

Management Report

for

Independent School District No. 16  
Spring Lake Park, Minnesota

June 30, 2019

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## PRINCIPALS

Thomas A. Karnowski, CPA  
Paul A. Radosevich, CPA  
William J. Lauer, CPA  
James H. Eichten, CPA  
Aaron J. Nielsen, CPA  
Victoria L. Holinka, CPA/CMA  
Jaclyn M. Huegel, CPA  
Kalen T. Karnowski, CPA

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

We have prepared this management report in conjunction with our audit of Independent School District No. 16's (the District) financial statements for the year ended June 30, 2019. We have organized this report into the following sections:

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

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

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

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

Minneapolis, Minnesota  
December 9, 2019

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

5353 Wayzata Boulevard • Suite 410 • Minneapolis, MN 55416 • Phone: 952-545-0424 • Fax: 952-545-0569 • [www.mmkr.com](http://www.mmkr.com)

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## AUDIT SUMMARY

The following is a summary of our audit work, key conclusions, and other information that we consider important or that is required to be communicated to the School Board, administration, or those charged with governance of the District.

### **OUR RESPONSIBILITY UNDER AUDITING STANDARDS GENERALLY ACCEPTED IN THE UNITED STATES OF AMERICA, GOVERNMENT AUDITING STANDARDS, AND TITLE 2 U.S. CODE OF FEDERAL REGULATIONS PART 200, UNIFORM ADMINISTRATIVE REQUIREMENTS, COST PRINCIPLES, AND AUDIT REQUIREMENTS FOR FEDERAL AWARDS (UNIFORM GUIDANCE)**

We have audited the financial statements of the governmental activities, each major fund, and the aggregate remaining fund information of the District as of and for the year ended June 30, 2019. Professional standards require that we provide you with information about our responsibilities under auditing standards generally accepted in the United States of America, *Government Auditing Standards*, and the Uniform Guidance, as well as certain information related to the planned scope and timing of our audit. We have communicated such information to you verbally and in our audit engagement letter. Professional standards also require that we communicate to you the following information related to our audit.

### **PLANNED SCOPE AND TIMING OF THE AUDIT**

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

### **AUDIT OPINION AND FINDINGS**

Based on our audit of the District's financial statements for the year ended June 30, 2019:

- We have issued an unmodified opinion on the District's basic financial statements.
- We reported no deficiencies in the District's internal control over financial reporting that we consider to be material weaknesses. It should be understood that internal controls are never perfected, and those controls, which protect the District's funds from such things as fraud and accounting errors, need to be continually reviewed by your management and modified as necessary.
- The results of our testing disclosed no instances of noncompliance required to be reported under *Government Auditing Standards*.
- We reported that the Schedule of Expenditures of Federal Awards is fairly stated, in all material respects, in relation to the basic financial statements.
- The results of our tests indicate that the District has complied, in all material respects, with the types of compliance requirements that could have a direct and material effect on each of its major federal programs.
- We reported no deficiencies in the District's internal controls over compliance that we considered to be material weaknesses with the types of compliance requirements that could have a direct and material effect on each of its major federal programs.
- We reported one finding based on our testing of the District's compliance with Minnesota laws and regulations.
  - For one contract tested, the District did not have required subcontractor payment information as required by state statutes.

## **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, 2019, we performed procedures to follow-up on any findings and recommendations that resulted from our prior year audit. We reported the following finding that was corrected by the District in the current year:

- District Audit Finding 2018-001 – Internal Control Over Compliance With Federal Allowable Cost Requirements

## **SIGNIFICANT ACCOUNTING POLICIES**

Management is responsible for the selection and use of appropriate accounting policies. The significant accounting policies used by the District are described in Note 1 of the notes to basic financial statements.

No new accounting policies were adopted and the application of existing policies was not changed during the fiscal year ended June 30, 2019. However, the District implemented the following governmental accounting standard during the fiscal year ended June 30, 2019:

- Governmental Accounting Standards Board (GASB) Statement No. 88, *Certain Disclosures Related to Debt, Including Direct Borrowings and Direct Placements*, which improved the information disclosed in notes to government financial statements related to debt, including direct borrowings and direct placements. It also clarified which liabilities governments should include when disclosing information related to debt.

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

## **ACCOUNTING ESTIMATES AND MANAGEMENT JUDGMENTS**

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

General education revenue and certain other revenues are computed by applying an allowance per student to the number of students served by the District. Student attendance is accumulated in a state-wide database—MARSS. Because of the complexity of student accounting and because of certain enrollment options, student information is input by other school districts and the MARSS data for the current fiscal year is not finalized until after the District has closed its financial records. General education revenue and certain other revenues are computed using preliminary information on the number of students served in the resident district and also utilizing some estimates, particularly in the area of enrollment options.

Special education state aid includes an adjustment related to tuition billings to and from other school districts for special education services, which are computed using formulas derived by the Minnesota Department of Education (MDE). Because of the timing of the calculations, this adjustment for the current fiscal year is not finalized until after the District has closed its financial records. The impact of this adjustment on the receivable and revenue recorded for state special education aid is calculated using preliminary information available to the District.

The District has recorded a liability in the Statement of Net Position for severance benefits payable for which it is probable employees will be compensated. The “vesting method” used by the District to calculate this liability is based on assumptions involving the probability of employees becoming eligible to receive the benefits (vesting), the potential use of accumulated sick leave prior to termination, and the age at which such employees are likely to retire.

The District has recorded activity for other post-employment benefits (OPEB) and pension benefits. These obligations are calculated using actuarial methodologies primarily described in GASB Statement Nos. 68, 74, and 75. These actuarial calculations include significant assumptions, including projected changes, healthcare insurance costs, investment returns, retirement ages, proportionate share, and employee turnover.

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

The District’s self-insured activities require recording a liability for claims incurred, but not yet reported, which are based on estimates.

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

Certain financial statement disclosures are particularly sensitive because of their significance to financial statement users. The disclosures included in the notes to the basic financial statements related to OPEB and pension benefits are particularly sensitive due to the materiality of the liabilities, and the large and complex estimates involved in determining the disclosures.

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

#### **DIFFICULTIES ENCOUNTERED IN PERFORMING THE AUDIT**

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

#### **CORRECTED AND UNCORRECTED MISSTATEMENTS**

Professional standards require us to accumulate all known and likely misstatements identified during the audit, other than those that are clearly trivial, and communicate them to the appropriate level of management. There were no misstatements detected as a result of audit procedures that were material, either individually or in the aggregate, to each opinion unit’s financial statements taken as a whole.

