Management Report

for

Independent School District No. 280
Richfield, Minnesota
June 30, 2014

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To the School Board and Management of
Independent School District No. 280
Richfield, Minnesota

We have prepared this management report in conjunction with our audit of Independent School District No. 280, Richfield, Minnesota's (the District) financial statements for the year ended June 30, 2014. The purpose of this report is to communicate information relevant to the financing of public education in Minnesota and to provide comments resulting from our audit process. We have organized this report into the following sections:

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

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

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

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

Minneapolis, Minnesota
November 13, 2014

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AUDIT SUMMARY

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

OUR RESPONSIBILITY UNDER AUDITING STANDARDS GENERALLY ACCEPTED IN THE UNITED STATES OF AMERICA, *GOVERNMENT AUDITING STANDARDS*, AND THE U.S. OFFICE OF MANAGEMENT AND BUDGET (OMB) CIRCULAR A-133

We have audited the financial statements of the governmental activities, each major fund, and the aggregate remaining fund information of the District as of and for the year ended June 30, 2014, and the related notes to the financial statements. Professional standards require that we provide you with information about our responsibilities under auditing standards generally accepted in the United States of America, *Government Auditing Standards*, and OMB Circular A-133, as well as certain information related to the planned scope and timing of our audit. We have communicated such information to you verbally and in our audit engagement letter. Professional standards also require that we communicate to you the following information related to our audit.

PLANNED SCOPE AND TIMING OF THE AUDIT

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

AUDIT OPINION AND FINDINGS

Based on our audit of the District's financial statements for the year ended June 30, 2014:

- 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 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 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:
    - One of twenty-five disbursements tested were not paid within thirty-five days of the receipt of goods or services, or the invoice for goods or services, as required by state law.

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, 2014, we performed procedures to follow-up on any findings and recommendations that resulted from our prior year audit. In the prior year, we reported a significant deficiency in the District's internal controls over compliance with federal procurement, suspension, and debarment requirements in its child nutrition cluster of federal programs. In testing these programs for the current year, it was noted that control procedures were put in place to provide reasonable assurance that federal child nutrition cluster funding was not being used for the purchase of goods or services from parties that are suspended or debarred, and therefore ineligible to participate in a contract involving federal grant funds. Therefore, no similar finding was reported in the current year.

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, 2014.

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

CORRECTED AND UNCORRECTED MISSTATEMENTS

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

ACCOUNTING ESTIMATES AND MANAGEMENT JUDGMENTS

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

> General education revenue and certain other revenues are computed by applying an allowance per student to the number of students served by the District. Student attendance is accumulated in a state-wide database—MARSS. Because of the complexity of student accounting and because of certain enrollment options, student information is input by other school districts and the MARSS data for the current fiscal year is not finalized until after the District has closed its financial records. General education revenue and certain other revenues are computed using preliminary information on the number of students served in the resident district and also utilizing some estimates, particularly in the area of enrollment options.
>
> Special education state aid includes an adjustment related to tuition billings to and from other school districts for special education services which are computed using formulas derived by the 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 described in Governmental Accounting Standards Board (GASB) Statement Nos. 27 and 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.

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

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

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

DIFFICULTIES ENCOUNTERED IN PERFORMING THE AUDIT

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

DISAGREEMENTS WITH MANAGEMENT

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

MANAGEMENT REPRESENTATIONS

We have requested certain representations from management that are included in the management representation letter dated November 13, 2014.

MANAGEMENT CONSULTATIONS WITH OTHER INDEPENDENT ACCOUNTANTS

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

OTHER AUDIT FINDINGS OR ISSUES

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

OTHER MATTERS

We applied certain limited procedures to Management's Discussion and Analysis, the Schedules of Funding Progress and Employer Contributions for the Other Post-Employment Benefits Plan, and the Schedule of Funding Progress for the Pension Benefits Plan, which are 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, Schedule of Expenditures of Federal Awards, and Uniform Financial Accounting and Reporting Standards (UFARS) Compliance Table accompanying the financial statements 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 other district information which accompany the financial statements but are not RSI. We did not audit or perform other procedures on this other information and we do not express an opinion or provide any assurance on it.

FUNDING PUBLIC EDUCATION IN MINNESOTA

Due to its complexity, it would be impossible to fully explain the funding of public education in Minnesota within this report. A summary of legislative changes affecting school districts and charter schools included later in this report gives an indication of how complicated the funding system is. This section provides some state-wide funding and financial trend information.

BASIC GENERAL EDUCATION REVENUE

The largest single funding source for Minnesota school districts is basic general education aid. Each year, the Legislature sets a basic formula allowance. Total basic general education revenue is calculated by multiplying the formula allowance by the number of pupil units for which a district is entitled to aid. Pupil units are calculated using a legislatively determined weighting system applied to average daily membership (ADM). Over the years, various modifications have been made to this calculation, including changes in weighting and special consideration for declining enrollment districts.

The table below presents a summary of the formula allowance for the past decade and as approved for the 2015 fiscal year. The amount of the formula allowance and the percentage change from year to year excludes non-comparable changes such as temporary funding increases, the "roll-in" of aids that were previously funded separately, potential reductions due to levying less than the maximum student achievement levy rate, and the one-time replacement of a portion of general education aid with federal fiscal stabilization funds in fiscal 2010.

Fiscal Year Ended June 30,	Formula Allowance Amount	Formula Allowance Percent Increase
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	$ 5,831	2.0 % *

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

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

STATE-WIDE SCHOOL DISTRICT FINANCIAL TRENDS

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.

