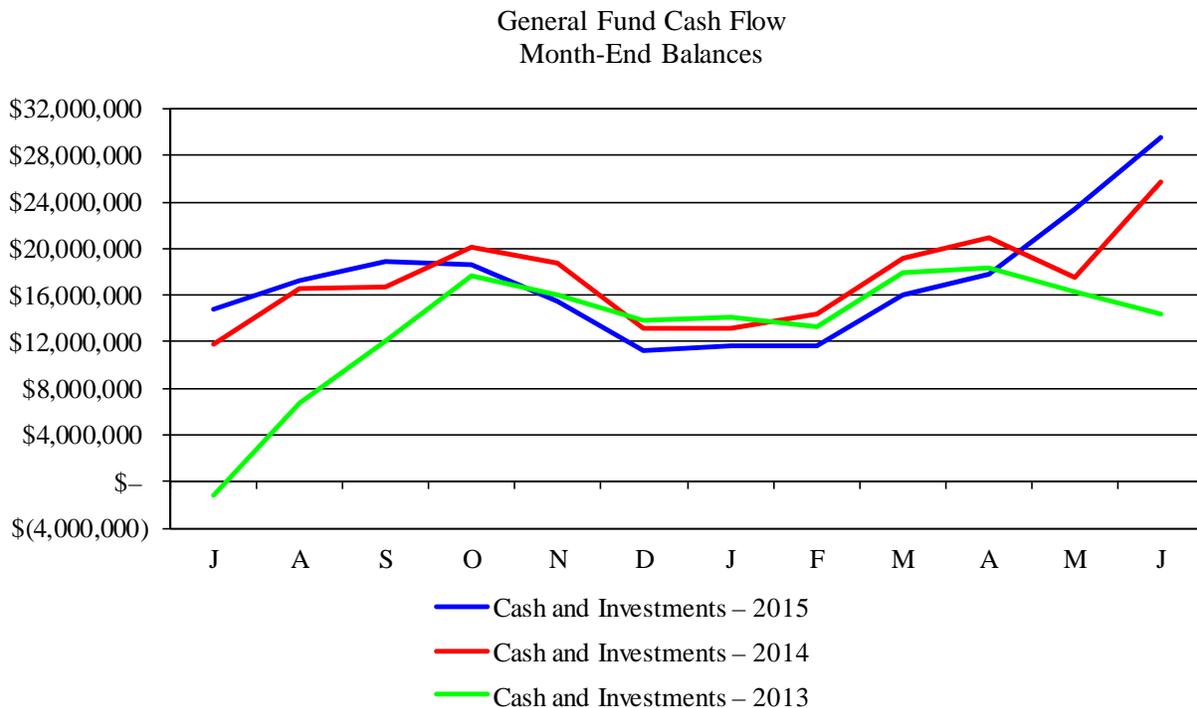
	June 30,				
	2011	2012	2013	2014	2015
Nonspendable fund balances	\$ 278,350	\$ 337,027	\$ 244,799	\$ 952,663	\$ 422,808
Restricted fund balances (1)	2,514,651	1,850,342	684,054	810,854	1,236,064
Unrestricted fund balances					
Assigned	2,830,859	804,305	708,318	1,834,953	3,036,146
Unassigned	12,132,508	13,967,269	13,722,291	11,824,573	10,301,993
Total fund balance	\$ 17,756,368	\$ 16,958,943	\$ 15,359,462	\$ 15,423,043	\$ 14,997,011
Total expenditures	\$ 101,743,189	\$ 103,795,906	\$ 107,526,647	\$ 109,823,763	\$ 112,060,646
Unrestricted fund balances as a percentage of expenditures	<u>14.7%</u>	<u>14.2%</u>	<u>13.4%</u>	<u>12.4%</u>	<u>11.9%</u>
Unassigned fund balances as a percentage of expenditures	<u>11.9%</u>	<u>13.5%</u>	<u>12.8%</u>	<u>10.8%</u>	<u>9.2%</u>
(1) Includes deficits in restricted fund balance accounts allowed to accumulate deficits under UFARS, which are part of unassigned fund balance on the accounting principles generally accepted in the United States of America-based financial statements.					

The table above reflects unrestricted and unassigned balances as a percentage of total General Fund expenditures, which differs from those 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, 2015, unrestricted fund balances in the General Fund represented 11.9 percent of annual expenditures, or about six weeks operations assuming level spending throughout the year.