#### **DISAGREEMENTS WITH MANAGEMENT**

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

#### **MANAGEMENT REPRESENTATIONS**

We have requested certain representations from management that are included in the management representation letter dated December 9, 2019.

## **MANAGEMENT CONSULTATIONS WITH OTHER INDEPENDENT ACCOUNTANTS**

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

## **OTHER AUDIT FINDINGS OR ISSUES**

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

## **OTHER MATTERS**

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

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

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

## FUNDING PUBLIC EDUCATION IN MINNESOTA

Due to its complexity, it would be impossible to fully explain the funding of public education in Minnesota within this report. A summary of legislative changes affecting school districts 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.

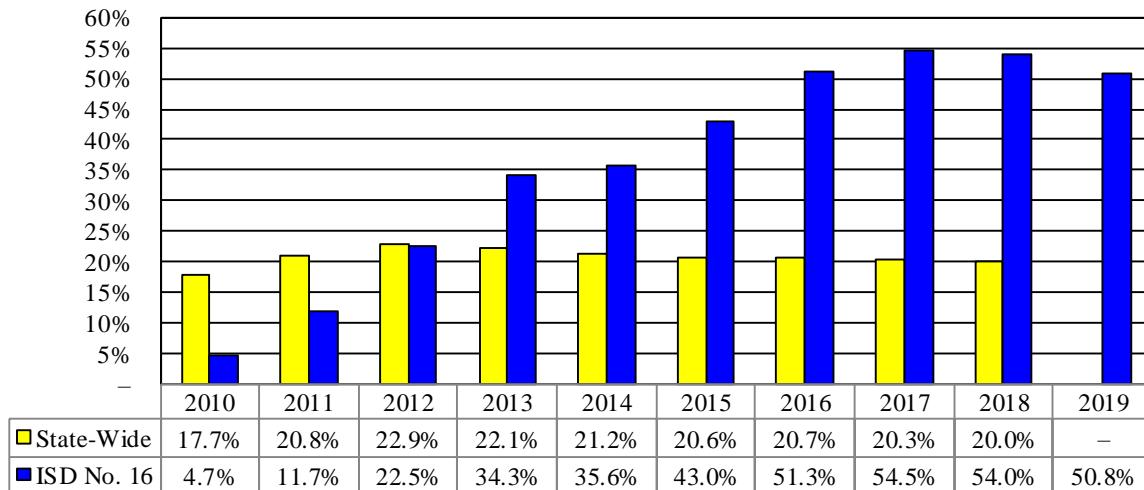
The table below presents a summary of the formula allowance for the past decade and as approved for the next two fiscal years. The amount of the formula allowance and the percentage change from year-to-year excludes temporary funding changes, the “roll-in” of aids that were previously funded separately, and changes that may vary dependent on actions taken by individual districts. The \$529 increase in 2015 was offset by changes to pupil weightings and the general education aid formula that resulted in an increase equivalent to approximately \$105, or 2.0 percent, state-wide.

Fiscal Year Ended June 30,	Formula Allowance	
	Amount	Percent Increase
2010	\$ 5,124	— %
2011	\$ 5,124	— %
2012	\$ 5,174	1.0 %
2013	\$ 5,224	1.0 %
2014	\$ 5,302	1.5 %
2015	\$ 5,831	2.0 %
2016	\$ 5,948	2.0 %
2017	\$ 6,067	2.0 %
2018	\$ 6,188	2.0 %
2019	\$ 6,312	2.0 %
2020	\$ 6,438	2.0 %
2021	\$ 6,567	2.0 %

## STATE-WIDE SCHOOL DISTRICT FINANCIAL HEALTH

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

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



Note: State-wide information is not available for fiscal 2019.

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

During the economic downturn that began in 2008, the average unrestricted fund balance as a percentage of operating expenditures maintained by Minnesota school districts increased, peaking at 22.9 percent at the end of fiscal 2012. This trend reflected districts' efforts to limit budget cuts, retain educational programs, and maintain adequate operating cash flow during a period of uncertain funding. As the state's economic condition improved in subsequent years, this ratio has gradually decreased to 20.0 percent at the end of fiscal 2018.

As of June 30, 2018, this ratio was 54.0 percent for the District, as compared to a state-wide average of 20.0 percent. The District's unrestricted operating fund balance as a percentage of operating expenditures was 50.8 percent at the end of the current year.

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

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

<b>Governmental Funds Revenue per Student (ADM) Served</b>								
	State-Wide		Metro Area		ISD No. 16 – Spring Lake Park			
	2017	2018	2017	2018	2017	2018	2019	
General Fund								
Property taxes	\$ 1,933	\$ 2,024	\$ 2,516	\$ 2,638	\$ 1,750	\$ 1,807	\$ 1,933	
Other local sources	515	520	423	433	275	263	444	
State	9,386	9,614	9,387	9,625	8,668	8,915	9,025	
Federal	450	450	480	474	299	313	312	
Total General Fund	12,284	12,608	12,806	13,170	10,992	11,298	11,714	
Special revenue funds								
Food Service	561	559	557	554	515	488	479	
Community Service	628	642	733	752	589	569	603	
Debt Service Fund	1,119	1,128	1,118	1,120	1,578	1,879	1,716	
Total revenue	\$ 14,592	\$ 14,937	\$ 15,214	\$ 15,596	\$ 13,674	\$ 14,234	\$ 14,512	
ADM served per MDE School District Profiles Report (current year estimated)					5,706	5,784	5,955	
Note: Excludes the Capital Projects – Building Construction and Post-Employment Benefits Debt Service Funds.								
Source of state-wide and metro area data: School District Profiles Report published by the MDE								

ADM used in the table 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.

Changes in enrollment also impact comparisons in the table above and on the next page when revenue and expenditures are based on fixed costs, such as debt levies and principal and interest on outstanding indebtedness.

The District earned \$86,415,541 in the governmental funds reflected above in fiscal 2019, an increase of \$4,092,082 (5.0 percent) from the prior year. Total revenue per ADM served increased by \$278 (2.0 percent) per student. The increase in the basic formula allowance as discussed earlier, along with an increase in special education, contributed to the overall revenue growth. The District also approved an increase in the General Fund property tax levy, which also contributed to the increase in total revenues. An increase in investment earnings, donations, and local grants contributed to the change in other local sources in the General Fund. The change in the Debt Service Fund is due, in part, to growing enrollment along with savings from debt refunding transactions in recent years.