Revenue per Student (ADM) Served

	State-Wide		Seven-County Metro Area		ISD No. 280 – Richfield		
	2012	2013	2012	2013	2012	2013	2014
General Fund							
Property taxes	$ 1,550	$ 1,608	$ 2,019	$ 2,101	$ 2,383	$ 2,484	$ 1,678
Other local sources	448	444	378	372	410	457	406
State	7,920	8,112	7,949	8,138	8,336	8,342	9,941
Federal	588	489	621	519	562	523	590
Total General Fund	10,506	10,653	10,967	11,130	11,691	11,806	12,615
Special revenue funds							
Food Service	488	495	483	495	442	488	497
Community Service	525	535	633	647	276	279	298
Debt Service Fund	1,088	1,079	1,180	1,172	900	831	934
Total revenue	$ 12,607	$ 12,762	$ 13,263	$ 13,444	$ 13,309	$ 13,404	$ 14,344
ADM served per MDE School District Profiles Report (current year estimated)					4,442	4,570	4,526

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

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

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 earned approximately $64.9 million in the governmental funds reflected above in fiscal 2014, an increase of $3.7 million (6.0 percent) from the prior year. Total revenue per ADM served increased by $940. In the General Fund, tax revenue decreased $806 per ADM and state aid revenue increased $1,599 per ADM, mainly due to a $4.7 million change in the tax shift, which shifts funding between taxes and state aids but is revenue neutral in total. Excluding the impact of the tax shift, General Fund property tax revenue was about $926,000 ($205 per ADM) higher than last year due to increases in the tax levy, and General Fund state aids increased about $2.2 million ($483 per ADM) primarily in general education and special education aid. Debt service revenue increased $103 per ADM due to an increase in the District's debt service-related tax levy.

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.

Expenditures per Student (ADM) Served

	State-Wide		Seven-County Metro Area		ISD No. 280 – Richfield		
	2012	2013	2012	2013	2012	2013	2014
General Fund							
Administration and district support	$ 823	$ 849	$ 805	$ 837	$ 834	$ 789	$ 833
Elementary and secondary regular instruction	4,866	4,982	5,103	5,273	5,592	5,530	5,665
Vocational education instruction	138	138	136	132	157	116	112
Special education instruction	1,866	1,909	2,004	2,055	2,149	2,229	2,351
Instructional support services	459	477	537	562	259	237	493
Pupil support services	895	919	957	991	1,056	1,054	1,148
Sites and buildings and other	802	850	755	800	1,549	1,531	1,446
Total General Fund – noncapital	9,849	10,124	10,297	10,650	11,596	11,486	12,048
General Fund capital expenditures	462	509	410	469	656	535	361
Total General Fund	10,311	10,633	10,707	11,119	12,252	12,021	12,409
Special revenue funds							
Food Service	486	500	480	500	441	454	522
Community Service	526	535	630	646	286	266	290
Debt Service Fund	1,337	1,234	1,312	1,322	926	919	962
Total expenditures	$ 12,660	$ 12,902	$ 13,129	$ 13,587	$ 13,905	$ 13,660	$ 14,183
ADM served per MDE School District Profiles Report (current year estimated)					4,442	4,570	4,526

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

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

Expenditure patterns also vary from district to district for various reasons. Factors affecting the comparison include the growth cycle or maturity of the District, average employee experience, availability of funding, population density, and even methods of allocating costs. The differences from program to program reflect the District's particular character, such as its community service programs, as well as the fluctuations from year to year for such things as capital expenditures.

The District spent approximately $64.2 million in the governmental funds reflected above in fiscal 2014, an increase of $1.8 million (2.8 percent) from the prior year. On a per ADM basis, this represents an increase of $523. General Fund expenditures were $388 per ADM higher than last year, with the largest increases in regular instruction ($135 per ADM), special education ($122 per ADM), and instructional support ($256 per ADM). Food service program expenditures were $68 per ADM higher than last year, mainly due to an increase in capital equipment purchases. Debt service expenditures for scheduled principal and interest payments on outstanding bonds increased $43 per student.

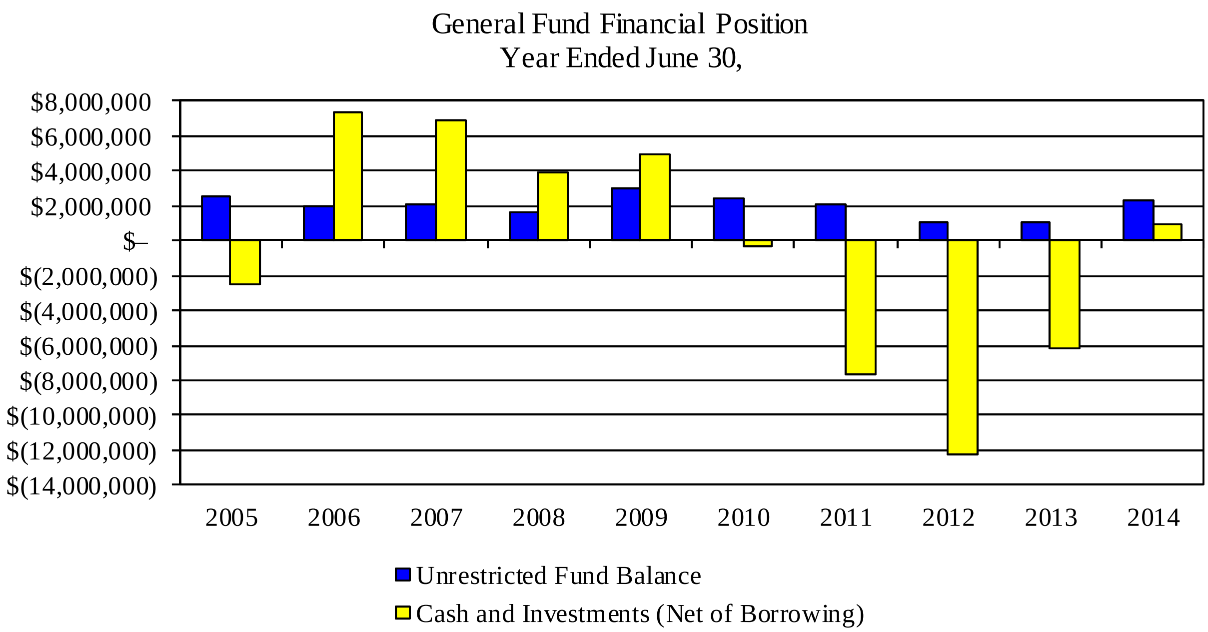
SUMMARY

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

FINANCIAL TRENDS OF YOUR DISTRICT

GENERAL FUND FINANCIAL POSITION

The following graph displays the District's General Fund trends of financial position in terms of unrestricted fund balance and cash balance.