GENERAL FUND CASH FLOW

The level of cash and investments varies considerably during the year due to the timing of various revenues and expenditures. The following graph summarizes the level of cash and investments (net of borrowing) over the past three years:

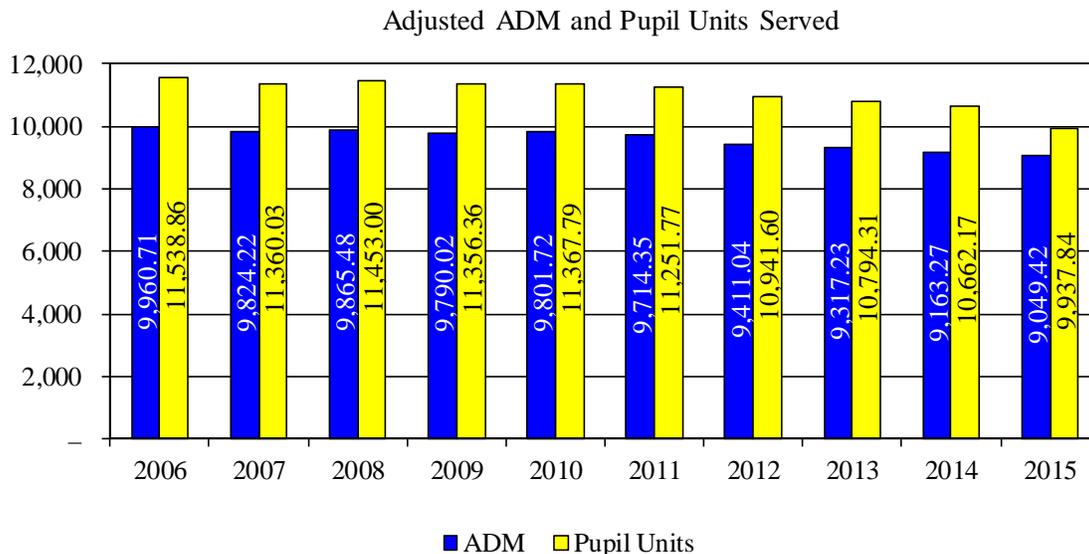


The graph above shows the peaks and valleys of the General Fund cash and investments balance on a monthly basis.

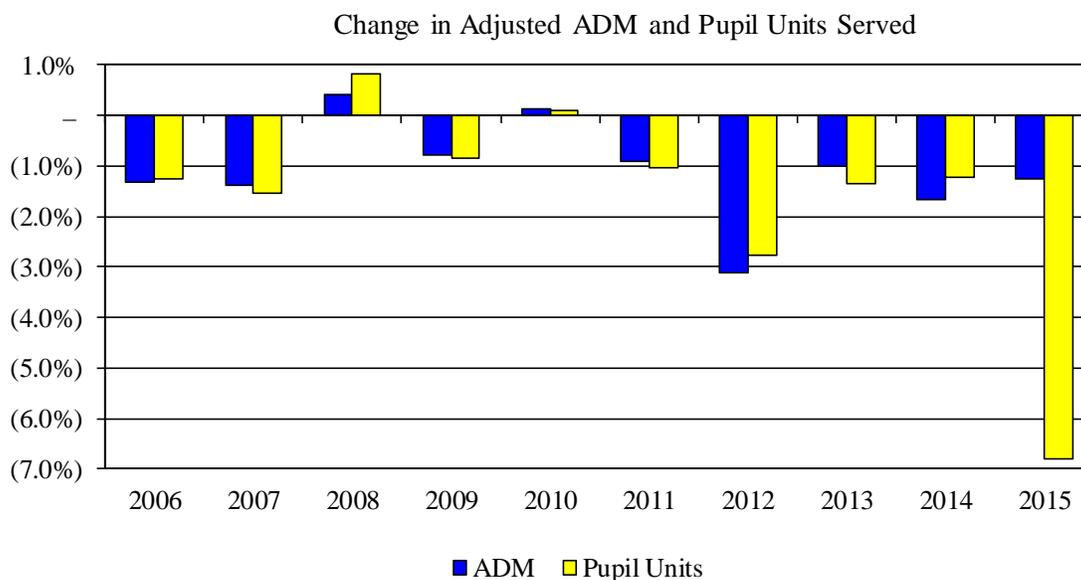
Legislative changes in the tax shift and state aid payment schedules used to help balance the state budget have a significant effect on the cash flow of Minnesota school districts. In fiscal 2012, the state holdback on aids normally paid on a 90–10 schedule was up to 40 percent, and the tax shift was at 48.6 percent of non-debt service levies. As the financial condition of the state began to improve, the holdback on state aid payments was reduced to 13.6 percent by the end of fiscal 2013. In fiscal 2014, the state was able to restore the metering of state aid payments to a 90–10 schedule, and buy the tax shift back down to zero (except for the shift of 31 percent of a district’s payable 2001 referendum levy that remains frozen by statute). These changes have resulted in an improvement in the District’s cash flow over the last two years, as illustrated by the graph above.

AVERAGE DAILY MEMBERSHIP 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 weights.