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

Governmental Funds Expenditures per Student (ADM) Served										
	State-Wide		Metro Area		ISD No. 16 – Spring Lake Park			2017	2018	2019
	2017	2018	2017	2018	2017	2018	2019			
<b>General Fund</b>										
Administration and district support	\$ 991	\$ 1,031	\$ 996	\$ 1,045	\$ 728	\$ 751	\$ 798			
Elementary and secondary										
regular instruction	5,539	5,646	5,887	5,976	4,437	4,710	4,891			
Vocational education instruction	166	170	153	154	90	86	93			
Special education instruction	2,225	2,298	2,334	2,418	1,489	1,576	1,696			
Community service	–	–	–	–	3	11	9			
Instructional support services	660	658	765	748	904	984	948			
Pupil support services	1,074	1,118	1,165	1,209	1,042	1,136	1,177			
Sites, buildings, and other	906	936	870	896	900	1,177	1,182			
Total General Fund – noncapital	11,561	11,857	12,170	12,446	9,593	10,431	10,794			
General Fund capital expenditures	627	658	592	636	1,043	1,109	806			
Total General Fund	12,188	12,515	12,762	13,082	10,636	11,540	11,600			
<b>Special revenue funds</b>										
Food Service	550	553	545	545	487	519	532			
Community Service	611	640	713	750	584	548	623			
Debt Service Fund	1,359	1,308	1,323	1,230	1,903	1,769	1,687			
Total expenditures	\$ 14,708	\$ 15,016	\$ 15,343	\$ 15,607	\$ 13,610	\$ 14,376	\$ 14,442			
ADM served per MDE School District Profiles Report (current year estimated)					5,706	5,784	5,955			

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

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

Expenditure patterns also vary from district to district for various reasons. Factors affecting the comparison include the growth cycle or maturity of the District, average employee experience, availability of funding, population density, and even methods of allocating costs.

The District's expenditures per ADM have been below both the metro area and state-wide averages in recent years.

The District spent \$85,997,834 in the governmental funds reflected above in fiscal 2019, an increase of \$2,847,934 (3.4 percent) from the prior year. On a per student basis, with growing enrollment, this represents an increase of \$66 (0.5 percent). General Fund operating expenditures (excluding capital) increased \$363 per student, mainly in elementary and secondary regular instruction (\$181 per pupil) and special education instruction (\$120 per pupil). General Fund capital expenditures decreased \$303 per pupil, mainly due to decreased spending with related building improvements being financed with construction funding in recent years. Debt Service Fund expenditures also decreased \$82 per pupil, mainly due to less debt issue costs in the current year and savings from debt refundings in recent years.

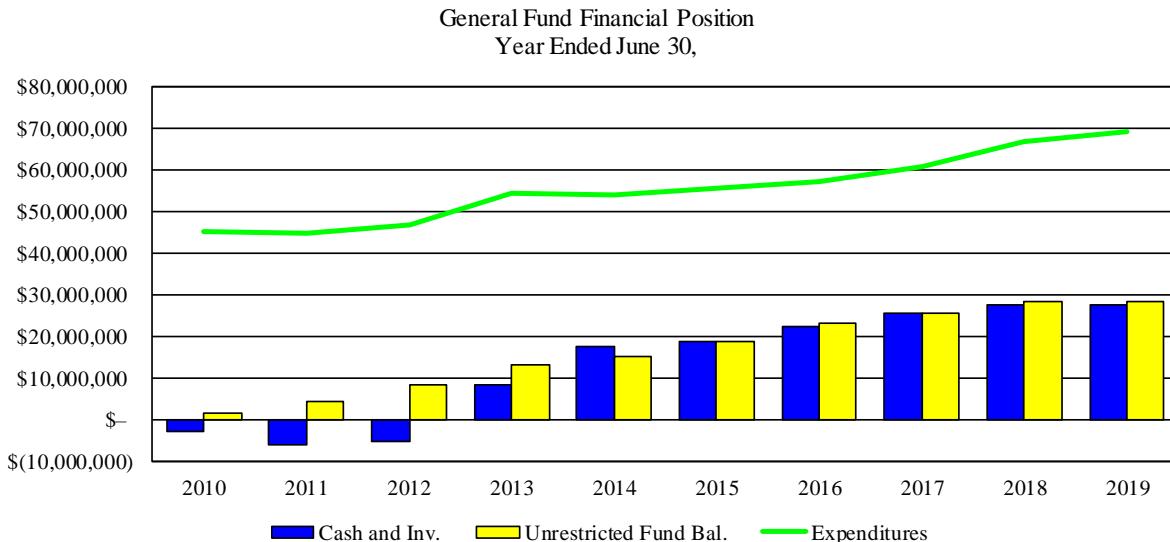
## SUMMARY

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

## FINANCIAL TRENDS OF YOUR DISTRICT

### GENERAL FUND FINANCIAL POSITION

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



The District ended fiscal year 2019 with a General Fund cash balance of \$27,379,580 (net of borrowing and interfund receivables and payables), a decrease of \$195,478 from the previous year. Unrestricted fund balance (consisting of any committed, assigned, or unassigned fund balances) at year-end totaled \$28,358,188, an increase of \$215,321.

Total fund balance of the General Fund increased by \$698,211, compared to a decrease of \$4,924,642 approved in the final budget.

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

## GENERAL FUND COMPONENTS OF FUND BALANCE

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

	June 30,				
	2015	2016	2017	2018	2019
Nonspendable fund balances	\$ 240,909	\$ 151,183	\$ 520,147	\$ 461,523	\$ 335,924
Restricted fund balances (1)	877,393	898,915	1,421,304	660,915	1,269,404
Unrestricted fund balances					
Assigned	3,048,575	5,467,187	6,799,600	8,523,970	9,818,292
Unassigned	15,664,846	17,646,475	18,626,747	19,618,897	18,539,896
Total fund balance	<u><u>\$ 19,831,723</u></u>	<u><u>\$ 24,163,760</u></u>	<u><u>\$ 27,367,798</u></u>	<u><u>\$ 29,265,305</u></u>	<u><u>\$ 29,963,516</u></u>
Unrestricted fund balances as a percentage of expenditures	<u><u>33.8%</u></u>	<u><u>40.4%</u></u>	<u><u>41.9%</u></u>	<u><u>42.2%</u></u>	<u><u>41.1%</u></u>
Unassigned fund balances as a percentage of expenditures	<u><u>28.3%</u></u>	<u><u>30.8%</u></u>	<u><u>30.7%</u></u>	<u><u>29.4%</u></u>	<u><u>26.8%</u></u>