The District's General Fund ended fiscal year 2014 with an unrestricted fund balance of $2,371,470, an increase of $1,364,193 from the prior year. General Fund cash and investments (net of cash flow and interfund borrowing) at year-end was $964,721, which is an improvement of $7,105,356 from last year, mainly due to the state buy-down of the property tax shift and change in the metering of state aids.

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

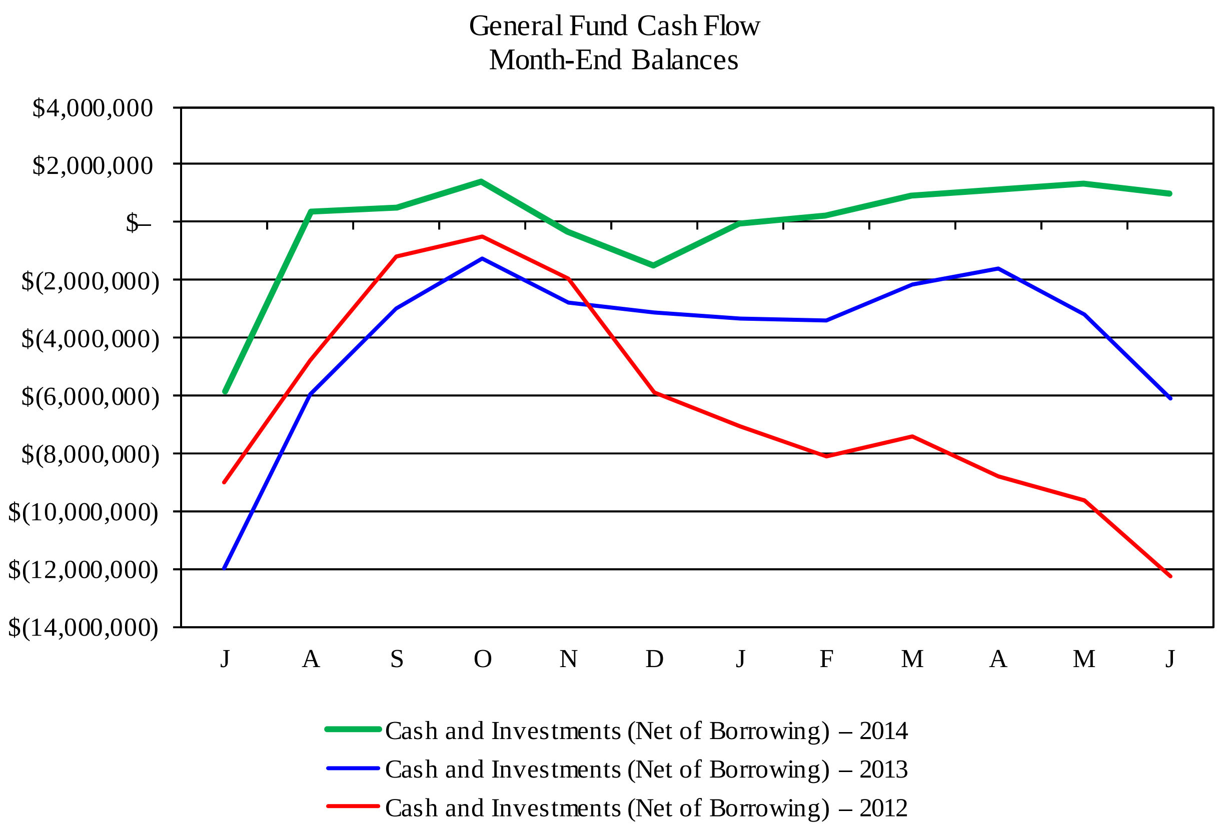
	June 30,				
	2010	2011	2012	2013	2014
Nonspendable fund balances	$ –	$ 608,995	$ 440,715	$ 302,585	$ 326,846
Restricted fund balances (1)	2,059,603	857,113	(50,520)	(157,173)	(9,072)
Unrestricted fund balances					
Assigned	246,178	2,067,588	607,067	227,762	1,093,890
Unassigned	2,230,924	–	482,795	779,515	1,277,580
Total fund balance	$ 4,536,705	$ 3,533,696	$ 1,480,057	$ 1,152,689	$ 2,689,244
Unrestricted fund balances as a percentage of expenditures	4.8%	5.0%	2.0%	1.8%	4.2%

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

Unrestricted fund balance as a percentage of expenditures is one key measure of a school district's financial health. 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, 2014, the unrestricted balance in the General Fund represented 4.2 percent of annual expenditures, or about two weeks of operations, assuming level spending throughout the year.

