Management Report

for

Independent School District No. 624
White Bear Lake, Minnesota
June 30, 2013

MMKR
CERTIFIED PUBLIC ACCOUNTANTS

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To the Board of Education and Management of
Independent School District No. 624
White Bear Lake, Minnesota

We have prepared this management report in conjunction with our audit of Independent School District No. 624, White Bear Lake Area Schools' (the District) financial statements for the year ended June 30, 2013. The purpose of this report is to communicate information relevant to the financing of public education in Minnesota and to provide comments resulting from our audit process. We have organized this report into the following sections:

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

We would be pleased to further discuss any of the information contained in this report or any other concerns that you would like us to address. We would also like to express our thanks for the courtesy and assistance extended to us during the course of our audit.

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
October 31, 2013

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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 Board of Education, 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, 2013, 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 with you in order to obtain sufficient audit evidence and complete an effective audit.

AUDIT OPINIONS AND FINDINGS

Based on our audit of the District's financial statements for the year ended June 30, 2013:

- 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 that are 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 requirements applicable to each major federal program.
- We reported one deficiency in the internal controls over compliance and its operation that we consider to be a material weakness in our testing of major federal programs:
    - During our audit, we noted the District did not have adequate internal controls in place to ensure adequate documentation of expenditures within the special education cluster (CFDA Nos. 84.027 and 84.773). During our testing, we noted 6 of 25 transactions we tested did not have a signed approval of the disbursement on file.
- We reported no findings based on our testing of the District's compliance with Minnesota laws and regulations.

OTHER COMMENTS AND RECOMMENDATIONS

During our testing, we noted that the District does not include in its internal control procedures a formal review and approval of the monthly bank reconciliation. The District is relying on other compensating controls to ensure the bank reconciliation process is completed correctly. It is our recommendation that the District include in its internal control procedures the requirement that at least one individual review and approve the monthly bank reconciliation once it has been prepared.

During our testing, we noted in 2 out of 25 disbursement transactions we tested that a better accounting code existed in the Uniform Financial Accounting and Reporting Standards (UFARS) Manual for the coding of the transaction. It is our recommendation that the District review the internal controls over the coding of disbursements to ensure all transactions are being coded to the most appropriate (UFARS) account code in the future.

During our testing, we noted 11 out of 25 receipt transactions we tested were coded to expenditure account codes rather than the revenue codes for which the receipt related. Although the size and scope of these transactions were not significant, we recommend the District code all receipts to revenue codes in the future in an effort to properly separate revenue transactions from expenditure transactions in the accounting system.

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, 2013, we performed procedures to follow-up on any findings and recommendations that resulted from our prior year audit. We reported the following findings that were corrected by the District in the current year:

- We noted in the prior year that the District recorded a prior period adjustment. No financial statement corrections were noted in the current year.
- The District did not have adequate controls in place to ensure adequate documentation of payroll-related expenditures within the Safe and Drug-Free Schools Grant. No exceptions were noted in our current year testing.
- We noted that the District did not have proper procedures in place to ensure all construction contracts subject to the Davis Bacon Act included a requirement that the contractor or subcontractor comply with the requirements of the Davis Bacon Act and Department of Labor regulations. This was not a current year finding.
- We noted in the prior year that the District did not properly obtain a withholding affidavit or IC-134 Form from the Commissioner of Revenue to ensure contractors are complying with the state payroll withholding requirements. This was not a current 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. For the fiscal year ended June 30, 2013, the District implemented Governmental Accounting Standards Board (GASB) Statement No. 63, *Financial Reporting of Deferred Outflows of Resources, Deferred Inflows of Resources, and Net Position*, and GASB Statement No. 65, *Items Previously Reported as Assets and Liabilities*.

GASB Statement No. 63 changed how governmental entities present a statement of net position, adding two new basic financial statement elements, and replacing "net assets" with "net position" as the terminology used to describe the difference between the other four elements. The two basic financial statement elements added are "deferred inflows of resources" and "deferred outflows of resources." These new elements are differentiated from assets (deferred outflows of resources) and liabilities (deferred inflows of resources), but have similar effects on net position.

GASB Statement No. 65 identifies specific items previously presented as assets that will now be presented as either deferred outflows of resources or outflows (expenses/expenditures), and items previously reported as liabilities that will now be presented as deferred inflows of resources or inflows (revenues).

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

CORRECTED AND UNCORRECTED MISSTATEMENTS

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

ACCOUNTING ESTIMATES AND MANAGEMENT JUDGMENTS

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

General education revenue and certain other revenues are computed by applying an allowance per student to the number of students served by the District. Student attendance is accumulated in a state-wide database—MARSS. Because of the complexity of student accounting and because of certain enrollment options, student information is input by other school districts and the MARSS data for fiscal year 2013 is not finalized until after the District has closed its financial records for the fiscal period. 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 fiscal 2013 is not finalized until after the District has closed its financial records for the fiscal period. The impact of this adjustment on the receivable and revenue recorded for state special education aid is calculated using preliminary information available to the District.

The District has recorded a liability in the Statement of Net Position and the Internal Service Fund 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 calculated obligations for other post-employment benefits (OPEB). These obligations are calculated using actuarial methodologies described in Governmental Accounting Standards Board (GASB) Statement No. 45. These actuarial calculations include significant assumptions, including projected changes, healthcare insurance costs, investment returns, retirement ages, and employee turnover.

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

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

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.

DISAGREEMENTS WITH MANAGEMENT

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

MANAGEMENT CONSULTATIONS WITH OTHER INDEPENDENT ACCOUNTANTS

In some cases, management may decide to consult with other accountants about auditing and accounting matters, similar to obtaining a "second opinion" on certain situations. If a consultation involves application of an accounting principle to the District's financial statements or a determination of the type of auditor's opinion that may be expressed on those statements, our professional standards require the consulting accountant to check with us to determine that the consultant has all the relevant facts. To our knowledge, there were no such consultations with other accountants.

OTHER AUDIT FINDINGS OR ISSUES

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

MANAGEMENT REPRESENTATIONS

We have requested certain representations from management that are included in the management representation letter dated October 31, 2013.

OTHER MATTERS

With respect to the supplemental information and the separately issued Schedule of Expenditures of Federal Awards and Uniform Financial Accounting and Reporting Standards (UFARS) Compliance Table, we made certain inquiries of management and evaluated the form, content, and methods of preparing the information to determine that the information complies with accounting principles generally accepted in the United States of America, the method of preparing it has not changed from the prior period, and the information is appropriate and complete in relation to our audit of the financial statements. We compared and reconciled the supplemental information, Schedule of Expenditures of Federal Awards, and the UFARS Compliance Table to the underlying accounting records used to prepare the basic financial statements or to the basic financial statements themselves.