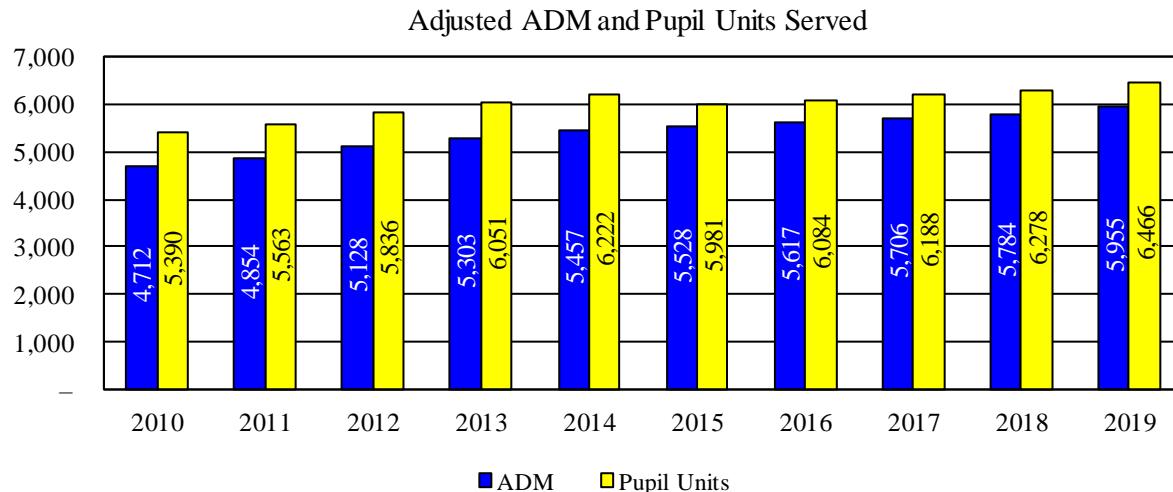
(1) Includes deficits in restricted fund balance accounts allowed to accumulate deficits under UFARS, which are part of unassigned fund balance on the accounting principles generally accepted in the United States of America-based financial statements.

The table above reflects the total General Fund unrestricted fund balance and percentages, which differs from those used in the previous discussion of state-wide fund balances, which are based on a state formula. The resources represented by this fund balance are critical to a district's ability to maintain adequate cash flow throughout the year, to retain its programs, and to cushion against the impact of unexpected costs or funding shortfalls.

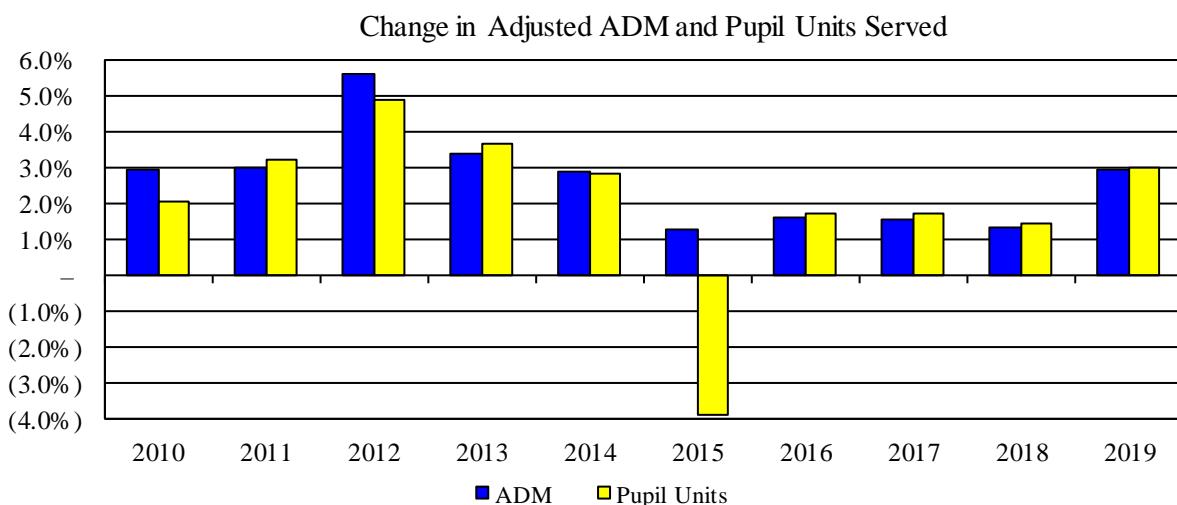
At June 30, 2019, unrestricted fund balances in the General Fund represented 41.1 percent of annual expenditures, or just over 21 weeks of operations assuming level spending throughout the year.

## AVERAGE DAILY MEMBERSHIP (ADM) AND PUPIL UNITS

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



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



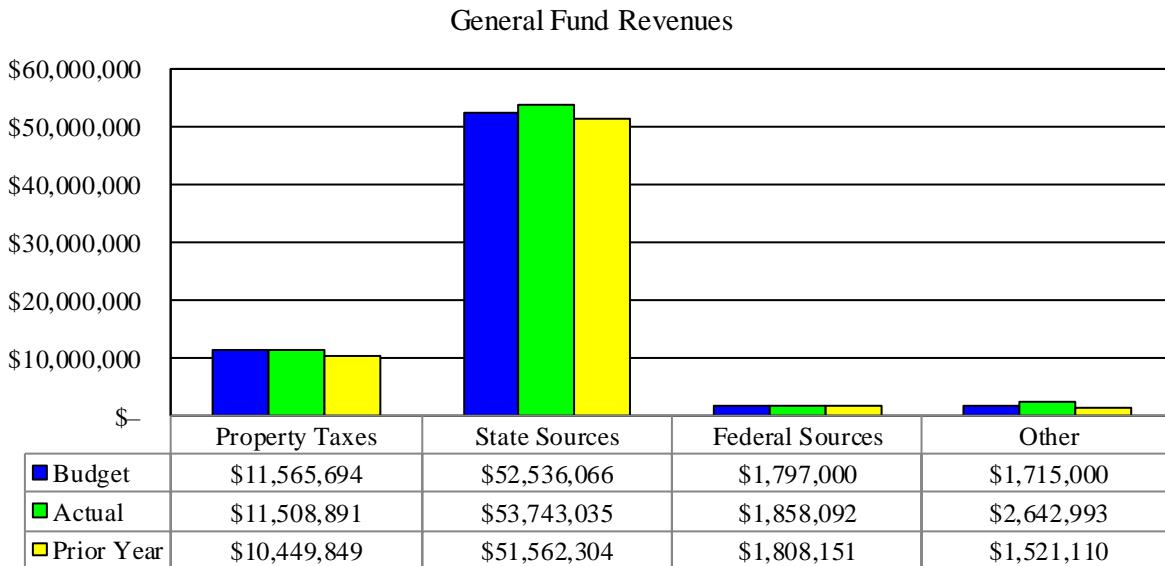
Note: The change in pupil units for 2015 includes the effect of legislative reductions to pupil units.