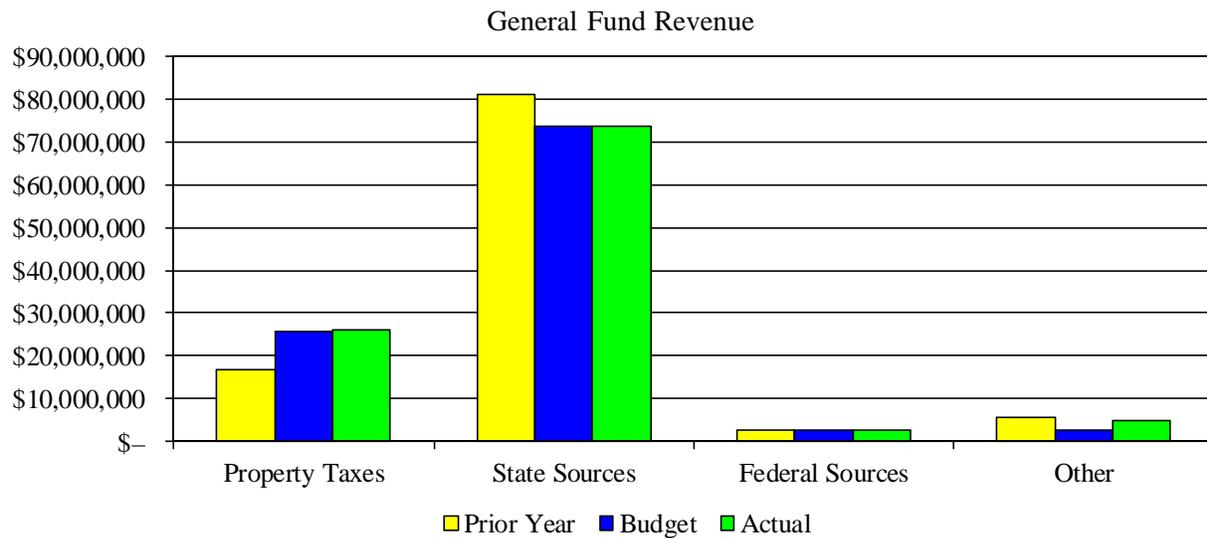
ADM is a measure of students attending class, which is converted to pupil units (the base for determining revenue) using a statutory formula. Not only is the original budget based on ADM estimates, the final audited financial statements are based on updated, but still estimated, ADM since the counts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

Adjusted ADM served by the District decreased 114 ADM (1.2 percent) from the prior year to 9,049 served in the current year.

The number of pupil units served by the District for fiscal 2015 was 9,938, a decrease of 724 (6.8 percent) from the prior year. This decrease was caused by legislative changes in pupil weightings used to convert ADM to pupil units, in addition to the drop in ADM served.

GENERAL FUND REVENUES

The following graph summarizes the District's General Fund revenue for 2015:

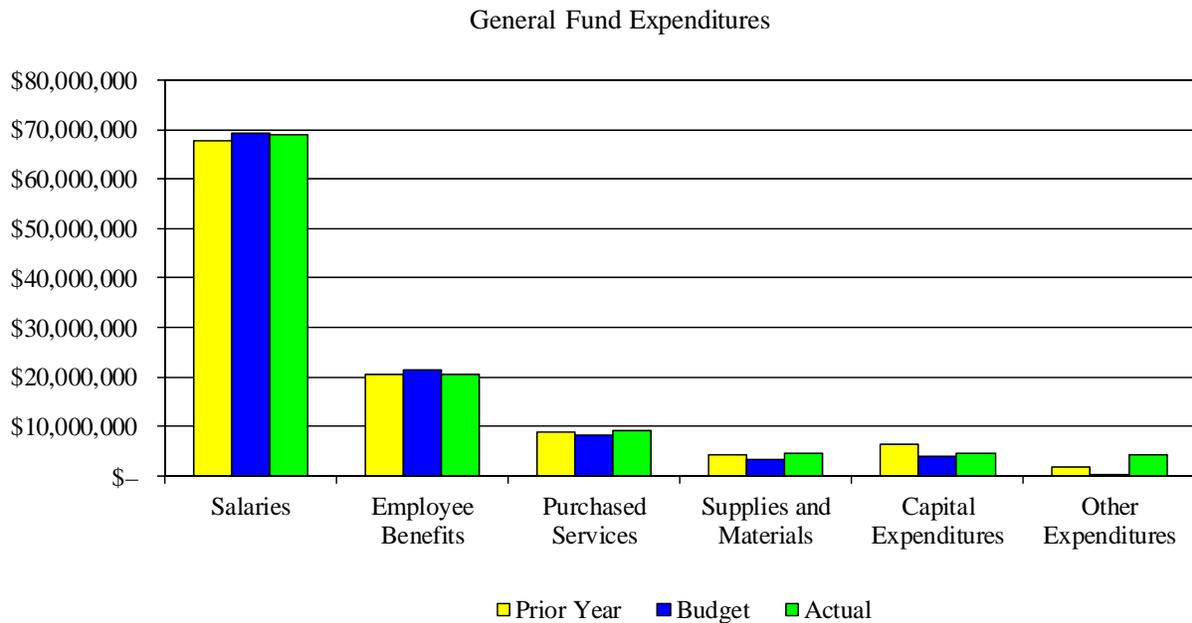


Total General Fund revenues were \$106,988,048 for the year ended June 30, 2015, which was \$2,279,164 (2.2 percent) over the final budget. Revenues from other local sources, including investment income, gifts, bequests, tuition, and rental income, were \$2,178,473 over budget, due to the District receiving more revenue from third party billings and more donations than anticipated, in addition to not budgeting for the fundraising revenue that the student activities generate throughout the year.

