

Management Report

for

Independent School District No. 280
Richfield, Minnesota

June 30, 2017

THIS PAGE INTENTIONALLY LEFT BLANK



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

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, 2017. 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 28, 2017

THIS PAGE INTENTIONALLY LEFT BLANK

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 (CFR) 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, 2017, 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*, 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, 2017:

- We have issued an unmodified opinion on the District's annual financial statements. The opinion included a paragraph emphasizing the District's implementation of new Governmental Accounting Standards Board (GASB) guidance for reporting certain pension plans and other post-employment benefits (OPEB), which reduced the District's beginning government-wide net position by \$15,243,652. Our opinion was not modified with respect to this matter.
- We reported no deficiencies in the District's internal control over financial reporting that we considered to be material weaknesses. It should be understood that internal controls are never perfected, and the controls which protect the District's funds from such things as fraud and accounting errors should be continually reviewed by management and modified as necessary.
- The results of our testing disclosed no instances of noncompliance required to be reported under *Government Auditing Standards*.
- We reported that the Schedule of Expenditures of Federal Awards is fairly stated, in all material respects, in relation to the basic financial statements.
- The results of our tests indicate that the District has complied, in all material respects, with the types of compliance requirements that could have a direct and material effect on each of its major federal programs.
- We reported one matter involving the internal control over compliance and its operation that we consider to be a significant deficiency in our testing of major federal programs. During our audit, we noted that the District did not accurately prepare the paid lunch equity calculation tool to ensure compliance with the Child Nutrition Program minimum lunch pricing requirements.
- We reported no findings based on our testing of the District's compliance with Minnesota laws and regulations.

FOLLOW-UP ON PRIOR YEAR FINDINGS AND RECOMMENDATIONS

As a part of our audit of the District's financial statements for the year ended June 30, 2017, we performed procedures to follow-up on any findings and recommendations that resulted from our prior year audit. In the prior year, we reported that the District did not have documented written controls to ensure compliance with the U.S. Office of Management and Budget's (OMB) Uniform Guidance cash management, allowable costs, subrecipient monitoring, and financial management standards. The District adopted the required written policies in 2017, and there was no similar finding in the current year.

OTHER COMMENTS AND RECOMMENDATIONS

Written Procurement Procedures for Uniform Guidance

When your District initially adopted the new Uniform Guidance (UG) requirement for federal programs, it exercised an option to delay implementation of the general procurement standards portion of the UG for a two-year grace period, which effectively ended on June 30, 2017. On May 17, 2017, the OMB amended the UG to extend the available grace period for an additional year, which would potentially exempt the District through the fiscal year ending June 30, 2018. Districts are required to document their decision to use the previous OMB procurement standards during the extension period. We recommend this decision be documented by School Board resolution.

If not already completed, we recommend the District begin the process of documenting its UG-compliant procurement procedures, including a clear timeline of when the UG procurement standards will be effective for the District. The UG requires the District to have written procurement procedures which reflect applicable state and local laws and regulations, provided that the procurements conform to applicable federal law and standards identified in 2 CFR 200.318. Districts are also required to have written standards of conduct that cover conflicts of interest and govern the performance of their employees engaged in the selection, award, and administration of contracts. The District should review the UG to obtain a better understanding of the procurement standards and identify any needed policy and procedure changes, as well as provide employee training in preparation for implementation, which is July 1, 2018, if the full grace period is elected.

Joint Power Bidding Arrangements

The District participates in a joint powers bidding arrangement for certain contracted goods and services utilized in its child nutrition program, through which one district solicits sealed bids or quotes on behalf of all the districts party to the agreement. This type of arrangement is common, and an effective use of resources. However, we remind the District that utilizing an arrangement like this does not relieve the District of its responsibility to ensure that the bidding process used complies with all applicable state and federal requirements. We recommend that when purchasing through an arrangement of this type, the District request a copy of the contract awarded and full bid documentation used in the process to review for compliance, and that this documentation be kept on file using the same records retention requirements the District follows for its own bidding process.

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.

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, 2017. However, the District implemented the following governmental accounting standards during the fiscal year ending June 30, 2017:

- GASB Statement No. 73, *Accounting and Financial Reporting for Pensions and Related Assets That Are Not Within the Scope of GASB Statement 68, and Amendments to Certain Provisions of GASB Statements 67 and 68*, which extended the accounting and financial reporting approach established in GASB Statement No. 68 to all pensions, including those not administered through a trust.
- GASB Statement No. 74, *Financial Reporting for Post-Employment Benefit Plans Other Than Pension Benefits*, which established new accounting and financial reporting requirements for OPEB plans.
- GASB Statement No. 75, *Accounting and Financial Reporting for Post-Employment Benefits Other Than Pensions*, which established new accounting and financial reporting requirements for governments whose employees are provided with OPEB.
- GASB Statement No. 79, *Certain External Investment Pools and Pool Participants*, which enhanced disclosures regarding investments.
- GASB Statement No. 82, *Pension Issues, an amendment of GASB Statements, No. 67, No. 68, and No. 73*, which addressed certain issues related to pension reporting and disclosures.

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 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 OPEB and pension benefits. These obligations are calculated using actuarial methodologies described in GASB Statement Nos. 68, 73, and 75. 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, 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 November 28, 2017.

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, 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. Such information has not been subjected to the auditing procedures applied in the audit of the basic financial statements and, accordingly, we do not express an opinion or provide any assurance on it.