GENERAL FUND CASH FLOW

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

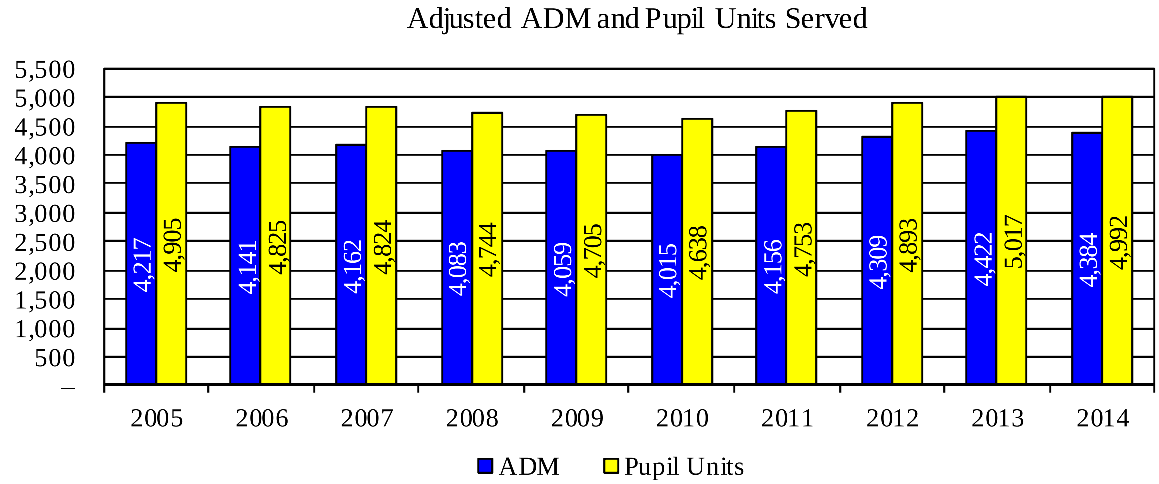


The graph above shows the peaks and valleys of the General Fund cash and investments balance (net of borrowing and interfund balances) on a monthly basis. The swing between its high and low month-end cash balances was about $7.3 million for fiscal 2014.

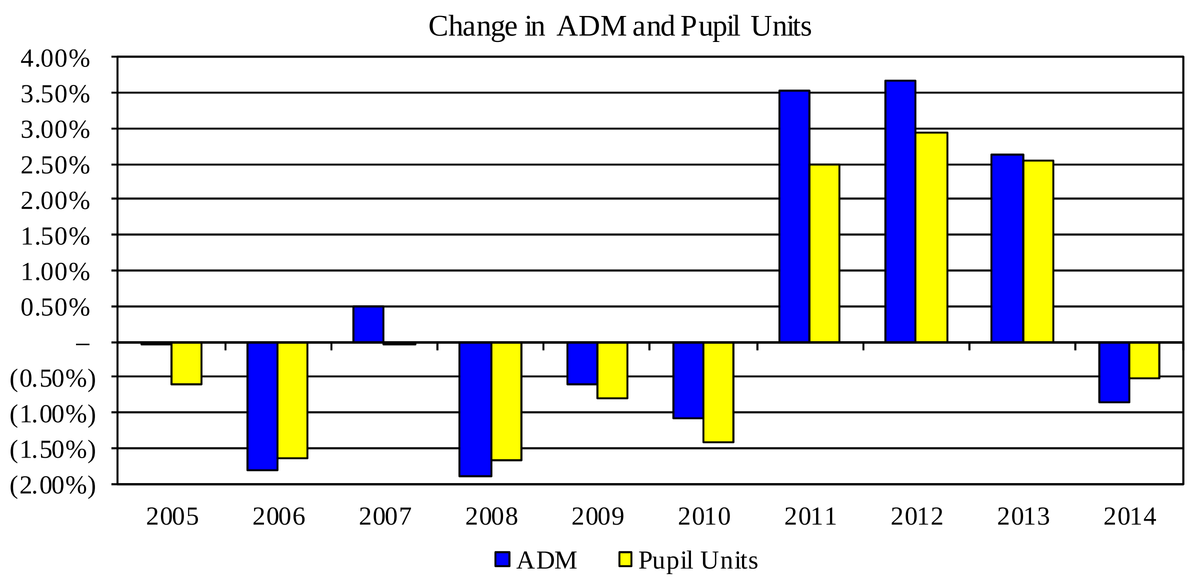
Legislative changes in the tax shift and state aid payment schedules used to help balance the state budget have a significant effect on the cash flow of Minnesota school districts. In fiscal 2012, the state holdback on aids normally paid on a 90–10 schedule was up to 40 percent, and the tax shift was at 48.6 percent of non-debt service levies. As the financial condition of the state began to improve, the holdback on state aid payments was reduced to 13.6 percent by the end of fiscal 2013. In fiscal 2014, the state was able to restore the metering of state aid payments to a 90–10 schedule, and buy the tax shift back down zero (except for the shift of 31 percent of a district's payable 2001 referendum levy that remains frozen by statute). These changes have resulted in a dramatic improvement in the District's cash flow over the last two years, as illustrated by the graph above. Despite this improvement, the District's General Fund cash flow would have been in a deficit position at times during the year without short-term cash flow borrowing.

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 ADM change from year to year, and the relationship of the resulting pupil units:

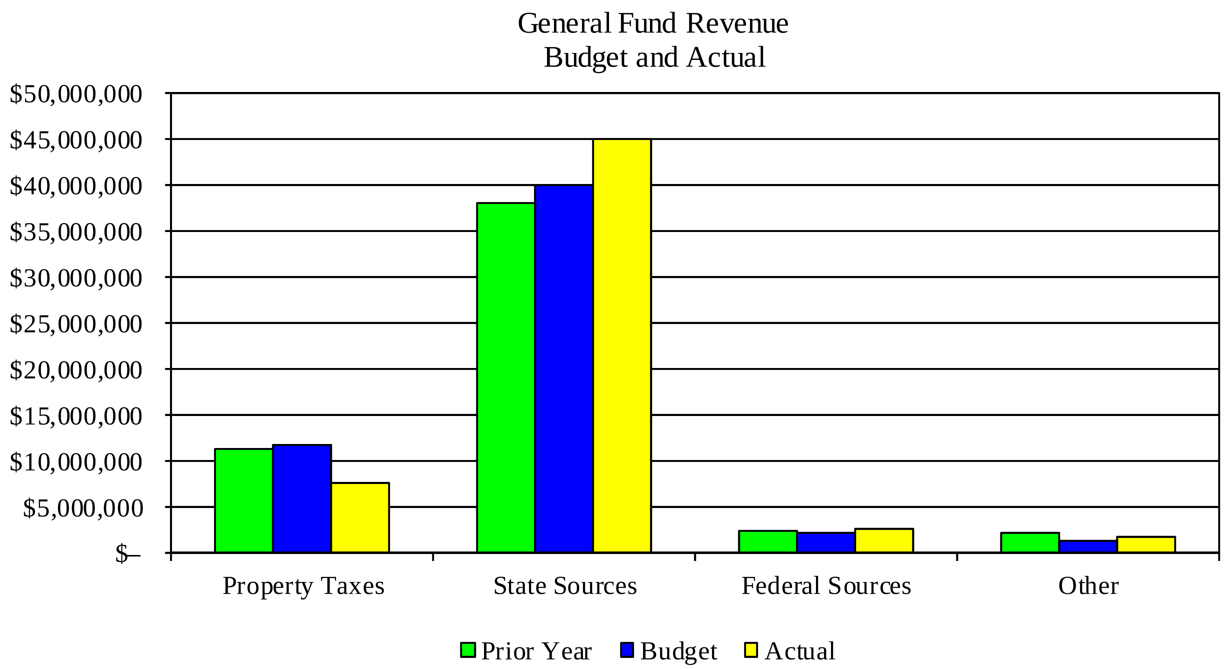


ADM is a measure of students attending class, which is then converted to pupil units (the base for determining revenue) using a statutory formula. Not only is the original budget based on ADM estimates, the final audited financial statements are based on updated, but still estimated, ADM since the counts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

The ADM served by the District for 2014 is estimated to be 4,384, a decrease of 38 (or about 0.9 percent) from the prior year. The pupil units generated from this ADM were approximately 4,992, a decrease of 25 (or 0.5 percent) from the prior year. The growth in ADM and pupil units served experienced by the District over the last three years leveled off in fiscal 2014.

GENERAL FUND REVENUES

The following graph summarizes the District's General Fund revenues for 2014:

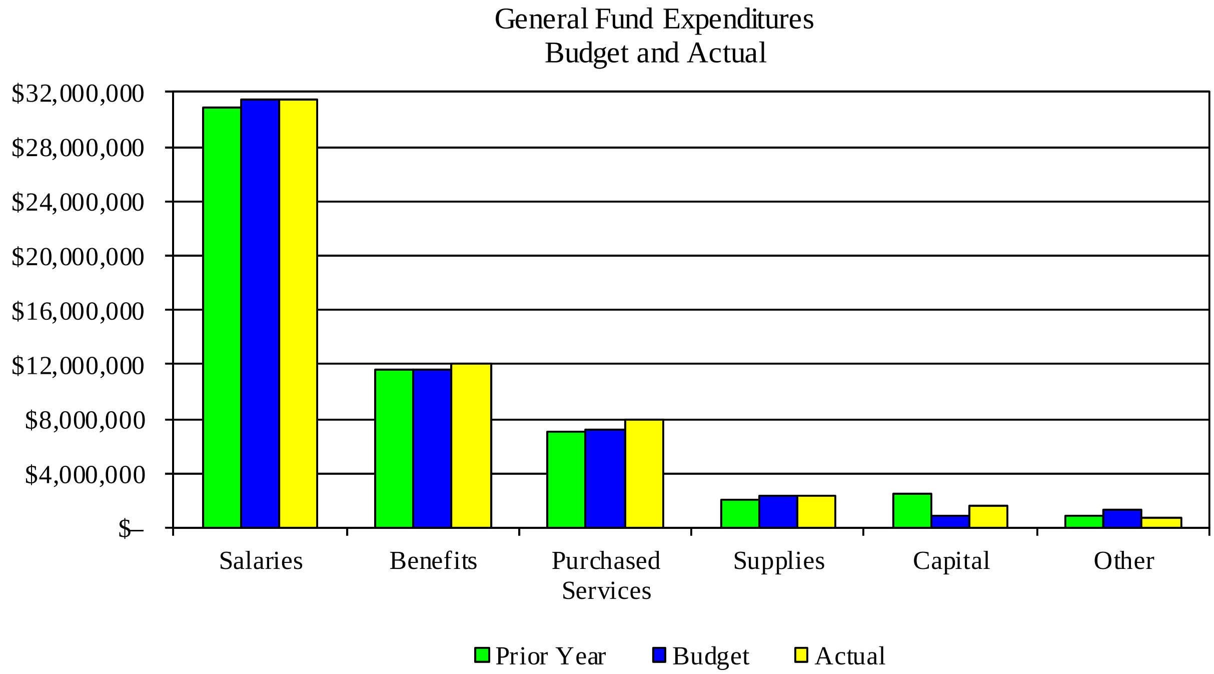


Total General Fund revenues were $57,095,559 for the year ended June 30, 2014, which was $1,969,256 (3.6 percent) over the final budget. Property tax revenue was under budget by $4,150,388 and state aid revenue was over budget by $5,116,228, both due mainly to the $4,273,374 tax shift, for which the District does not budget. Excluding the tax shift, revenues from state sources were $842,854 over budget, mainly in special education aid. Federal revenue was over budget by $532,926, mainly in federal special education program funding due to district efforts to spend carryover entitlements. Revenue from other local sources, including investment income, gifts, bequests, tuition, and rental income, were $470,490 over budget. The District budgets conservatively in this area given the unpredictable nature of these revenue sources.