ADM is a measure of students attending class, which is then converted to pupil units (the base for determining revenue) using a statutory formula. Not only is the original budget based on ADM estimates, the final audited financial statements are based on updated, but still estimated, ADM since the counts are not finalized until around January of the following year. When viewing revenue budget variances, one needs to consider these ADM changes, the impact of the prior year final adjustments, which affect this year's revenue, and also the final adjustments caused by open enrollment gains and losses.

The District served an estimated adjusted ADM of 5,955 in 2019, an increase of 171 from the previous year. The number of pupil units served by the District for fiscal 2019 was 6,466, an increase of 188 (3.0 percent) from the prior year.

## GENERAL FUND REVENUES

The following graph presents the District's General Fund revenues for 2019:



Total General Fund revenues were \$69,753,011 for the year ended June 30, 2019, which was \$2,139,251 (3.2 percent) over the final budget and \$4,411,597 (6.8 percent) more than the prior year.

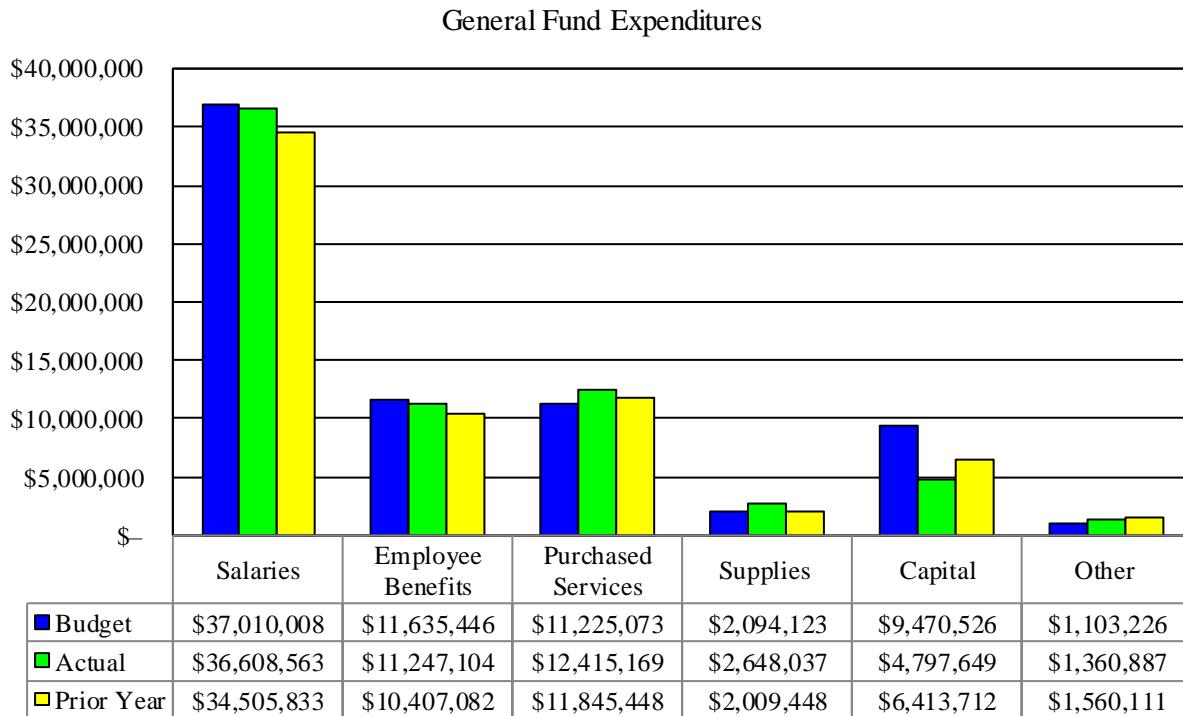
The variance to budget was mainly in state and other sources, which were \$1,206,969 and \$927,993 over budget, respectively. Conservative budgeting for students served, state special education, long-term facilities maintenance, and pension pass-through funding contributed to the favorable variance in state sources. Conservative budgeting for other sources, which includes investment earnings, donations, and fees, added to the favorable variance in this category presented above.

The increase from the prior year was spread across all of the above sources. The largest increase was in state sources. The increase in state sources was due to the District serving more students in the current year along with funding improvements in general education, special education, and long-term facilities maintenance funding formulas. Property taxes increased as anticipated with the increase in the adopted levy. An increase in investment earnings, donations, and local grants, contributed to the change in other sources in the above graph.

The graph above reflects the concentration of state sources (77.0 percent), followed by property taxes (16.5 percent) recognized to finance General Fund operations.

## GENERAL FUND EXPENDITURES

The following graph presents the District's General Fund expenditures for 2019:



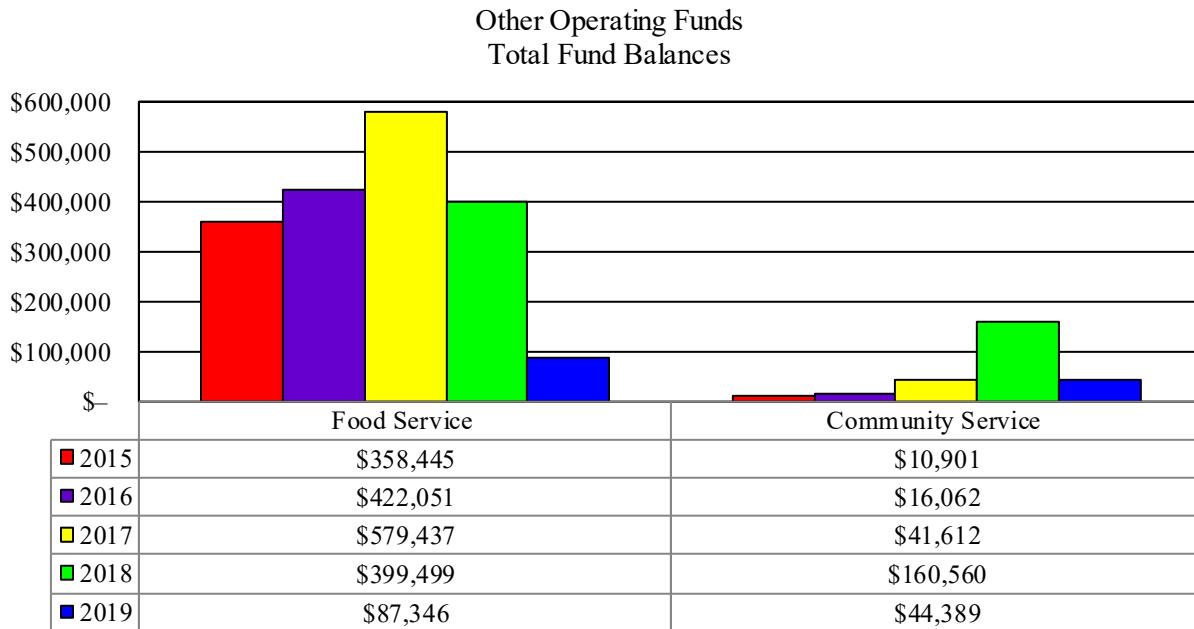
Total General Fund expenditures were \$69,077,409 for the year ended June 30, 2019, which was \$3,460,993 (4.8 percent) under the final budget and \$2,335,775 (3.5 percent) more than the prior year.