General Fund total revenues were \$730,959 (0.7 percent) more than the previous year. The change in revenue between property taxes and state aids from year to year was the result of the prior year \$8.7 million state buy-down of the tax shift discussed earlier in this report. Excluding the impact of the tax shift, property tax revenue increased approximately \$618,000 due to increases in the District's levies. Revenue from state aids, excluding the tax shift, was approximately \$931,000 higher than the prior year. General education aid increased \$1,691,000 due to increases in the basic formula allowance, all-day kindergarten, and other changes to general education funding. This was partially offset by a decrease in special education aid of about \$510,000. Finally, revenue from other local sources was \$802,272 less than last year, due to lower revenue from rent, third party billings, and donations.

GENERAL FUND EXPENDITURES

The following graph summarizes the District's General Fund expenditures for 2015:

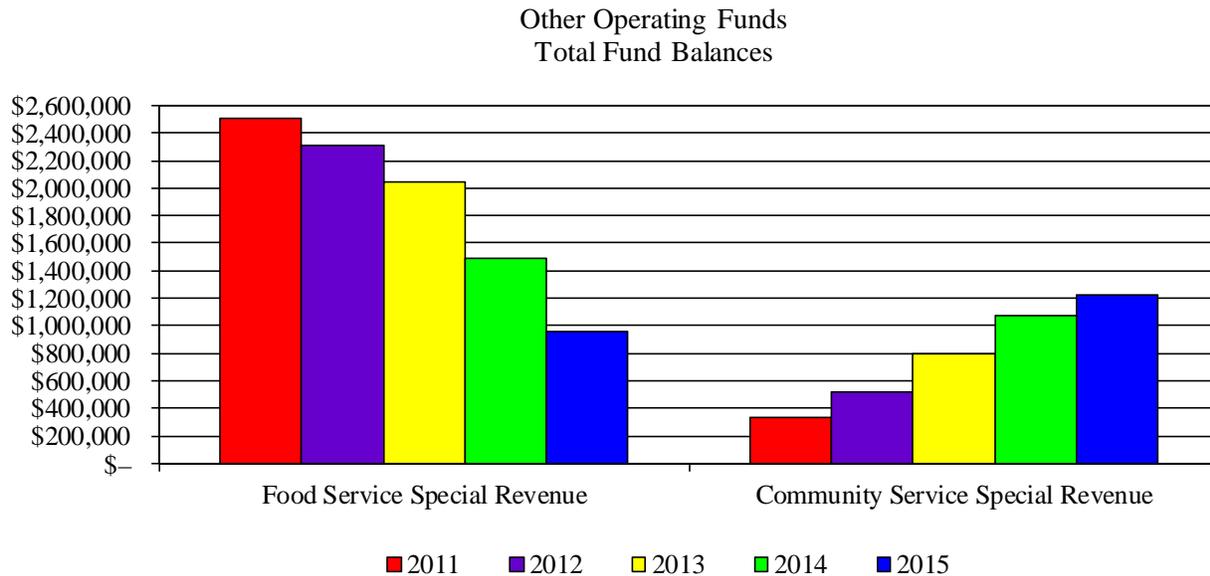


Total General Fund expenditures for 2015 were \$112,060,646, an increase of \$2,236,883 (2.0 percent) from the prior year. Personnel-related costs were \$1,314,080 (1.5 percent) higher than last year, mainly due to contracted increases in salaries. Purchased services were \$258,942 higher than the prior year, spread across several program areas, including district, instructional, and pupil support services. Capital expenditures were \$1,898,673 lower than the previous year and other expenditures (including debt service) were \$2,350,915 higher than the previous year, mainly due to the amount of Apple iLearn technology products financed through capital leases and traded in in 2015.

Total General Fund expenditures were over budget by \$5,387,135 (5.1 percent) in 2015. Other expenditures were over budget by \$3,761,640, mainly due to payments on capital leases, which are not included in the budget by the District. Supplies and materials were over budget by \$1,288,725, due to costs related to the student activities and the expenditure of other site carryovers the District also does not include in its budget.

OTHER FUNDS OF THE DISTRICT

The following graph presents fund balances for the District’s Food Service Special Revenue Fund and Community Service Special Revenue Fund for the last five years:



Food Service Special Revenue Fund

The District’s Food Service Special Revenue Fund ended fiscal 2015 with a fund balance of \$961,763, which is a decrease of \$530,669 from last year, compared to a budgeted decrease of \$658,870. Food service revenue was \$4,489,627, which was under budget by \$190,373, mainly in meal sales. Total expenditures of \$5,020,296 were \$318,574 under budget, as supplies (food) and materials were \$207,541 less than projected.