General Fund total revenues were $3,138,303 higher than the previous year. As discussed earlier, the relationship between property taxes and state sources was changed by about $4.7 million due to the effects of the tax shift on the last two fiscal years. Excluding the impact of the tax shift, General Fund property tax revenue increased $926,003 from the prior year, mainly due to increases in the referendum market value levy and levy adjustments to recover prior year abatements. Revenues from state aids were $2,184,478 higher than last year, excluding the change in the tax shift. The District earned $900,447 more general education state aid this year, mainly due to increases in the basic general education allowance and compensatory revenue. State aid for special education increased $767,165 from the prior year due to increased current year funding and prior year final aid payments exceeding estimates. The District also received $665,804 more aid under the new achievement and integration state aid program than the prior year under the old integration aid formula. Revenue from federal sources increased $279,477, mainly in the Title I, Title III, and special education program areas. Revenue from other local sources was $251,655 lower than last year due to two county grants received in fiscal 2013 for improvements to district athletic fields and playgrounds.

GENERAL FUND EXPENDITURES

The following graph presents the District's General Fund expenditures for 2014.

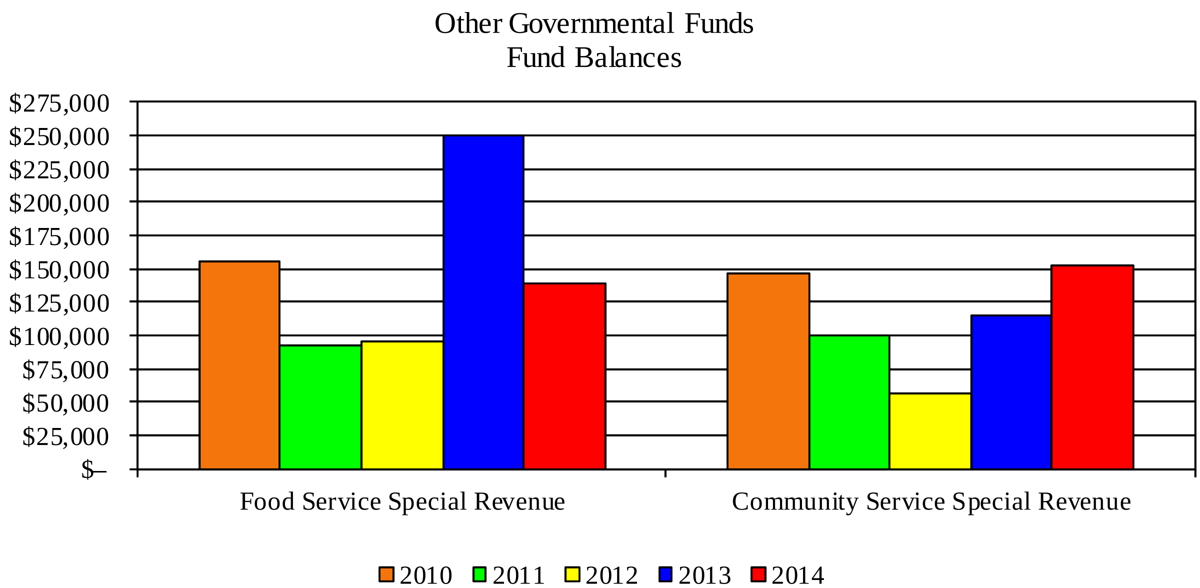


Total General Fund expenditures for 2014 were $56,161,612, an increase of $1,224,760 from the prior year. Salary and benefits costs were $962,920 higher than last year due to scheduled contractual increases and inflationary increases in benefit costs. Expenditures for purchased services and supplies increased $850,153 and $330,470, respectively; while capital expenditures decreased $812,287. These changes were primarily the result of UFARS modifications implemented by the MDE mid-way through the 2014 fiscal year, which changed where fees paid to computer consortiums (Technology and Information Educational Services) and educational software and license costs are recorded.

General Fund expenditures for 2014 exceeded budget by $1,186,004 in total. Benefits expenditures were $327,956 over budget, mainly in health insurance and pension costs. Purchased service costs were $740,783 over budget, mainly due to contracted services related to federal Title programs and transportation costs exceeding projections. Capital expenditures were over budget by $674,908, mainly due to the purchase of $602,608 of equipment using capital leases, for which the District does not budget. Finally, other expenditures were $571,183 under budget, mainly due to unspent allocations of gifts and donations to the individual building sites, which may be carried over for future use.

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 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 Food Service Special Revenue Fund ended the year with a total fund balance of $139,340, a decrease of $110,738 from the prior year, compared to a decrease of $125,967 projected in the budget. Revenues of $2,250,915 exceeded budget by $48,415, mainly due to improved breakfast and lunch participation. Expenditures were $2,361,653, which exceeded budget by $33,186, primarily in employee benefits and capital outlay.

Community Service Special Revenue Fund

The Community Service Special Revenue Fund ended the year with a total fund balance of $152,183, an increase of $36,540, compared to a budgeted increase of $7,150. Revenues of $1,347,186 exceeded budget by $77,539, mainly due to a new federal "Race to the Top" grant that was not in the budget. Expenditures for the year were $1,310,646, which exceeded budget by $48,149 due to expenditures related to the unanticipated federal grant.

It is critical that the Food Service and Community Service Special Revenue Funds be self-sustaining, so as not to place an additional burden on the General Fund. As the graph above indicates, the District has been successful in maintaining the fiscal health of these two funds in recent years.

Debt Service Fund

The funding of debt service is controlled in accordance with each outstanding debt issue's financing plan. At June 30, 2014, the Debt Service Fund had a fund balance of $755,024, an increase of $125,199 from last year, which was $68,014 higher than the increase projected in the budget.

Internal Service Fund

The District established an Internal Service Fund to account for and finance the uninsured risk of loss for its employee medical insurance plan. At June 30, 2014, the District has a net position of $1,879,371 accumulated to finance future medical benefits for participating employees.

Post-Employment Benefits Trust Fund

In 2009, the District 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. The District issued $15,885,000 of General Obligation Taxable OPEB Bonds, the proceeds of which were contributed into the trust. During the year, this fund paid out $697,419 for benefits that would have otherwise been paid from the District’s governmental funds. At year-end, the trust’s net position of $11,640,269 is available for future OPEB payments.