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

FUNDING PUBLIC EDUCATION IN MINNESOTA

Due to its complexity, it would be impossible to fully explain the funding of public education in Minnesota within this report. 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 next two 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, and the one-time replacement of a portion of general education aid with federal fiscal stabilization funds in fiscal 2010.

Fiscal Year Ended June 30	Formula Allowance Amount	Formula Allowance Percent Increase
2004	$ 4,601	– %
2005	$ 4,601	– %
2006	$ 4,783	4.0 %
2007	$ 4,974	4.0 %
2008	$ 5,074	2.0 %
2009	$ 5,124	1.0 %
2010	$ 5,124	– %
2011	$ 5,124	– %
2012	$ 5,174	1.0 %
2013	$ 5,224	1.0 %
2014	$ 5,302	1.5 %
2015	$ 5,806	1.5 % *

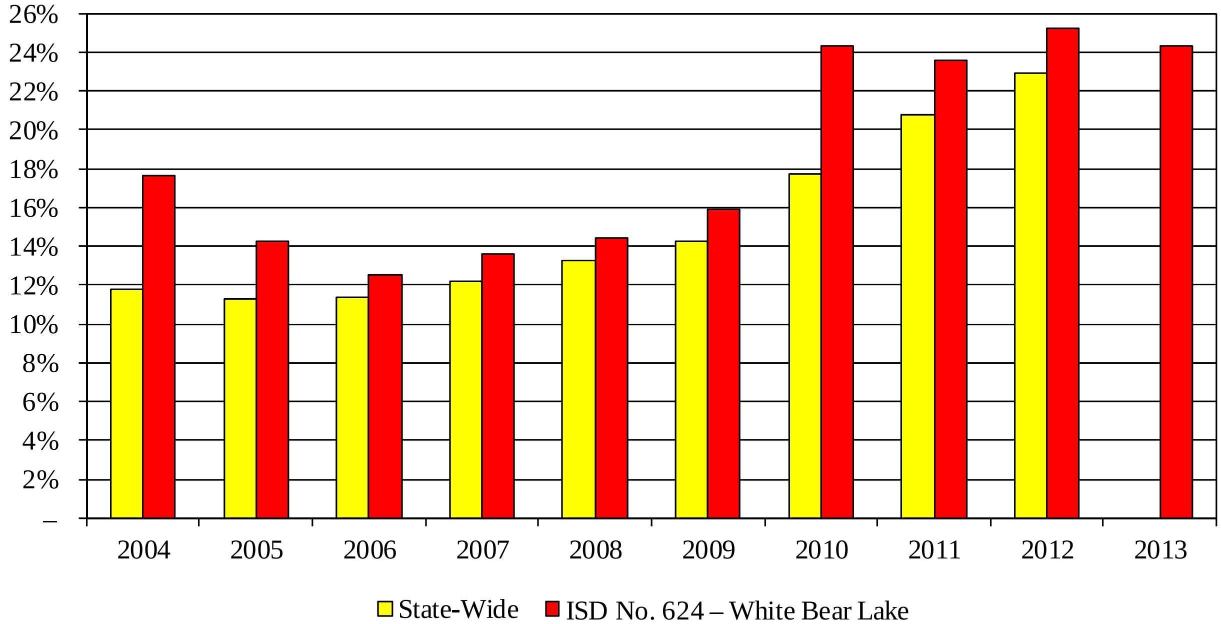
* The $504 increase in 2015 was offset by changes to pupil weightings and the general education aid formula that reduced the increase to the equivalent of $80 or 1.5% state-wide.

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

STATE-WIDE SCHOOL DISTRICT FINANCIAL HEALTH

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

State-Wide Unrestricted/Unreserved Operating Fund Balance
as a Percentage of Operating Expenditures



Note: State-wide information is not available for fiscal 2013.

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

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

As of June 30, 2012, this ratio was 25.3 percent for the District, as compared to a state-wide average of 22.9 percent. The District's unrestricted operating fund balance as a percentage of operating expenditures was 24.3 percent at the end of the current year.

The table below shows a comparison of governmental fund revenue per ADM received by Minnesota school districts and your district. Revenues for all governmental funds are included, except for the Capital Projects – Building Construction Fund and 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. 624 – White Bear Lake		
	2011	2012	2011	2012	2011	2012	2013
General Fund							
Property taxes	$ 2,130	$ 1,550	$ 2,811	$ 2,019	$ 3,407	$ 2,544	$ 2,638
Other local sources	432	448	358	378	154	127	151
State	7,213	7,920	7,063	7,949	6,238	7,187	7,580
Federal	720	588	755	621	621	445	347
Total General Fund	10,495	10,506	10,987	10,967	10,420	10,303	10,716
Special revenue funds							
Food Service	474	488	470	483	479	491	503
Community Service	513	525	619	633	510	577	632
Debt Service Fund	1,053	1,088	1,131	1,180	1,006	1,065	1,132
Total revenue	$ 12,535	$ 12,607	$ 13,207	$ 13,263	$ 12,415	$ 12,436	$ 12,983
ADM served per MDE School District Profiles Report (current year estimated)					8,234	8,144	8,067

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

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

The ADM served used in the table above and on the following page is based on enrollments consistent with those used in the MDE School District Profiles Report, which include extended time and shared time ADM, and may differ from the ADM reported elsewhere in this report.

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 had revenue of $104.7 million in governmental funds reflected above in fiscal 2013, an increase of $3.4 million (3.4 percent) from the prior year. Most of this increase was in state revenue due to an increase in the general education formula and an increase in special education entitlements.

Total revenue per ADM served increased by $547, or 4.4 percent, for similar reasons.

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. 624 – White Bear Lake		
	2011	2012	2011	2012	2011	2012	2013
General Fund							
Administration and district support	$ 813	$ 823	$ 788	$ 805	$ 856	$ 738	$ 765
Elementary and secondary regular instruction	4,829	4,866	5,107	5,103	4,593	4,686	4,886
Vocational education instruction	144	138	136	136	108	113	101
Special education instruction	1,904	1,866	2,015	2,004	2,199	2,090	2,272
Instructional support services	446	459	526	537	517	544	509
Pupil support services	874	895	937	957	788	853	937
Sites, buildings, and other	811	802	765	755	993	972	1,011
Total General Fund operating expenditures (excluding capital)	9,821	9,849	10,274	10,297	10,054	9,995	10,481
General Fund capital expenditures	452	462	419	410	342	415	872
Special revenue funds							
Food Service	469	486	469	480	498	492	508
Community Service	515	526	623	630	588	650	675
Debt Service Fund	1,111	1,337	1,208	1,312	1,039	1,103	1,216
Total expenditures	$ 12,368	$ 12,660	$ 12,993	$ 13,129	$ 12,522	$ 12,656	$ 13,752
ADM served per MDE School District Profiles Report (current year estimated)					8,234	8,144	8,067

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

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 total expenditures per ADM are typically lower than the metro area averages.