Community Service Special Revenue Fund

The District’s Community Service Special Revenue Fund ended the year with a fund balance of \$1,218,558, an increase of \$139,084 from the prior year, compared to a budgeted increase of \$301,387. Revenues were over budget by \$439,470, mainly in fees from preschool, adult education, and drivers’ education programs, which experienced higher than anticipated participation. Total expenditures were over budget by \$546,678, primarily in purchased services and salaries.

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 experienced a fund balance increase of \$4,709,490 in fiscal 2015, compared to a budgeted decrease of \$5,690,996, due to the issuance of the 2015A General Obligation Alternative Facilities Bonds which were not included in the budget. The year-end fund balance of \$11,136,244 is restricted for the Alternative Facilities Program and other capital projects.

Debt Service Fund

The funding of debt service is controlled in accordance with each outstanding debt issue’s financing plan. Fund balance decreased \$140,737 in 2015 to a year-end balance of \$1,718,842, of which \$1,514,494 is restricted for general debt service and \$204,348 is restricted for OPEB bonds debt service.

GOVERNMENT-WIDE FINANCIAL STATEMENTS

The District's financial statements include fund-based information that focuses on budgetary compliance, and the sufficiency of the District's current assets to finance its current liabilities. The GASB Statement No. 34 reporting model also requires the inclusion of two government-wide financial statements designed to present a clear picture of the District as a single, unified entity. These government-wide 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,		Increase (Decrease)
	2015	2014	
Net position – governmental activities			
Total fund balances – governmental funds	\$ 30,032,418	\$ 26,281,282	\$ 3,751,136
Pension and OPEB assets	14,057,379	14,268,834	(211,455)
Total capital assets, net of depreciation	98,997,227	100,386,332	(1,389,105)
Bonds, loans, and leases payable	(72,974,987)	(73,776,622)	801,635
PERA and TRA pensions	(78,839,636)	–	(78,839,636)
Other adjustments	(2,213,664)	(2,748,608)	534,944
Total net position – governmental activities	<u>\$ (10,941,263)</u>	<u>\$ 64,411,218</u>	<u>\$ (75,352,481)</u>
Net position			
Net investment in capital assets	\$ 49,968,770	\$ 46,150,573	\$ 3,818,197
Restricted	4,820,097	5,314,896	(494,799)
Unrestricted	<u>(65,730,130)</u>	<u>12,945,749</u>	<u>(78,675,879)</u>
Total net position	<u>\$ (10,941,263)</u>	<u>\$ 64,411,218</u>	<u>\$ (75,352,481)</u>

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, OPEB, and pensions. Consequently, many Minnesota school districts have accumulated deficits in this component of net position.

Total net position decreased \$75,352,481 in fiscal 2015, primarily due to a change in accounting principle for reporting the District's participation in the Public Employees Retirement Association and Teachers Retirement Association pension plans that reduced beginning unrestricted net position by \$80,088,587.

The District's net investment in capital assets increased \$3,818,197. The change in this category of net position is typically determined by the relationship between the depreciation of capital assets and the repayment of the debt issued to construct or acquire the assets.

Restricted net position decreased \$494,799, primarily in amounts restricted for capital asset acquisition and food service.

LEGISLATIVE SUMMARY

After two years with Democratic control of the governor's office and both legislative chambers, the Republicans picked up 11 seats in the House of Representatives (the House) in the 2014 elections, gaining control of that chamber for 2015. Despite the 2015 legislative session beginning with a projected budget excess of \$1.87 billion for the 2016–2017 biennium, the most favorable budget forecast in over a decade, little was accomplished during the session due to partisan disagreement. One of the many areas of contention was the education finance bill, which was passed by the House and Senate late in the regular session without a universal preschool provision demanded by the governor. As promised, the governor vetoed the education finance bill along with several others, forcing a special session. Ultimately, the K–12 education finance bill was passed in a special session adding \$525 million in state funding for K–12 education over the 2016–2017 biennium.

The following is a brief summary of recent legislative changes and issues affecting the future funding of Minnesota school districts:

Basic General Education Revenue – The per pupil basic general education formula allowance increased \$529 to \$5,831 for fiscal year (FY) 2015, with simultaneous changes to pupil weights and the general education formula structure reducing the increase to the equivalent of \$105 per pupil state-wide. The 2015 Legislature approved 2 percent increases for each of the two subsequent fiscal years, raising the per pupil allowance to \$5,948 for FY 2016 and \$6,067 for FY 2017.

A number of other changes were made to the general education formula, including:

- The extended time allowance increased from \$5,017 to \$5,117 beginning in FY 2016.
- Charter schools with extended time programs will receive 25 percent of the state average per adjusted pupil unit (about \$19 per adjusted pupil unit [APU]) beginning in FY 2016.
- Funding eligibility for English learner revenue is extended from 6 to 7 years in FY 2017.
- School districts not in a compensatory pilot project are allowed to allocate up to 50 percent of compensatory revenue among building sites based on a local plan beginning in FY 2016.