Total expenditures were under budget as mentioned in the previous paragraph and presented in the graph above. The largest variance was in capital spending that was under budget by \$4,672,877. The District had less demand for capital spending in the General Fund with more capital spending being financed by the Capital Projects – Building Construction Fund. Capital expenditures in the General Fund were also under budget due to timing of projects, which the District has included in assigned fund balance. Spending for purchased services was more than anticipated by \$1,190,096, mainly in elementary and secondary regular instruction and in sites and buildings.

Expenditure increases were primarily due to contractual salary and benefit increases as anticipated in the budget. Salaries and employee benefits, which account for 69.3 percent of General Fund spending, were \$789,787 under budget (1.6 percent) and \$2,942,752 (6.6 percent) over the prior year.

## **OTHER FUNDS OF THE DISTRICT**

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



### **Food Service Special Revenue Fund**

The District's Food Service Special Revenue Fund ended fiscal 2019 with a fund balance decrease of \$312,153, compared to a balanced budget adopted by the School Board. Food service revenue was \$2,852,556, which was under budget by \$47,444, mainly in other revenue. Expenditures were \$3,167,284 and over budget by \$267,284, mainly in salaries and related benefits. The ending fund balance of \$87,346 in this fund represents 2.8 percent of current year expenditures.

### **Community Service Special Revenue Fund**

The District's Community Service Special Revenue Fund ended fiscal 2019 with a fund balance decrease of \$116,171, compared to a balanced budget adopted by the School Board. Revenues were \$3,590,995, which exceeded budget by \$290,995. Expenditures were \$3,710,016 and over budget by \$410,016, mainly in salaries and related benefits. The ending fund balance of \$44,389 in this fund represents 1.2 percent of current year expenditures.

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

## **Capital Projects – Building Construction Fund**

The Capital Projects – Building Construction Fund ended the year with a fund balance decrease of \$12,459,884, compared to a \$14,900,000 decrease anticipated in the budget. At June 30, 2019, \$1,151,832 of fund balance remains for completing projects.

## **Debt Service Fund**

Total Debt Service Fund revenues and other financing sources exceeded expenditures and other financing uses by \$209,299 in the current year, compared to an increase of \$144,493 approved in the final budget.

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

## **Proprietary Funds – Internal Service Funds**

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

	June 30,		
	2017	2018	2019
Operating revenue			
Charges for services	\$ 5,133,616	\$ 5,574,330	\$ 5,786,618
Operating expenses			
Health benefit claims	4,348,325	3,935,803	4,231,405
Dental benefit claims	381,437	403,967	443,002
Total operating expenses	<u>4,729,762</u>	<u>4,339,770</u>	<u>4,674,407</u>
Operating income	403,854	1,234,560	1,112,211
Nonoperating revenue			
Investment earnings	7,241	20,594	90,164
Change in net position	411,095	1,255,154	1,202,375
Net position			
Beginning of year	<u>1,156,986</u>	<u>1,568,081</u>	<u>2,823,235</u>
End of year	<u>\$ 1,568,081</u>	<u>\$ 2,823,235</u>	<u>\$ 4,025,610</u>

## **Post-Employment Benefits Trust Fund**

The District has established a Post-Employment Benefits Trust Fund to account for an irrevocable trust account established to finance the District's liability for post-employment healthcare benefits. At year-end, trust net position of \$6,496,176 is available to pay these benefits.

## GOVERNMENT-WIDE FINANCIAL STATEMENTS

The District's financial statements include fund-based information that focuses on budgetary compliance, and the sufficiency of the District's current assets to finance its current liabilities. The governmental reporting model also requires the inclusion of two government-wide financial statements designed to present a clear picture of the District as a single, unified entity. These government-wide financial statements provide information on the total cost of delivering educational services, including capital assets and long-term liabilities.

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

	June 30,		
	2019	2018	Change
Net position – governmental activities			
Total fund balances – governmental funds	\$ 33,846,278	\$ 45,826,976	\$(11,980,698)
Total capital assets, net of depreciation	152,676,602	144,313,752	8,362,850
Long-term liabilities excluding pensions	(132,900,611)	(140,873,240)	7,972,629
Pension adjustments	(50,645,391)	(63,765,824)	13,120,433
OPEB adjustments	770,397	942,127	(171,730)
Other adjustments	2,233,295	912,013	1,321,282
 Total net position – governmental activities	 \$ 5,980,570	 \$(12,644,196)	 \$ 18,624,766
Net position			
Net investment in capital assets	\$ 25,541,727	\$ 23,079,326	\$ 2,462,401
Restricted	2,158,339	1,662,151	496,188
Unrestricted	(21,719,496)	(37,385,673)	15,666,177
 Total net position	 \$ 5,980,570	 \$(12,644,196)	 \$ 18,624,766

Some of the District's fund balances translate into restricted net position by virtue of external restrictions (statutory restrictions) or by the nature of the fund they are in (e.g. Food Service Special Revenue Fund balance can only be spent for food service program costs). The unrestricted net position category consists mainly of the General Fund unrestricted fund balances, offset against noncapital long-term obligations such as severance payable and net pension liabilities.