The District had expenditures of approximately $110.9 million in the governmental funds reflected above in fiscal 2013, an increase of about $7.8 million from the prior year. On a per student basis, this represents an increase of $1,096. Expenditures increased $457 per student in the General Fund capital expenditures, mainly due to the issuance of a capital lease of $3.9 million during the year. General Fund operating expenditures increased $486 per student mainly in regular and special education instruction from scheduled salary and benefit increases.

SUMMARY

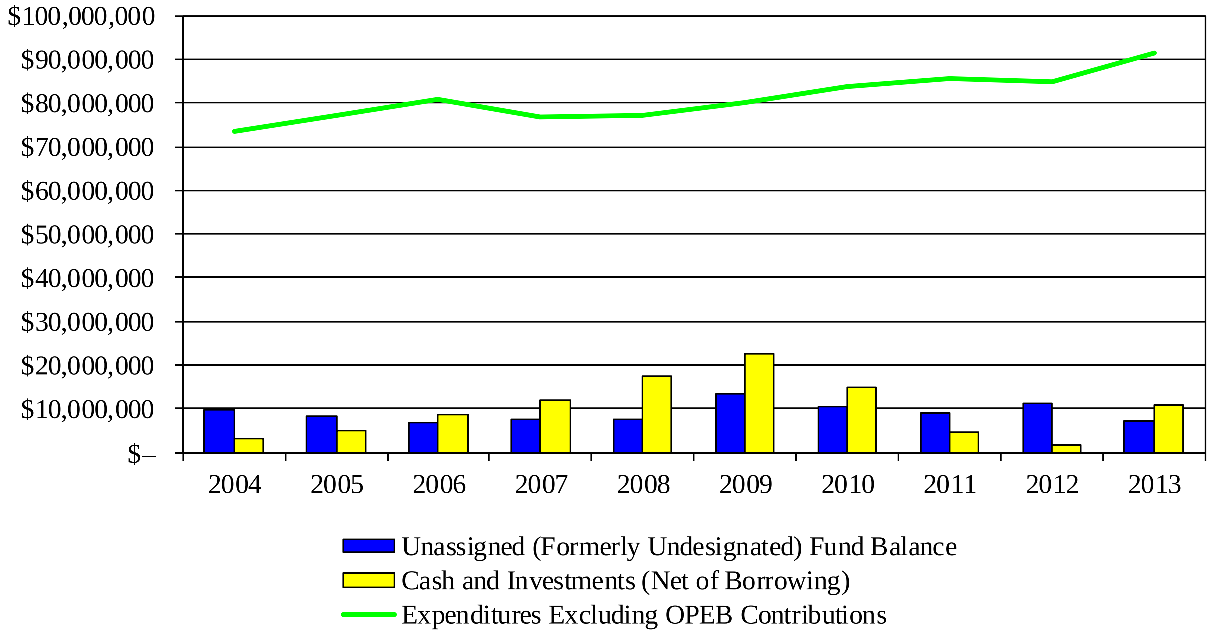
The funding for and financial position of Minnesota school districts has fluctuated significantly over the past several years due to a number of factors, including those discussed above. This situation has created a challenge for school boards, administrators, and management of these districts in providing 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 volume of financial activity. Unassigned (formerly undesignated) fund balance and cash balance are typically used as indicators of financial health, while annual expenditures measure the size of the operation.

General Fund – Financial Position
Year Ended June 30



The District ended fiscal year 2013 with a General Fund cash balance of $11,027,823, an increase of $9,298,533 from the previous year. This change was primarily due to the change in the metering of state aid payments in fiscal 2013. The unassigned (formerly undesignated) fund balance at year-end was $7,295,063, a decrease of $3,820,160. The General Fund continues to experience a stable fund balance position.

The net change to fund balance of the General Fund decreased $1,609,260. This decline compares to a budgeted decline in fund balance of $809,260. This result was due to revenue exceeding budgeted amounts by $621,357 and expenditures (net of other financing sources and uses) being over budgeted amounts by $1,430,617. Most of this was the result of capital expenditures for sites and buildings exceeding projections by about $1.3 million.

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

	Year Ended June 30,				
	2009	2010	2011	2012	2013
Nonspendable fund balances	$ –	$ 479,163	$ 586,628	$ 219,984	$ 1,255,743
Restricted (formerly reserved) fund balances	2,815,375	3,120,086	3,148,469	2,106,435	1,022,955
Unrestricted (formerly unreserved) fund balances					
Assigned (formerly designated)	3,803,746	6,474,495	7,818,797	6,697,066	8,955,687
Unassigned (formerly undesignated)	13,302,596	10,551,796	8,882,644	11,115,223	7,295,063
Total fund balance	$ 19,921,717	$ 20,625,540	$ 20,436,538	$ 20,138,708	$ 18,529,448
Unassigned (formerly undesignated) fund balances as a percentage of expenditures	11.1%	12.6%	10.4%	13.1%	8.0%

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.

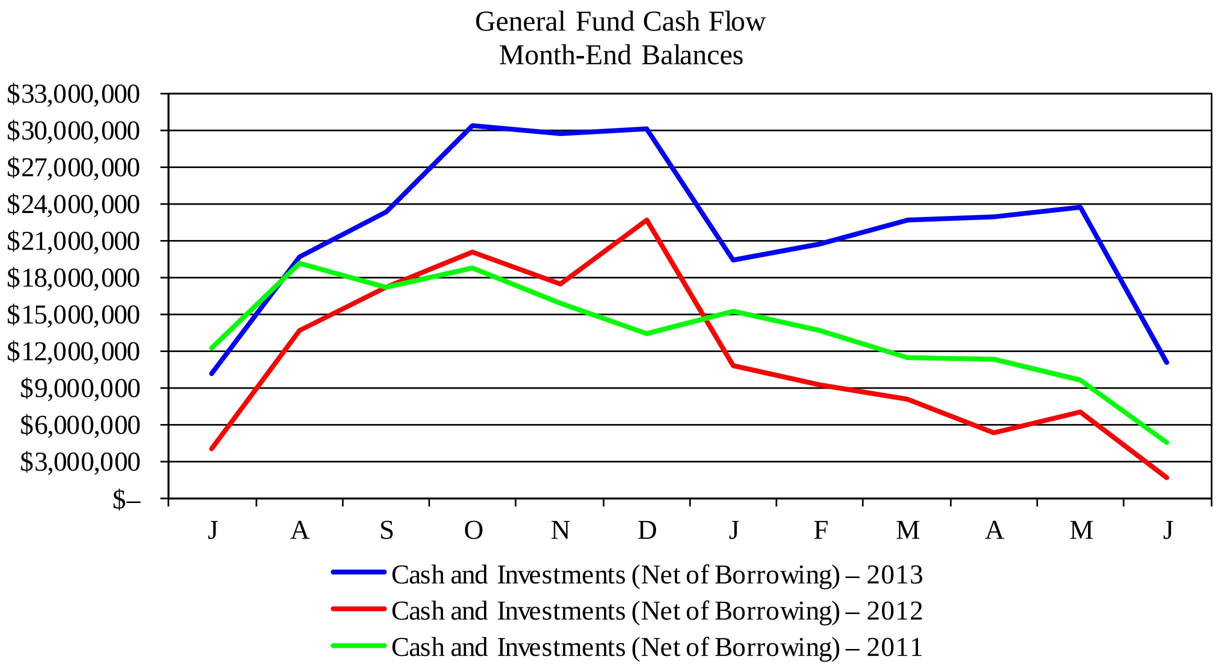
The Board of Education has formally adopted a fund balance policy regarding the minimum unassigned fund balance for the General Fund. The policy states that the District will strive to maintain a minimum unassigned General Fund balance of five weeks of operating expenses. At June 30, 2013, the unassigned fund balance of the General Fund was 8.0 percent of total fiscal 2013 expenditures, or 4.1 weeks of operating expenditures.