The following changes were made to elements of the general education tax levy:

- The student achievement levy, reestablished to allow districts to levy up \$20 million state-wide for FY 2016 (taxes payable 2015), is being phased out. There will be no change to the \$20 million limit for FY 2017 (taxes payable 2016). The levy is reduced to \$10 million state-wide for FY 2018 (taxes payable 2017), and eliminated for FY 2019.
- The equalization factor for operating capital was increased from \$14,500 for FY 2016 to \$14,740 for FY 2017, \$17,473 for FY 2018, and \$20,510 for FY 2019 and later years.

Language was also added requiring districts to use the 2 percent general education staff development set-aside for: teacher development and evaluation, principal development and evaluation, professional development, in-service education, and staff development plans. Staff development plans are required to be aligned and integrated with teacher development and evaluation agreements.

Quality Compensation Program (Q Comp) – The 2015 Legislature made the following changes to the Q Comp alternative compensation for teachers program:

- The cap on basic Q Comp aid increases 16.5 percent to \$75,636,000 beginning in FY 2017.
- Cooperatives other than intermediate districts are eligible to participate in Q Comp beginning in FY 2017. The year prior to participating, 70 percent of the teachers employed by the cooperative must agree to adopt a Q Comp system.
- Beginning in FY 2017, the Q Comp aid formula for intermediates and other cooperatives changes to \$3,000 per licensed teacher employed on October 1 of the previous year.
- Alternative teacher pay systems are now allowed to include incentives for teachers to pursue training, advanced certifications, or master's degrees; and for teachers identified as effective or highly effective to work in hard-to-fill positions or hard-to-staff schools.

Compensatory Pilot Grants – Funding for compensatory pilot grants has been extended, with state-wide funding for FY 2016 and later set at the FY 2015 level of \$7,342,500. Recipient districts are required to post plans and accountability measures on their website.

Special Education Funding – State funding for special education is being transitioned to new funding formulas beginning in FY 2016.

For FY 2016, state regular special education aid will be the lesser of: 62 percent of old formula special education expenditures for the prior year; 50 percent of nonfederal special education expenditures for the prior year; or 56 percent of the amount calculated using a new pupil-driven formula based on prior year data.

Beginning in FY 2016, special education aid will be paid directly to cooperatives and intermediate districts, rather than flowing through the resident districts. Tuition bills will be reduced by the aid paid directly to these entities.

The formula for special education excess cost aid for FY 2016 will be the greater of: 56 percent of the difference between the district's unreimbursed nonfederal special education costs and 7 percent of the district's general education revenue; or 62 percent of the difference between the district's unreimbursed old formula special education costs and 2.5 percent of the district's general education revenue.

Long-Term Facilities Maintenance Revenue – Beginning in FY 2017, the current deferred maintenance, health and safety, and alternative facilities programs will be rolled into a new long-term facilities maintenance revenue program.

The new revenue for FY 2017 will be \$193 per APU, multiplied by the lesser of one, or the ratio of the district's average building age to 35 years. Funding will increase to \$292 per APU for FY 2018 and \$380 per APU for FY 2019, multiplied by the same building age factor. Additional funding will be available for approved indoor air quality, fire alarm and suppression, and asbestos abatement projects with a cost per site of \$100,000 or more. Districts may issue bonds for this program, levy on a pay-as-you-go basis, or a combination of the two. The 25 largest districts currently eligible for alternative facilities revenue will continue to be eligible for reimbursement of approved project costs without a per-pupil limit.

Revenue for long-term facilities maintenance will be equalized up to a limit of one times the annual allowance per APU. The aid/levy mix for the equalized portion of the revenue will be calculated using an equalizing factor of 123 percent of the state average adjusted net tax capacity (ANTC) per pupil unit, calculated with an exclusion of 50 percent of the value of class 2a Agricultural Land from ANTC. Levy equalization will be the same regardless of whether the district chooses to issue bonds or make annual pay-as-you-go levies. Debt service levies under the program will be excluded from regular debt service equalization.

All districts are guaranteed to receive at least as much revenue and at least as much state aid as they would have received under the existing law.

American Indian Education Aid – The Success for the Future Grant Program is being replaced with a new American Indian Education Aid, effective FY 2016. Districts, charters, and Bureau of Indian Education schools with at least 20 American Indian students are eligible for aid. The aid entitlement will equal the lesser of approved costs or \$20,000, plus \$358 per American Indian student enrolled on October 1 of the previous year in excess of 20. There will be a hold harmless for districts currently receiving Success for the Future grants.

College Entrance Exams – Taking a nationally recognized college entrance exam is now optional. However, districts must provide and administer the test upon request once to a student in the 11th or 12th Grade. The Legislature appropriated \$6 million to reimburse districts for the costs of providing the nationally recognized college entrance exam at the students’ option. Costs will be reimbursed until the appropriation is exhausted.