Total net position increased by \$18,624,766 during fiscal 2019. The District's net investment in capital assets increased \$2,462,401 this year. The change in this category of net position typically depends on the relationship of the rate at which the District is adding additional capital assets, the rate capital assets are being depreciated, and how that relates to the rate at which the District is repaying the debt issued to purchase or construct those assets. The increases the District has seen in recent years have also been impacted by facility-related levies, which have allowed the District to undertake improvement projects without additional debt.

The change in restricted net position was due to an increase in amounts restricted for capital asset acquisition and debt service. The change in unrestricted net position is due to changes in the District's proportionate share of the Public Employees Retirement Association and the Teachers Retirement Association pension plan liabilities and related deferrals.

## LEGISLATIVE SUMMARY

The 2019 Legislature passed education and tax bills that included appropriation increases of between \$563 million and \$593 million for K–12 education over the fiscal year (FY) 2020–2021 biennium, with the majority of the additional appropriations being added to the general education and special education funding formulas. The following is a brief summary of specific legislative changes from the 2019 session or previous legislative sessions impacting Minnesota school districts in future years.

**General Education Revenue** – The Legislature approved annual increases of 2 percent to the basic general education formula allowance for the FY 2020–2021 biennium. The per pupil allowance will increase \$126 to \$6,438 for FY 2020, and another \$129 to \$6,567 for FY 2021. Other small additions to general education funding were approved to: provide permanent funding for early middle college programs serving students under the age of 22; extend the opportunity to participate in post-secondary enrollment options – career and technical education programs to nonpublic students in the 10th grade; and provide transportation for pregnant teens and teen moms attending established programs that provide parent training and quality on-site child care.

**Compensatory Revenue** – The portion of compensatory revenue required to be used for extended time activities increased from 1.7 percent of total compensatory revenue for FY 2018 to 3.5 percent in FY 2019, and will increase to 3.5 percent plus the annual percentage change in the basic general education thereafter.

**Early Learning** – The Legislature appropriated funding to maintain the 4,000 Voluntary Pre-Kindergarten (VPK) and School Readiness Plus program seats currently set to expire after FY 2019, through FY 2020 and FY 2021. Students in these programs will not be used in declining enrollment revenue calculations for FY 2022, and will not be used to drive FY 2022 compensatory revenue for sites where VPK funding is discontinued after FY 2021, due to the reduction in the number of funded seats.

**Special Education Revenue** – The 2019 education bill included a number of enhancements to special education funding designed to hold the state average cross subsidy per pupil constant at the FY 2019 level of \$820 per average daily membership (ADM) for FY 2020 and FY 2021. The changes included:

- Establishing a new component of the state special education funding formula, known as cross subsidy reduction aid, beginning in FY 2020. Cross subsidy reduction aid will equal a percentage of each district's "initial cross subsidy" for the prior fiscal year, with the percentages set at 2.60 percent for FY 2020 and 6.43 percent for FY 2021. Initial cross subsidy is defined as the district's nonfederal special education costs including transportation, less state special education aid after tuition adjustments and general education aid attributable to students receiving special education services outside of the regular classroom for at least 60.00 percent of the school day. Charter schools are not eligible for cross subsidy reduction aid.
- Updating the pupil-driven portion of the initial special education aid formula to use FY 2018 data beginning in FY 2021, rather than continuing to use 2011 data adjusted for inflation.
- Phasing out the special education aid cap over two years, with the cap eliminated for FY 2021 and beyond. For FY 2020, the cap increases to the greater of the FY 2019 cap, or the sum of 56 percent of FY 2019 program costs plus 100 percent of FY 2019 special education transportation costs and the tuition adjustment.
- Reducing the tuition rate paid by the resident school district for open enrolled special education students served by another district or charter school from 90 percent of unfunded costs to 85 percent for FY 2020, and 80 percent for FY 2021 and later. Charter schools will be eligible for additional special education aid from the state to fully offset the impact of the tuition rate change.

- Reducing the hold harmless guarantee by changing the formula to reduce reliance on the FY 2016 base year so that districts where special education expenditures have fallen or grown slowly since FY 2016 do not benefit disproportionately from the hold harmless guarantee compared to other districts. The hold harmless (minimum aid) guarantee for FY 2020 will be limited to 90.0 percent of FY 2019 regular program costs, plus 100.0 percent of special education transportation costs, plus the tuition adjustment. The percentage of FY 2019 regular program costs used to calculate the hold harmless will decrease to 85.0 percent for FY 2021, 80.0 percent for FY 2022, and 75.0 percent for FY 2023. In addition, the annual inflation adjustment used to calculate the hold harmless will be reduced by 0.2 percent annually from the 4.6 percent factor used in FY 2019 until the adjustment reaches 2.0 percent.

**Safe Schools Supplemental Aid** – A one-time appropriation of \$30 million was made for Safe Schools Supplemental Aid in FY 2020, contingent upon the closing balance of the state’s General Fund for FY 2019 exceeding the balance projected at the end of the 2019 legislative session. If the balance exceeds the projection by \$63 million, the entire \$30 million will be appropriated. If the balance exceeds the projection by between \$33 and \$63 million, the amount over \$33 million will be appropriated. The aid would be allocated among school districts and charter schools based on their respective share of state-wide adjusted ADM for FY 2018. Districts would be required to restrict the use of the funding for the same purposes as the safe schools levy. Charter schools would be required to restrict the use for the same purposes as the safe schools levy or for building lease costs not covered by charter school lease aid.

**School Building Bond Agricultural Tax Credit** – Effective for taxes beginning with the payable 2018 levy (FY 2019), a tax credit on all property classified as agricultural (excluding the house, garage, and one acre of an agricultural homestead) was provided equal to 40 percent of the tax on the property attributable to school district building bond levies. The appropriation for this tax credit is \$34.8 million for FY 2019, \$45.2 million for FY 2020, and \$52.5 million for FY 2021. The 2019 Legislature increased the credit percentage to 50 percent for the levy payable in 2020, 55 percent for payable in 2021, 60 percent for payable in 2022, and 70 percent for payable in 2023 and thereafter.

**Forecast Adjustments** – Forecast article adjustments to FY 2019 appropriations (including final payments from FY 2018 and current payments for FY 2019) were approved to match the February 2019 forecast amount for each affected program. This eliminated the potential proration of forecasted program aids, including special education aid, for FY 2018 and FY 2019, due to the veto of the 2018 omnibus budget bill.