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

The significant change in equity components above is a result of the implementation of GASB Statement No. 54, *Fund Balance Reporting and Governmental Fund Type Definitions*.

GENERAL FUND CASH FLOW

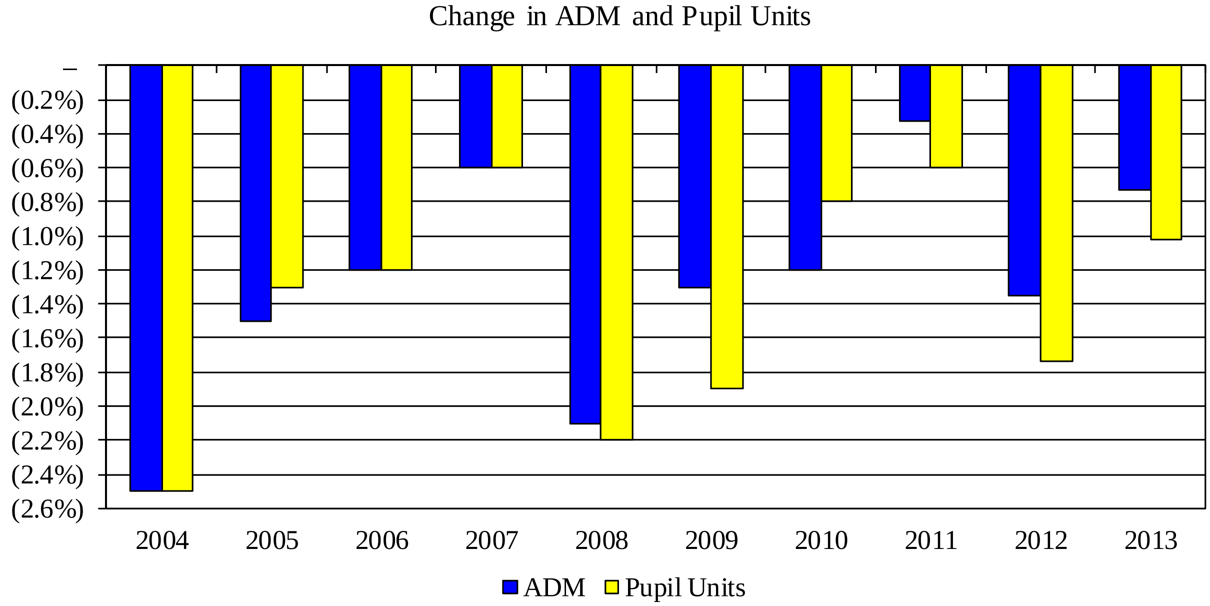
The level of cash and investments varies considerably during the year due to the timing of various revenues and expenditures. The following graph summarizes the level of cash and investments (net of borrowing) over the past three years:



The graph above shows the peaks and valleys of the General Fund cash and investments balance (net of borrowing and interfund balances) on a monthly basis. The swing between its high and low month-end cash balances was about $20.2 million for fiscal 2013. Changes in the tax shift and state aid payment schedules significantly affect the cash flow of Minnesota school districts. As further described in the Legislative Summary section of this report, the metering of state aids normally paid on a 90–10 schedule has changed several times over the last few years, with the state holdback as high as 40 percent at one point in fiscal year 2012. At June 30, 2013, the metering of state aids was being paid on a 86.4–13.6 schedule.

AVERAGE DAILY MEMBERSHIP AND PUPIL UNITS

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

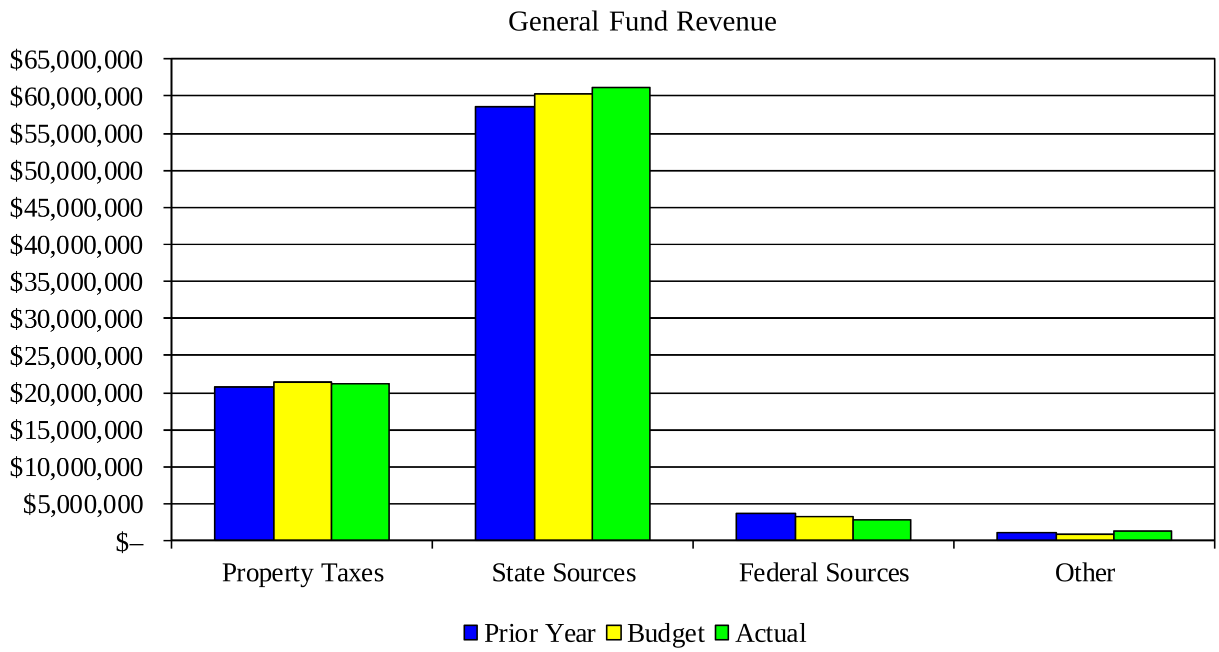


ADM is a measure of students attending class, which is then converted to pupil units (the base for determining revenue) using a statutory formula. Not only is the original budget based on ADM estimates, the final audited financial statements are based on updated, but still estimated, ADM since the counts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

Adjusted ADM served by the District decreased 59 ADM from the prior year to 8,002 served in the current year. The District continues to experience steady declines in the number of students it serves.