Post-Secondary Enrollment Options (PSEO) – Students in 9th and 10th Grades are now allowed to enroll in PSEO courses if approved by their serving district and the postsecondary institution. They may also enroll in world language courses available to 11th and 12th Graders consistent with world language standards and proficiency seals and certificates. Students not on track to graduate are no longer restricted from PSEO participation.

Full Service Community Schools – Eligible school sites can receive grants in FY 2016 and FY 2017 through a new Full-Service Community Schools Program. To be eligible, a school must be on a development plan for continuous improvement or be in a district with an approved achievement and integration program, and have established two programs in specified program areas to meet school community needs. Sites can earn up to \$100,000 each year for a site coordinator and up to \$20,000 for one year of implementation planning.

Early Learning Programs – While the Governor’s proposed universal preschool provision did not become law, finding increases of \$92.5 million for several early learning programs were approved for the 2016–2017 biennium, including: \$48.25 million for the Early Learning Scholarship Program; \$30.75 million for School Readiness; \$10 million for Head Start; and \$3.5 million for the “Parent Aware” early childhood rating system. Funding for Early Childhood Family Education linked to the general education formula also increased.

Fund Transfers – The authority for school districts to transfer money from one fund or account to another, as long as the transfer does not increase state aid obligations or increase local property taxes, was extended through FY 2017. School boards may only approve such transfers after adopting a resolution stating that the transfer will not diminish instructional opportunities for students. This authorization excludes transfers from the food service or community service funds, and prohibits transfers from the reserved account for staff development.

Four-Day School Week – Future approvals of districts adopting a four-day week will depend upon meeting “World’s Best Workforce” goals. Districts that currently have four-day week schedules are grandfathered in until the FY 2020 school year. If discontinued, districts are allowed one year to transition off the four-day week schedule.

Withdrawal from Cooperatives – In the event of a dispute involving a district’s withdrawal from a cooperative, any administrative law judge fees are required to be split equally by the district and the cooperative.

Financial Reporting Dates – The deadline for districts or charters to make prior year financial data corrections for final payments was moved from December 30 to December 15 following the fiscal year-end.

ACCOUNTING AND AUDITING UPDATES

GASB STATEMENT NO. 72, *FAIR VALUE MEASUREMENT AND APPLICATION*

The primary objective of this statement is to address accounting and financial reporting issues related to fair value measurements. Fair value is the price that would be received to sell an asset or paid to transfer a liability in an orderly transaction between market participants at the measurement date. This statement provides guidance for determining a fair value measurement for financial reporting purposes. It also provides guidance for applying fair value to certain investments and disclosures related to all fair value measurements.

This statement generally requires investments to be measured at fair value. An investment is defined as a security or other asset that (a) a government holds primarily for the purpose of income or profit and (b) has a present service capacity based solely on its ability to generate cash or to be sold to generate cash. This statement is effective for financial statements for fiscal years beginning after June 15, 2015. Earlier application is encouraged.

GASB STATEMENT NO. 73, *ACCOUNTING AND FINANCIAL REPORTING FOR PENSIONS AND RELATED ASSETS THAT ARE NOT WITHIN THE SCOPE OF GASB STATEMENT NO. 68, AND AMENDMENTS TO CERTAIN PROVISIONS OF GASB STATEMENT NOS. 67 AND 68*

The objective of this statement is to improve the usefulness of information about pensions included in financial statements of state and local governments for making decisions and assessing accountability. This statement also clarifies the application of certain provisions of GASB Statement Nos. 67 and 68 regarding 10-year schedules of required supplementary information and other recognition issues pertaining to employers and nonemployer contributing entities. These changes will improve financial reporting by establishing a single framework for the presentation of information about pensions, enhancing comparability for similar information reported by employers and nonemployer contributing entities.

The requirements of this statement that address accounting and financial reporting by employers and governmental nonemployer contributing entities for pensions not within the scope of GASB Statement No. 68 are effective for financial statements for fiscal years beginning after June 15, 2016, and the requirements of this statement that address financial reporting for assets accumulated for purposes of providing those pensions are effective for fiscal years beginning after June 15, 2015. The requirements of this statement for pension plans that are within the scope of GASB Statement No. 67 or for pensions that are within the scope of GASB Statement No. 68 are effective for fiscal years beginning after June 15, 2015. Earlier application is encouraged.

GASB STATEMENT NO. 74, *FINANCIAL REPORTING FOR POSTEMPLOYMENT BENEFIT PLANS OTHER THAN PENSION PLANS*

The objective of this statement is to improve the usefulness of information about post-employment benefits other than pensions (other post-employment benefits [OPEB]). This statement replaces GASB Statement Nos. 43 and 57. It also includes requirements for defined contribution OPEB plans that replace the requirements for those OPEB plans in GASB Statement Nos. 25, 43, and 50. GASB Statement No. 75, *Accounting and Financial Reporting for Postemployment Benefits Other Than Pensions*, establishes new accounting and financial reporting requirements for governments whose employees are provided with OPEB, as well as for certain nonemployer governments that have a legal obligation to provide financial support for OPEB provided to the employees of other entities.