**Operating Referendum / Local Optional Revenue** – Effective for the tax levy payable in FY 2021, the operating referendum and local operational revenue (LOR) levies were simplified by transferring \$300 per pupil unit (PU) of referendum revenue to LOR, thereby eliminating the board-approved referendum levy and increasing the LOR levy authority to \$724 per PU. The referendum cap is reduced by the \$300 per PU transferred to LOR. The annual recalculation of referendum allowances approved prior to FY 2014 based on the amount of LOR a district opts to receive is also eliminated. Inflation adjusted referendum authority transferred to LOR will continue to be adjusted for the life of the referendum. This change is revenue neutral for all districts.

**Operating Referendum Equalization** – Effective for the tax levy payable in FY 2021, the equalizing factor for Tier 2 of the referendum (New Tier 1) is increased from \$510,000 to \$567,000. This is expected to provide \$9.4 million of property tax relief to taxpayers, and result in \$600,000 of additional referendum state aid for charter schools.

**Pension Benefit Reforms** – The 2018 pension bill included a number of reforms to the various defined benefit pension plans across the state, including the plans administered by the Teachers Retirement Association (TRA), St. Paul Teachers Retirement Fund Association (S PTRFA), and the Public Employees Retirement Association. Employer contribution rates were increased for the TRA plan (a total increase of 1.25 percent phased in over a 6-year period beginning in FY 2019) and the S PTRFA plan (a total increase of 2.50 percent phased in over a 6-year period beginning in FY 2019). Employee contribution rates were also increased by 0.25 percent beginning in FY 2024 for the TRA plan and beginning in FY 2023 for the S PTRFA plan. The pension adjustment component of the general education aid formula was increased by an amount equal to the product of the salaries paid to members of these two plans times the district’s pension adjustment rate for the fiscal year to help offset the cost of the employer contribution increases.

**Board Control of Extracurricular Student Activities** – In order to align the Uniform Financial Accounting and Reporting Standards with the new requirements of Governmental Accounting Standards Board Statement No. 84, effective for FY 2020 school boards are required to take charge of and control the financial transactions related to all extracurricular student activity accounts. This eliminates the previously available alternative for school boards to allow these accounts to operate outside of board control, and thereby be accounted for and reported outside of the district’s funds.

**Disposal of Surplus Computers** – Authorizes a school district to sell or give a surplus computer to a charitable organization for educational use, or to currently enrolled district students who intend to enroll the following year.

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## ACCOUNTING AND AUDITING UPDATES

### **GASB STATEMENT NO. 84, *FIDUCIARY ACTIVITIES***

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

This statement establishes criteria for identifying fiduciary activities of all state and local governments. The focus of the criteria generally is on (1) whether a government is controlling the assets of the fiduciary activity and (2) the beneficiaries with whom a fiduciary relationship exists. An activity meeting the criteria should be reported in a fiduciary fund in the basic financial statements. This statement describes four fiduciary funds that should be reported, if applicable: (1) pension (and other employee benefit) trust funds, (2) investment trust funds, (3) private-purpose trust funds, and (4) custodial funds. Custodial funds generally should report fiduciary activities that are not held in a trust or equivalent arrangement that meets specific criteria. The Minnesota Department of Education has also issued guidance for implementing this standard, which will impact the reporting of extracurricular student activity accounts previously not under board control, and potentially other fiduciary funds, beginning in the 2019–2020 fiscal year.

### **GASB STATEMENT NO. 87, *LEASES***

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

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

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

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

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

**GASB STATEMENT NO. 90, MAJORITY EQUITY INTEREST—AN AMENDMENT OF GASB STATEMENTS NO. 14 AND NO. 61**

The primary objectives of this statement are to improve the consistency and comparability of reporting a government's majority equity interest in a legally separate organization and to improve the relevance of financial statement information for certain component units.

It specifies that a majority equity interest in a legally separate organization should be reported as an investment if a government's holding of the equity interest meets the definition of an investment. It further specifies that such investments should generally be measured using the equity method, unless it is held by a special-purpose government engaged only in fiduciary activities, a fiduciary fund, or an endowment (including permanent and term endowments) or permanent fund, in which case the majority equity interest should be measured at fair value.

All other holdings of a majority equity interest in a legally separate organization that do not meet the definition of an investment result in the government being financially accountable for the legally separate organization and, therefore, the government should report that organization as a component unit, and should report an asset related to the majority equity interest using the equity method.

This statement also requires that a component unit in which a government has a 100 percent equity interest account for its assets, deferred outflows of resources, liabilities, and deferred inflows of resources at acquisition value at the date the government acquired a 100 percent equity interest in the component unit. Transactions presented in flows statements of the component unit in that circumstance should include only transactions that occurred subsequent to the acquisition.

The requirements of this statement are effective for reporting periods beginning after December 15, 2018. Earlier application is encouraged. The requirements should be applied retroactively, except for the provisions related to reporting a majority equity interest in a component unit and reporting a component unit if the government acquires a 100 percent equity interest, which should be applied prospectively.

## **GASB STATEMENT NO. 91, *CONDUIT DEBT OBLIGATIONS***

The primary objectives of this statement are to provide a single method of reporting conduit debt obligations by issuers and eliminate diversity in practice associated with (1) commitments extended by issuers (2) arrangements associated with conduit debt obligations, and (3) related note disclosures. This statement achieves those objectives by clarifying the existing definition of a conduit debt obligation; establishing that a conduit debt obligation is not a liability of the issuer; establishing standards for accounting and financial reporting of additional commitments and voluntary commitments extended by issuers and arrangements associated with conduit debt obligations; and improving required note disclosures.

A conduit debt obligation is defined as a debt instrument having all of the following characteristics:

- There are at least three parties involved: (1) an issuer, (2) a third party obligor, and (3) a debt holder or a debt trustee.
- The issuer and the third party obligor are not within the same financial reporting entity.
- The debt obligation is not a parity bond of the issuer, nor is it cross-collateralized with other debt of the issuer.
- The third party obligor or its agent, not the issuer, ultimately receives the proceeds from the debt issuance.
- The third party obligor, not the issuer, is primarily obligated for the payment of all amounts associated with the debt obligation (debt service payments).

This statement also addresses arrangements, often characterized as leases, that are associated with conduit debt obligations. In those arrangements, capital assets are constructed or acquired with the proceeds of a conduit debt obligation and used by third party obligors in the course of their activities.

This statement requires issuers to disclose general information about their conduit debt obligations, organized by type of commitment, including the aggregate outstanding principal amount of the issuers' conduit debt obligations and a description of each type of commitment. Issuers that recognize liabilities related to supporting the debt service of conduit debt obligations also should disclose information about the amount recognized and how the liabilities changed during the reporting period.

The requirements of this statement are effective for reporting periods beginning after December 15, 2020. Earlier application is encouraged.

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