GENERAL FUND REVENUE

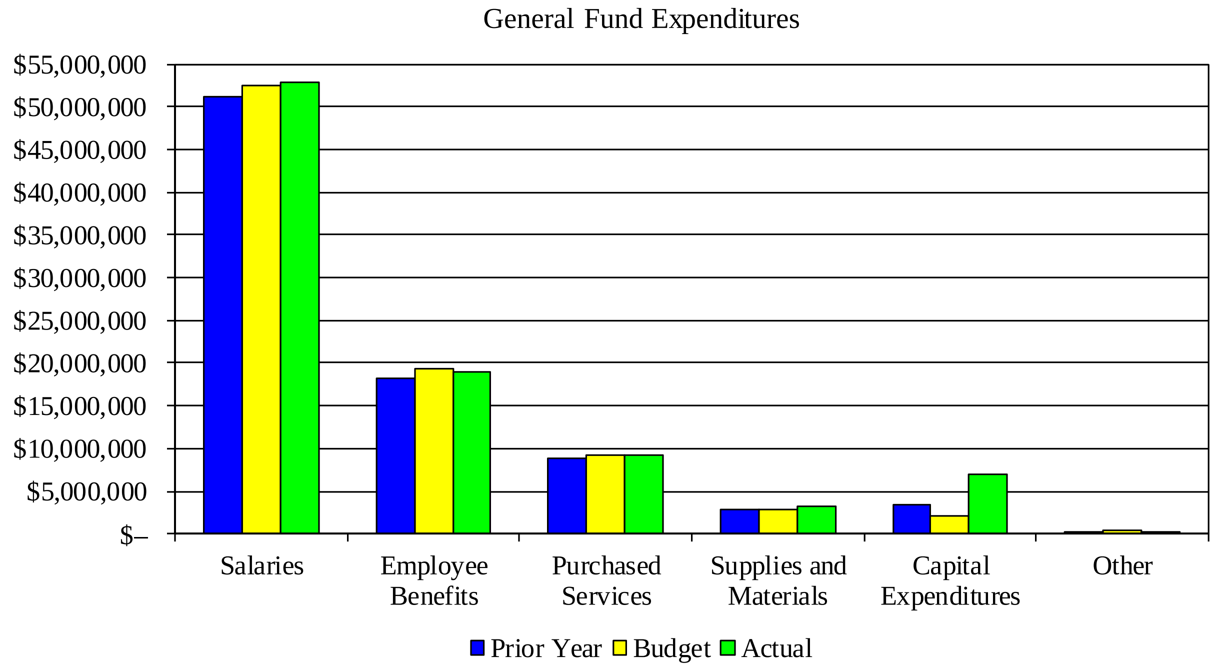
The following graph summarizes the District's General Fund revenue for 2013:



Total General Fund revenues for 2013 were $86,444,357, an increase of $2,527,814, or 3.0 percent, from the prior year, and $621,357, or 0.7 percent, over budget. The largest variance was in state sources, which was $2,611,749 more than the prior year and exceeded budget by $796,325, both primarily in the special education program area. The variance in state special education aid was mainly attributable to prior year clean up settlements exceeding accrued receivables, as tuition adjustments ended up more favorable than projected. State revenue also increased due to the increase in the General Education State Aid Formula.

GENERAL FUND EXPENDITURES

The following graph summarizes the District's General Fund expenditures for 2013:



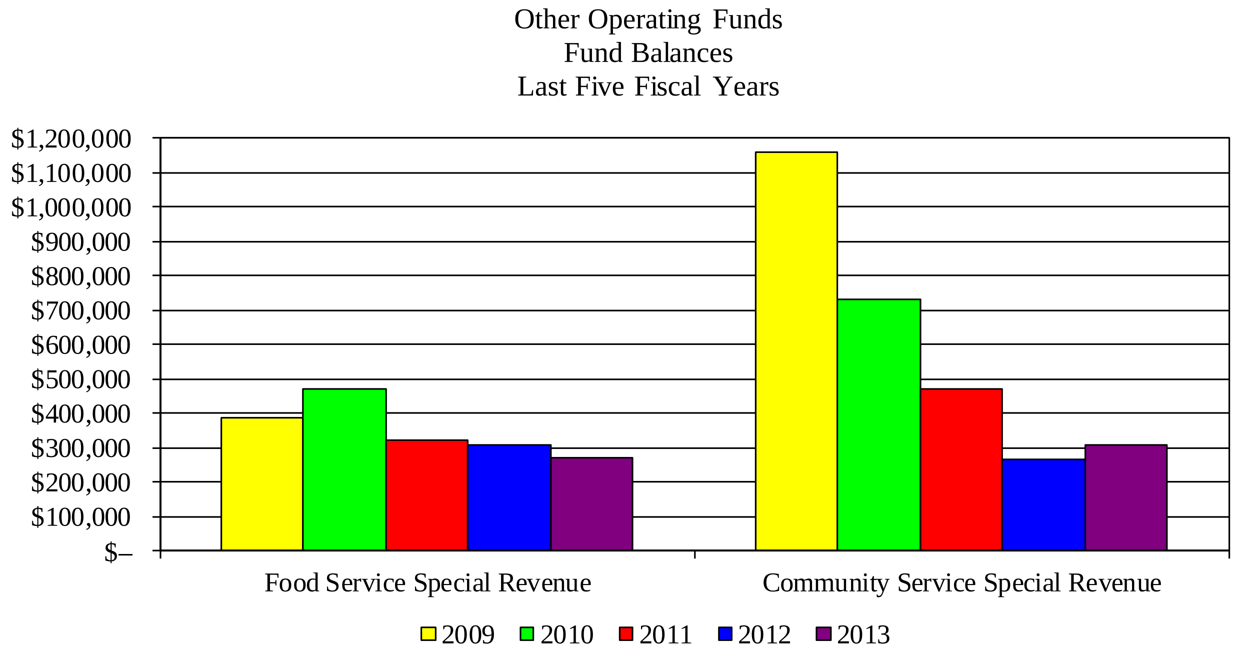
Total General Fund expenditures for 2013 were $91,575,467, an increase of $6,794,999 (8.0 percent) from the prior year, and $5,338,467 over budget.