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, 2014	June 30, 2013	Increase (Decrease)
Total fund balances – governmental funds	$ 3,735,791	$ 2,148,235	$ 1,587,556
Capital assets, less accumulated depreciation	56,747,536	59,152,096	(2,404,560)
Long-term liabilities	(53,415,699)	(56,315,099)	2,899,400
Negative net OPEB obligations asset	4,207,143	5,941,245	(1,734,102)
Other	901,389	(195,335)	1,096,724
Total net position – governmental activities	$ 12,176,160	$ 10,731,142	$ 1,445,018
Net position			
Net investment in capital assets	$ 21,879,228	$ 21,746,464	$ 132,764
Restricted	237,628	361,385	(123,757)
Unrestricted	(9,940,696)	(11,376,707)	1,436,011
Total net position	$ 12,176,160	$ 10,731,142	$ 1,445,018

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 non-capital long-term obligations such as severance payable. Consequently, many Minnesota school districts have accumulated deficits in this component of net position.

Total net position increased $1,445,018 during fiscal 2014. The District's net investment in capital assets increased $132,764, mainly due to the relationship of debt retirement as compared to depreciation on capital assets. Restricted net position decreased by $123,757, primarily due to the planned use of Food Service Special Revenue Fund balance for capital equipment purchases. Unrestricted net position increased $1,436,011, primarily due to the unrestricted fund balance increase in the General Fund.

LEGISLATIVE SUMMARY

The 2014 legislative session began with a projected budget excess for the remainder of the biennium of $1.09 billion, later revised upward to a projected excess of $1.23 billion in the February 2014 economic forecast. In addition to the bonding bill and supplemental budget typically addressed during an even-year short session, the projected excess enabled the Legislature to repay $246 million of K–12 education finance shifts and to replenish the state "Rainy Day Fund" budget reserve with the addition of $150 million. The supplemental budget adopted by the 2014 Legislature contained $54.0 million in additional state aid appropriations for K–12 education for fiscal year 2015, including a $25 increase to the basic general education formula allowance. The 2014 Legislature also adopted a number of technical corrections and modifications to the significant education funding changes adopted by the 2013 legislature.

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

Basic General Education Revenue – The per pupil basic general education formula allowance for fiscal year (FY) 2015 was set to increase $504 to $5,806, with simultaneous changes to pupil weights and the general education formula structure reducing the increase to the equivalent of $80 per pupil state-wide. The 2014 Legislature approved an additional $25 increase, bringing the FY 2015 formula allowance to $5,831. This also increases the other aids linked to the formula allowance.

Pupil Unit Weights – Pupil unit weights for FY 2015 will change as follows:

	FY 2014	FY 2015
Pre-Kindergarten and Disabled Kindergarten	1.25	1.0
Part-Time Kindergarten (under 850 instruction hours)	0.612	0.55
All-Day Kindergarten (at least 850 instruction hours)	0.612	1.0
Grades 1–3	1.115	1.0
Grades 4–6	1.06	1.0
Grades 7–12	1.30	1.2

Other Changes to the General Education Formula – A number of other changes were made to general education formula for FY 2015, including:

- Marginal cost pupil units are eliminated and a new declining enrollment revenue component of general education aid is established equal to the decline in adjusted pupil units between the prior year and current year times 28 percent of the basic general education aid allowance.
- The extended time allowance increases from $4,601 to $5,017.
- The gifted and talented revenue allowance increases from $12 to $13.
- The revenue set aside for learning and development is converted to a flat amount per ADM of $299 per kindergarten student and $459 per student in Grades 1 through 6.
- The small schools allowance increases from $522.40 to $544, and the qualifying threshold decreases from 1,000 to 960 pupil units.
- Operating capital revenue increases from $73 per pupil unit + $100 times the building age index to $79 per pupil unit + $109 times the building age index.
- The equity revenue allowance increases from $75 to $80 for sliding scale, and from $46 to $50 for flat rate.
- The pension adjustment reduction to general education aid is eliminated, with districts having a below average pension adjustment guaranteed to receive a minimum of the state average gain from the elimination of the pension adjustment.
- Quality Compensation (Q Comp) revenue is rolled out of the general education formula and established as a separate categorical aid, and the transition revenue calculation is amended to adjust for the roll-out.
- General education revenue generated for all-day kindergarten may be used for programs to meet the needs of 3 and 4-year-olds within the district.

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

The funding formula for state special education aid remains the same through FY 2015. For FY 2016, special education will be the lesser of: 62 percent of old formula special education expenditures for the prior year; 50 percent of nonfederal special education expenditures for the prior year; or 56 percent of the amount calculated using a new pupil driven formula based on prior year data.

Beginning in FY 2015, special education tuition billing is changed so that the resident district is responsible for 90 percent of unfunded costs (versus 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.

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.

A new special education cross subsidy reduction aid was added for FY 2014 and FY 2015 only. 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.

The formula for special education excess cost aid was simplified beginning in FY 2014 by basing the calculation on prior year data and excluding special education tuition receipts and expenditures. For FY 2016, excess cost aid will be the greater of: 56 percent of the difference between the district's unreimbursed nonfederal special education costs and 7 percent of the district's general education revenue; or 62 percent of the difference between the district's unreimbursed old formula special education costs and 2.5 percent of the district's general education revenue.

Teacher Development and Evaluation Aid – For FY 2015 only, school districts, intermediate districts, and charter schools not receiving Q Comp revenue are eligible for teacher development and evaluation aid equal to $302 times the number of full-time equivalent teachers employed on October 1 of the previous school year. The entitlement is limited to $10 million state-wide.