This statement will improve financial reporting primarily through enhanced note disclosures and schedules of required supplementary information that will be presented by OPEB plans administered through trusts meeting the specified criteria. The new information will enhance the decision-usefulness of the financial reports of those OPEB plans, their value for assessing accountability, and their transparency by providing information about measures of net OPEB liabilities and explanations of how and why those liabilities changed from year to year. The net OPEB liability information, including ratios, will offer an up-to-date indication of the extent to which the total OPEB liability is covered by the fiduciary net position of the OPEB plan. The comparability of the reported information for similar types of OPEB plans will be improved by the changes related to the attribution method used to determine the total OPEB liability. The contribution schedule will provide measures to evaluate decisions related to the assessment of contribution rates in comparison with actuarially determined rates, if such rates are determined. In addition, new information about rates of return on OPEB plan investments will inform financial report users about the effects of market conditions on the OPEB plan's assets over time and provide information for users to assess the relative success of the OPEB plan's investment strategy and the relative contribution that investment earnings provide to the OPEB plan's ability to pay benefits to plan members when they come due.

This statement is effective for financial statements for fiscal years beginning after June 15, 2016. Earlier application is encouraged.

GASB STATEMENT NO. 75, ACCOUNTING AND FINANCIAL REPORTING FOR POSTEMPLOYMENT BENEFITS OTHER THAN PENSIONS

The primary objective of this statement is to improve accounting and financial reporting by state and local governments for post-employment benefits other than pensions (OPEB). It also improves information provided by state and local governmental employers about financial support for OPEB that is provided by other entities. This statement replaces the requirements of GASB Statement Nos. 45 and 57. GASB Statement No. 74 establishes new accounting and financial reporting requirements for OPEB plans.

This statement establishes standards for recognizing and measuring liabilities, deferred outflows of resources, deferred inflows of resources, and expense/expenditures. For defined benefit OPEB, this statement identifies the methods and assumptions that are required to be used to project benefit payments, discount projected benefit payments to their actuarial present value, and attribute that present value to periods of employee service. Note disclosure and required supplementary information requirements about defined benefit OPEB also are addressed. This statement is effective for fiscal years beginning after June 15, 2017. Earlier application is encouraged.

Similar to changes implemented for pensions, this statement requires the liability of employers and nonemployer contributing entities to employees for defined benefit OPEB (net OPEB liability) to be measured as the portion of the present value of projected benefit payments to be provided to current active and inactive employees that is attributed to those employees' past periods of service (total OPEB liability), less the amount of the OPEB plan's fiduciary net position.

GASB STATEMENT NO. 77, TAX ABATEMENT DISCLOSURES

This statement requires disclosure of tax abatement information about (1) a reporting government's own tax abatement agreements, and (2) those that are entered into by other governments and that reduce the reporting government's tax revenues. Tax abatements are widely used by state and local governments, particularly to encourage economic development. For financial reporting purposes, this statement defines a tax abatement as resulting from an agreement between a government and an individual or entity in which the government promises to forgo tax revenues and the individual or entity promises to subsequently take a specific action that contributes to economic development or otherwise benefits the government or its citizens.

The requirements of this statement improve financial reporting by giving users of financial statements essential information that is not consistently or comprehensively reported to the public at present. Disclosure of information about the nature and magnitude of tax abatements will make these transactions more transparent to financial statement users. As a result, users will be better equipped to understand (1) how tax abatements affect a government's future ability to raise resources and meet its financial obligations, and (2) the impact those abatements have on a government's financial position and economic condition. The requirements of this statement are effective for financial statements for periods beginning after December 15, 2015. Earlier application is encouraged.

CHANGES TO FEDERAL GRANT AUDIT REQUIREMENTS

In December 2013, the OMB issued *Uniform Administrative Requirements, Cost Principles, and Audit Requirements for Federal Audits*, which supersedes all or parts of eight OMB circulars; consolidating federal cost principles, administrative principles, and audit requirements in one document. This new Uniform Guidance includes a number of significant changes to both administrative requirements and the federal Single Audit process.

Significant changes in administrative requirements include: changes to time and effort documentation, updating internal control framework to be consistent with changes to the Committee of Sponsoring Organizations) of the Treadway Commission (COSO) internal control framework, creating written policies and procedures to implement requirements of cash management and allowability of costs, implementing new procurement standards, and additional compliance and control requirements for districts making subawards. Auditees are required to implement the administrative requirements of the new Uniform Guidance for new awards or funding increments on or after December 26, 2014.

Significant changes to the federal Single Audit process include: an increase in dollar threshold for requiring a Single Audit from \$500,000 to \$750,000; changes to the thresholds and process used for determining major programs; reductions in the percentages of expenditures required to be covered by a Single Audit from 50 percent to 40 percent for high risk auditees and from 25 percent to 20 percent for low risk auditees; revised criteria for determining low-risk auditees; and an increase in the threshold for reporting questioned costs from \$10,000 to \$25,000. The revised audit requirements will be effective for audits of fiscal years beginning on or after December 26, 2014.