District expenditures were over budgeted amounts mostly in capital expenditures, salaries, and supplies and materials by $4,913,559, $465,489, and $351,049, respectively. Capital expenditures were over budget due to the issuance of a $3,900,000 capital lease for building construction. Salaries were over budgeted amounts in special education instruction as the needs were higher than projected. Supplies and materials were also over budget mainly in elementary and secondary regular instruction, most of this relates to higher than expected costs for textbooks.

Expenditures were more than the prior year due to higher costs in capital expenditures ($3,652,448) and salaries and benefits ($2,614,033). Capital expenditures increased related to the issuance of the capital lease for building construction and increased capital outlay for sites and buildings. Salaries and benefit increases were from pay raises, modest hiring of new staff members, increases in the related benefits, and increases in the costs of workers' compensation insurance.

OTHER FUNDS OF THE DISTRICT

The following graph shows what is referred to as the other operating funds. The remaining non-operating funds are only included in narrative form below, since their level of fund balance can fluctuate significantly due to such things as issuing and spending the proceeds of refunding or building bonds and, therefore, the trend of fund balance levels are not necessarily a key indicator of financial health. It does not mean that these funds cannot experience financial trouble or that their fund balances are unimportant.



Food Service Special Revenue Fund

The District's Food Service Special Revenue Fund experienced a $37,278 decrease in fund balance, which was $177,278 under the projected budget.

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

Community Service Special Revenue Fund

The District's Community Service Special Revenue Fund experienced an increase in fund balance of $41,771 for the year ended June 30, 2013, which was $156,771 more than the planned decline in fund balance of $115,000 in the budget.

The Community Service Special Revenue Fund, like the Food Service Special Revenue Fund, needs to be self-sustaining. In addition to cost controls, financial analysis of the costs of providing programs, including overhead, is important. Fees and tuition charges should be sufficient to cover these costs as well as potential funding shortfalls from state, federal, or property tax sources.

Capital Projects – Building Construction Fund

At June 30, 2013, this fund has a year-end balance of $2,278,190, which is restricted for the alternative facilities program.

Debt Service Fund

The funding of debt service is controlled in accordance with each outstanding debt issue's financing plan.

Severance Obligations Internal Service Fund

The District, as part of the implementation of GASB Statement No. 45, converted the former Employee Benefit Trust Fund to a Severance Obligations Internal Service Fund to finance the severance obligations of the District. The following table presents the activity reported for the past five fiscal years in this Internal Service Fund:

	2009	2010	2011	2012	2013
Operating revenue					
Contributions from governmental funds	$ 440,274	$ 403,654	$ 451,530	$ 250,366	$ 699,593
Operating expenses					
Post-employment severance benefits	405,701	511,838	270,372	128,233	282,291
Operating income (loss)	34,573	(108,184)	181,158	122,133	417,302
Nonoperating revenue					
Investment earnings	103,948	104,243	113,217	112,792	113,537
Change in net assets	138,521	(3,941)	294,375	234,925	530,839
Net assets					
Beginning of year	134,643	273,164	269,223	563,598	798,523
End of year	$ 273,164	$ 269,223	$ 563,598	$ 798,523	$ 1,329,362

The District underwent an actuarial study dated July 1, 2011 to determine its severance benefit liabilities based on current contracts and employees in place. A number of variables and estimates are used to determine this liability as of year-end as mentioned earlier in this report. The assets held in this fund at June 30, 2013 totaled $3,864,013 and will be used to pay the District's liability for severance totaling $2,534,651 as of June 30, 2013.

Post-Employment Benefits Trust Fund – Fiduciary Fund

The District established a Post-Employment Benefits Trust Fund – Fiduciary Fund to finance post-employment health benefit liabilities. The District established this fund in fiscal 2009 through the issuance of $40,085,000 in bonds. These funds are held in trust restricted for the payment of OPEB liabilities. The assets held in this fund at June 30, 2013 totaled $43,353,213 and will be used by the District in future years to finance the OPEB obligations of the District.

ANALYSIS OF OPEB FUNDING

The District underwent an actuarial study dated July 1, 2011 to determine the District's post-employment health benefit liabilities based on current contracts and employees in place.

This pension plan is funded by the District's Post-Employment Benefits Irrevocable Trust Fund, which is reported in the District's financial report as a fiduciary fund. As of the most recent actuarial study dated July 1, 2011, the plan was 187 percent funded, which is based on an actuarial accrued liability for benefits of $24,621,323 and the actuarial value of assets within the irrevocable trust fund of $46,153,625. The assets in the trust fund exceeded the OPEB accrued liability reported in the actuarial study by $21,532,302 at July 1, 2011.

GOVERNMENT-WIDE FINANCIAL STATEMENTS

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

Theoretically, net position represents the resources the District has leftover to use for providing services after its debts are settled. However, those resources are not always in expendable form, or there may be restrictions on how some of those resources can be used. Therefore, the statement divides the net position into three components: net investment in capital assets; restricted; and unrestricted. The following table presents a summarized conversion of the District's governmental fund balances (as discussed earlier) to net position and the separate components of net position for the last three years:

	June 30, 2011	June 30, 2012	June 30, 2013
Net position – governmental activities			
Total fund balances – governmental funds	$ 23,884,272	$ 55,860,386	$ 23,103,298
Negative net OPEB obligation	42,002,137	41,216,996	40,397,681
Total capital assets, less accumulated depreciation	60,220,992	57,875,702	59,686,247
Total long-term liabilities	(99,965,237)	(125,939,000)	(96,344,161)
Accrued interest payable	(1,889,165)	(1,875,723)	(1,747,968)
Unamortized premiums	(637,332)	(3,519,477)	(3,049,526)
Other	561,155	1,128,251	2,262,185
Total net position – governmental activities	$ 24,176,822	$ 24,747,135	$ 24,307,756
Net position			
Net investment in capital assets	$ 453,384	$ 1,630,228	$ 2,130,306
Restricted	4,221,609	2,601,876	1,132,318
Unrestricted	19,501,829	20,515,031	21,045,132
Total net position	$ 24,176,822	$ 24,747,135	$ 24,307,756

Some of the District's fund balances translate into restricted net position by virtue of external restrictions (statutory reserves) 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 non-capital long-term obligations such as vacation or severance payable. Consequently, many Minnesota school districts have accumulated deficits in this component of net position.

LEGISLATIVE SUMMARY

The 2013 legislative session began with a projected budget deficit of $1.1 billion, later revised down to a deficit of $627 million in the February 2013 economic forecast. With the Democrats controlling the House, Senate, and Governor's office, it was anticipated that setting the state's biennial budget would be an easier task than in recent contentious legislative sessions. However, the Governor's budget proposal included a number of highly controversial recommendations, including an additional state income-tax tier for the highest wage earners and an expansion of sales tax base to a number of services. As a result, the session went as long as was constitutionally allowable, with the last bill passed at midnight on the final day of the session.