Alternative Learning Center (ALC) Reserve – ALC reserve requirements and tuition billing language was amended to clarify that the amount required to be reserved or paid to the serving district under tuition billing is at least 90 percent *but no more than 100 percent* of general education revenue, and that local optional revenue is not included in the calculation.

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, known as the "student achievement levy," is reestablished. 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 of 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 voter-approved operating referendum revenue 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" was established, providing school districts with land 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). Beginning in FY 2016 (levy payable 2015), the name of this levy is changed from "Location Equity" to "Local Option"; does not require districts to have land in the seven-county metro area; and will no longer require a board resolution to opt out of the levy.

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. Beginning in FY 2016, the levy allowance for intermediate districts increases from $10 to $15 per pupil unit. The use of this levy is expanded to include facility security enhancements, efforts to improve school climate, and mental health services.

Fund Transfers – The authority for school districts to transfer money from one fund or account to another, as long as the transfer does not increase state aid obligations or increase local property taxes, was extended through FY 2015. School boards may only approve such transfers after adopting a resolution stating that the transfer will not diminish instructional opportunities for students. This authorization excludes transfers from the food service or community service funds, and prohibits transfers from the reserved account for staff development through FY 2015.

Child Nutrition Program Aids – Beginning in FY 2015, state school lunch aid for reduced price lunch students increases from 12.5 cents per lunch to 52.5 cents, making lunches free for those students. State aid for school breakfasts for kindergarten students increases from 55 cents to $1.30, making school breakfasts free for all kindergarten students.

Early Childhood Family Education (ECFE) – Beginning in FY 2015, the ECFE formula is linked to the general education formula, equaling 2.3 percent of the basic general education allowance. For FY 2015, this increases the EFCE allowance from $120 to $134.11. New program requirements were also added related to the assessment of community needs for program services.

School Readiness – Beginning in FY 2015, the state-wide entitlement for school readiness will increase $2 million per year.

Early Learning Scholarships – State-wide funding for early learning scholarships increases $4.65 million for FY 2015 and $4.884 million for later years. The $5,000 limit on scholarships is eliminated beginning in FY 2015, and the Commissioner of Education is directed to establish a target for the average scholarship based on the results of a rate survey.

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.

Review and Comment – The estimated cost threshold at which facility projects are required to undergo review and comment was raised from $1.4 million to $2.0 million. Facility additions, remodeling, or maintenance projects funded entirely with certain revenue sources (general education, health and safety, alternative facilities, deferred maintenance, lease levies, or facilities bonding), and technology purchases funded with capital projects referendum, are exempted from review and comment. The consultation requirement for smaller projects was eliminated.

ACCOUNTING AND AUDITING UPDATES

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. 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.

CHANGES TO FEDERAL GRANT AUDIT REQUIREMENTS

In December 2013, the OMB issued *Uniform Administrative Requirements, Cost Principles, and Audit Requirements for Federal Audits*, which supersedes all or parts of eight OMB circulars; consolidating federal cost principles, administrative principles, and audit requirements in one document. The "Super Circular" includes a number of significant changes to the federal Single Audit process, including: an increase in dollar threshold for requiring a Single Audit from $500,000 to $750,000; changes to the thresholds and process used for determining major programs; reductions in the percentages of expenditures required to be covered by a Single Audit from 50 percent to 40 percent for high risk auditees and from 25 percent to 20 percent for low risk auditees; revised criteria for determining low-risk auditees; and an increase in the threshold for reporting questioned costs from $10,000 to $25,000. Auditees are required to implement the administrative requirements of the new Super Circular by December 26, 2014. The revised audit requirements will be effective for fiscal year 2016 district audits.

COSO INTERNAL CONTROL FRAMEWORK

The clarified auditing standards applicable to governmental audits incorporate a definition of internal control that is based on the internal control integrated framework developed and issued in 1992 by the Committee of Sponsoring Organizations of the Treadway Commission (COSO). In May 2013, COSO issued an updated framework which supersedes the original after December 15, 2014. The new COSO framework retains the basic definition of internal control and its five components established in its original framework, along with the fundamental requirements to consider these five components and to use judgment when assessing and evaluating the effectiveness of a system of internal controls. The new COSO framework enhances and clarifies a number of concepts from the original framework to make it easier to use and apply. One of the more significant enhancements was the establishment of 17 principles, associated with the 5 components of internal control, intended to assist users in understanding the requirements of effective internal control and designing effective systems of internal control.

The 5 components of internal control and 17 underlying principles are as follows:

Control Environment –

1. Organization demonstrates a commitment to integrity and ethical values.
2. Governing body is independent from management and exercises oversight control.
3. Management establishes structure, reporting lines, authority, and responsibilities.
4. Organization demonstrates a commitment to the competence of individuals involved with internal control.
5. Organization holds individuals accountable for internal control responsibilities.

Risk Assessment –

6. Organization specifies clear objectives for the identification and assessment of risks.
7. Organization identifies and analyzes risk.
8. Organization assesses the potential for fraud risks.
9. Organization identifies and assesses significant changes that could impact internal control.

Control Activities –

10. Organization selects and develops control activities to mitigate risks.
11. Organization selects and develops general information technology (IT) controls.
12. Organization establishes and implements control policies and procedures.

Information and Communication –

13. Organization uses relevant, quality information to support internal control.
14. Organization communicates internal control information internally.
15. Organization communicates internal control information externally.

Monitoring –

16. Organization conducts ongoing and/or separate internal control evaluations.
17. Organization evaluates and communicates deficiencies to responsible parties for corrective action.

COSO defines an effective system of internal control as one that reduces to an acceptable level the risk of failing to achieve an organizational objective in the areas of operations, compliance, or reporting. According to the new framework, an organization can achieve effective internal control by applying all of the principles listed above. To achieve this, each of these five components and the relevant principles must be present and functioning, and the five components must operate in an integrated manner. Local governments should be reviewing their internal control systems to assure these principles have been incorporated and implemented.