The laws passed by the 2013 Legislature included a number of significant changes to Minnesota school district financing. Included were the reestablishment of a general education tax levy, revisions and reforms to district operating referendum levies, substantial overhauls of the general education and special education funding formulas, funding for all-day kindergarten, and a simplification of school district pupil accounting. Minnesota school districts will benefit from 1.5 percent increases to the basic general education formula allowance approved for each year of the biennium. Also passed was a one-time initiative to dedicate any further surplus accrued by the state through June 30, 2013 to accelerate the state aid payment schedule for school districts, potentially reducing the lingering negative impact of legislative shifts on their cash flow.

The following is a brief summary of recent legislation that has significantly affected the funding of Minnesota school districts:

Basic General Education Revenue – The per pupil basic general education formula allowance for fiscal year (FY) 2013 was $5,224. The allowance will increase $78 to $5,302 for FY 2014. The allowance for FY 2015 increases $504 to $5,806; however, simultaneous changes to pupil weights and the general education formula structure reduce the state-wide general education revenue increase to the equivalent of an $80 formula increase under the old pupil weights and formula structure.

Pupil Unit Weights – Pupil unit weights for FY 2014 are unchanged from FY 2013, with the clarification that a kindergarten pupil receiving at least 850 hours of instruction during the school year is considered to be a full-time pupil for calculating extended-time general education revenue. Pupil weights for FY 2015 have been reduced and simplified. Weights for students in pre-kindergarten through grade 6 will be 1.0 for districts with free all-day kindergarten, with the weighting set at 0.55 for kindergarten pupils receiving less than 850 hours of instruction during the school year or in an all-day kindergarten program that charges a fee. Pupil weights will be 1.2 for students in grades 7 through 12.

Other Pupil Accounting Changes – In addition to the simplification of pupil unit weights, the following changes were made to pupil accounting:

- Beginning in FY 2014, school districts are required to have at least 165 days of instruction for students in grades 1 through 11, unless the school district has a four-day week schedule approved by the Commissioner of Education.
- Beginning in FY 2014, school districts and charter schools will no longer generate extended time revenue for students in programs designed to accelerate their grade level advancement to enable them to graduate before their peers.
- Marginal cost pupil units are eliminated beginning in FY 2015 and a new declining enrollment revenue component of general education aid is established, equal the decline in adjusted pupil units between the prior year and current year times 28 percent of the basic general education aid allowance.

Other Changes to the General Education Formula – In addition to the basic formula allowance increase, a number of other changes were made to the general education formula for FY 2015 to neutralize the impact of pupil weighting changes, including:

- An increase in the extended time allowance from $4,601 to $5,017.
- An increase in the gifted and talented revenue allowance from $12 to $13.
- An increase in the small schools allowance from $522.40 to $544, along with a decrease in the qualifying threshold from 1,000 to 960 pupil units.
- An increase in the operating capital revenue from $73 per pupil unit + $100 times the building age index to $79 per pupil unit + $109 times the building age index.
- Increases in the equity revenue allowances, from $75 to $80 for sliding scale and from $46 to $50 for flat rate.
- The elimination of the pension adjustment reduction to general education aid, with districts having below average pension adjustment guaranteed to receive a minimum of the state average gain from the elimination of the pension adjustment.

Changes to the Uses of General Education Aid – The following changes and clarifications were made regarding the allowable uses of general education aid:

- Effective FY 2014, operating capital revenue may be used for hardware, software, and annual licensing fees related to the purchase or lease of computers.
- Effective FY 2014, staff development revenue may be used for teacher evaluation costs.
- Effective FY 2014, up to 5 percent of a district's compensatory revenue may be used for programs designed to prepare children for entry into school.
- Effective FY 2015, general education revenue generated for all-day kindergarten may be used for programs to meet the needs of three and four-year-olds within the district.
- Effective FY 2015, Q-Comp revenue is rolled out of the general education formula and established as a separate categorical aid.
- Effective FY 2015, the revenue set aside for learning and development is converted from an amount based on pupil unit weights to a flat amount per ADM of $299 per kindergarten student and $459 per student in Grades 1 through 6.

Special Education Funding Reform – Beginning in FY 2016, the state funding formulas for special education will change as follows:

- ***Special Education Regular Aid*** – Special education regular aid for FY 2016 will be limited to 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.
- ***Special Education Excess Cost Aid*** – Special education excess cost aid for FY 2016 will be the greater of the following, calculated using prior year data:
  - 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.

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.

In transitioning to the new formula, during FY 2014 and FY 2015:

- ***Special Education Regular Aid*** – The current special education regular aid formula remains in place for these two years.
- ***Special Education Cross Subsidy Reduction Aid*** – A new special education cross subsidy reduction aid will be added for these two fiscal years only. Aid for FY 2014 will equal the lesser of $20 per ADM served or 1 percent of the amount generated for the district under the new pupil-based formula, with a state-wide limit of $13 million. Aid for FY 2015 will equal the lesser of $48 per ADM served or 2.27 percent of the amount generated for the district under the new pupil-based formula, with a state-wide limit of $30 million.
- ***Special Education Excess Cost Aid*** – the calculation of special education excess cost aid for these two fiscal years will use prior year data and will exclude special education tuition receipts and expenditures. The calculations will take into account special education cross subsidy aid and general education aid attributable to students served outside of the regular classroom more than 60 percent of the time.

Beginning in FY 2015, special education tuition billing is changed so that the resident district is responsible for 90 percent of unfunded costs (vs. 100 percent currently) and the serving district or charter school is responsible for 10 percent of unfunded costs for open-enrolled students. This does not apply to students placed by tuition agreement, or served by a charter school with at least 70 percent special education students.

General Education Levy Reform – The following changes were made to various elements of the general education tax levy effective FY 2015:

- A uniform general education levy is reestablished, known as the “student achievement levy.” All districts may levy up to the student achievement rate, which is set to raise $20 million state-wide in FY 2015. Districts that levy less than the maximum permitted rate will be subject to a proportionate reduction in its general education aid.
- The equalization factor for operating capital is increased to offset the impact of the student achievement levy.
- Operating referendum revenue is converted from an amount based on resident marginal cost pupil units to an amount based on adjusted pupil units (APUs), due to the elimination of marginal cost pupil units. The separate alternative attendance adjustment is eliminated and rolled into the allowance per APU. The allowance per APU will be set so the total revenue prior to applicable caps is the same as under the old law.
- Districts are allowed to convert up to $300 per APU of existing operating referendum revenue from voter approved to board approved. Districts with approved operating referendums of less than $300 per APU are permitted to authorize additional referendum revenue up to the $300 per APU limit. Operating referenda will be equalized based on a new, three-tiered formula.
- A new “location equity levy” is established, providing school districts with any land area in the seven-county metro area with authority for a location equity levy of $424 per APU. Districts with adjusted ADM of greater than 2,000 that do not qualify as metro districts are eligible for a location equity levy of $212 per APU. Both levies are equalized at $510,000. Districts may opt out of location equity revenue by a board vote taken by September 1 of the fiscal year preceding the fiscal year when the revenue takes effect (e.g. September 2013 for FY 2015 revenue).

Career and Technical Levy – Beginning in FY 2014, this levy is converted to an equalized aid and levy, with an equalization factor of $7,612. The state-wide limit for career and technical revenue is increased 34 percent to $20,657,000 for FY 2014. Revenue for FY 2014 will continue to be based on the current formula, with the proration factor adjusted to hit the state-wide revenue target. Beginning in 2015, the state-wide revenue limit expires, and funding will be based on 35 percent of approved program expenditures.

Safe Schools Levy – Beginning in FY 2015, the safe schools levy increases from $30 to $36 per pupil unit, with $4 of the increase representing new revenue and $2 to adjust for the changes to pupil weightings. The use of this levy is expanded to include facility security enhancements, efforts to improve school climate, and mental health services.

Achievement and Integration Revenue – Beginning in FY 2014, integration revenue is replaced with achievement and integration revenue. Revenue for 2014 consists of two components, initial revenue and incentive revenue. Initial revenue equals $350 per APU times a minority concentration factor, plus 66 percent of the difference between FY 2013 integration revenue and FY 2014 revenue computed using the new rate. Incentive revenue equals $10 per APU. Total achievement and integration revenue will be split between aid and levy.

Districts will be required to use at least 80 percent of achievement and integration revenue for innovative and integrated learning environments. Up to 20 percent of this revenue may be used for professional development. Administration expenditures may not exceed 10 percent of revenue. The MDE will keep 0.3 percent of each district's initial revenue for oversight costs.

Schools Lunch Aid – The state reimbursement rate for each school lunch served increases from 12 cents to 12.5 cents, effective July 1, 2013.

Early Learning Scholarships – Early learning program scholarships of up to $5,000 per year per child are available for families with a child age three or four on September 1st of the current year that have income equal to or less than 185 percent of the federal poverty level. Any sibling ages zero to five have access to a scholarship to attend the same program. Parents under the age of 21 pursuing a high school degree may be eligible for a scholarship for a child age 0 to 5.

Fund Transfers – For FY 2013 through FY 2015, school districts are authorized to transfer any money from one fund or account to another, excluding transfers from the food service or community service funds, as long as the transfer does not increase state aid obligations or increase local property taxes. School boards may only approve such transfers after they have adopted a resolution stating that the transfer will not diminish instructional opportunities for students. For FY 2014 and FY 2015 only, this authorization was modified to also prohibit transfers from the reserved account for staff development.

State Aid Payment Deferral – State aids normally paid on a 90–10 schedule have been paid on a deferred payment schedule since FY 2009 for both school districts and charter schools. Originally set to a 60–40 payment schedule for FY 2012, a series of operating surpluses have enabled the state to accelerate the aid payment schedule to 86.4–13.6 as of June 30, 2013. The Legislature created a one-time mechanism to use any state surplus that accumulates by June 30, 2013 to further repay school district aid payment shifts.

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

PERA and TRA Rates – Contribution rates for employers and employees for both the TRA Basic and Coordinated Plans increase by 0.5 percent each year through FY 2015. There is no additional aid to help fund these increases.

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

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

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

The primary objective of this statement is to improve accounting and financial reporting by state and local governments for pensions. This statement replaces the requirements of GASB Statement Nos. 27 and 50, as they relate to pensions that are provided through pension plans administered as trusts or equivalent arrangements that meet certain criteria (as described above for GASB Statement No. 67). The requirements of GASB Statement Nos. 27 and 50 remain applicable for pensions that are not covered by the scope of this statement.

This statement establishes standards for measuring and recognizing liabilities, deferred outflows of resources, deferred inflows of resources, and expense/expenditures. In addition, this statement details the recognition and disclosure requirements for employers with liabilities (payables) to a defined benefit pension plan and for employers whose employees are provided with defined contribution pensions. This statement also addresses circumstances in which a nonemployer entity has a legal requirement to make contributions directly to a pension plan. This statement is effective for financial statements for fiscal years beginning after June 15, 2014. Earlier application is encouraged.

Included in this statement are major changes in how employers that participate in cost-sharing pension plans, such as TRA and PERA, account for pension benefit expenses and liabilities. In financial statements prepared using the economic resources measurement focus and accrual basis of accounting (government-wide and proprietary funds), a cost-sharing employer that does not have a special funding situation is required to recognize a liability for its proportionate share of the net pension liability of all employers with benefits provided through the pension plan.

A cost-sharing employer is required to recognize pension expense and report deferred outflows of resources and deferred inflows of resources related to pensions for its proportionate share of collective pension expense and collective deferred outflows of resources and deferred inflows of resources related to pensions. In addition, the effects of (1) a change in the employer's proportion of the collective net pension liability and (2) differences during the measurement period between the employer's contributions and its proportionate share of the total of contributions from employers included in the collective net pension liability are required to be determined. These effects are required to be recognized in the employer's pension expense in a systematic and rational manner over a closed period equal to the average of the expected remaining service lives of all active and inactive employees that are provided with pensions through the pension plan.

GASB STATEMENT NO. 69 – GOVERNMENT COMBINATIONS AND DISPOSALS OF GOVERNMENT OPERATIONS

This statement provides accounting and financial reporting guidance, including disclosure requirements, for government combinations and disposals of government operations. Government combinations include mergers, acquisitions, and transfers of operations. Included within the scope of this statement are combinations of governmental entities or combinations of governmental entities, with nongovernmental entities (such as a nonprofit entity) as long as the new or continuing organization is a government. This statement does not apply to combinations in which a government acquires an organization that continues to exist as a separate entity, or acquires an equity interest in an organization that remains legally separate from the acquiring government. A disposal of operations occurs when a government either transfers or sells specific operations. The provisions of this statement are effective for financial statements for periods beginning after December 15, 2013. Earlier application is encouraged.

CHANGES TO FEDERAL GRANT AUDIT REQUIREMENTS

The U.S. Office of Management and Budget (OMB) has issued *Proposed OMB Uniform Guidance: Cost Principles, Audit, and Administrative Requirements for Federal Awards*, which proposes broad revisions to OMB Circular A-133 and other key grant reforms. The proposed guidance includes a number of significant changes to the federal Single Audit process, including; an increase in dollar threshold for requiring a Single Audit, changes to the process for determining major programs, a reduction in the percentage of expenditures required to be covered by a Single Audit, revised criteria for determining low-risk auditees, a reduction in the types of compliance requirements to be tested, and an increase in the threshold for reporting questioned costs. The proposed guidance would also consolidate OMB circulars and cost principles; and change certain federal requirements related to indirect costs, time and effort reporting, and grant administration.