FUNDING PUBLIC EDUCATION IN MINNESOTA

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

BASIC GENERAL EDUCATION REVENUE

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

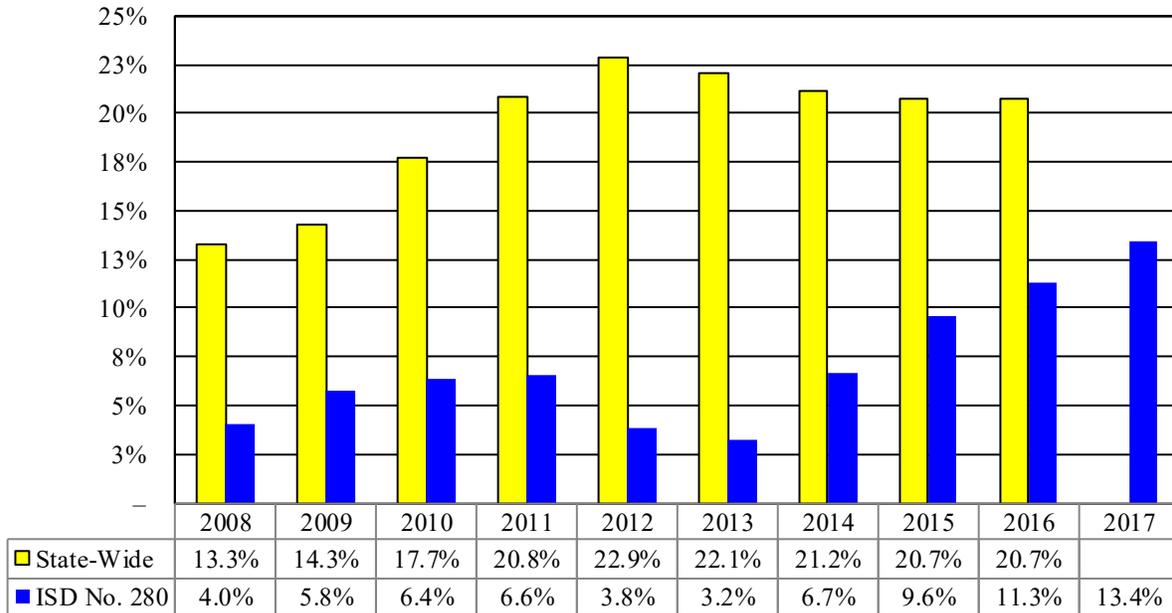
The table below presents a summary of the formula allowance for the past decade and as approved for the 2018 and 2019 fiscal years. The amount of the formula allowance and the percentage change from year-to-year excludes temporary funding changes, the “roll-in” of aids that were previously funded separately, 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
2008	\$ 5,074	2.0 %
2009	\$ 5,124	1.0 %
2010	\$ 5,124	– %
2011	\$ 5,124	– %
2012	\$ 5,174	1.0 %
2013	\$ 5,224	1.0 %
2014	\$ 5,302	1.5 %
2015	\$ 5,831	2.0 %
2016	\$ 5,948	2.0 %
2017	\$ 6,067	2.0 %
2018	\$ 6,188	2.0 %
2019	\$ 6,312	2.0 %

STATE-WIDE SCHOOL DISTRICT FINANCIAL TRENDS

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 2017.

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, stabilizing at 20.7 percent for fiscal 2015 and fiscal 2016.

The District's unrestricted operating fund balance as a percentage of operating expenditures was 13.4 percent at the end of the current year, as compared to 11.3 percent at June 30, 2016.

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 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			
	2015	2016	2015	2016	2015	2016	2017	
General Fund								
Property taxes	\$ 1,657	\$ 1,777	\$ 2,187	\$ 2,342	\$ 2,768	\$ 2,897	\$ 2,992	
Other local sources	489	495	387	392	371	457	355	
State	8,967	9,271	9,030	9,357	9,529	10,068	10,182	
Federal	441	432	447	447	505	458	464	
Total General Fund	<u>11,554</u>	<u>11,975</u>	<u>12,051</u>	<u>12,538</u>	<u>13,173</u>	<u>13,880</u>	<u>13,993</u>	
Special revenue funds								
Food Service	522	548	516	545	528	600	654	
Community Service	551	591	651	692	302	330	333	
Debt Service Fund	<u>1,061</u>	<u>1,053</u>	<u>1,127</u>	<u>1,084</u>	<u>961</u>	<u>820</u>	<u>889</u>	
Total revenue	<u>\$ 13,688</u>	<u>\$ 14,167</u>	<u>\$ 14,345</u>	<u>\$ 14,859</u>	<u>\$ 14,964</u>	<u>\$ 15,630</u>	<u>\$ 15,869</u>	
ADM served per MDE School District Profiles Report (current year estimated)					<u>4,491</u>	<u>4,477</u>	<u>4,486</u>	
Note: Excludes the Post-Employment Benefits Debt Service Funds.								
Source of state-wide and seven-county metro area data: School District Profiles Report published by the MDE								

ADM used in the table above and on the next page are based on enrollments consistent with those used in the MDE School District Profiles Report, which include extended time ADM, and may differ from ADM reported in other tables.

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

The District earned approximately \$71.2 million in the governmental funds reflected above in fiscal 2017, an increase of \$1.2 million (1.7 percent) from the prior year, or \$239 per ADM. General Fund revenue was \$113 per ADM higher than the prior year, mainly in state aid (up \$114 per ADM) and property tax revenue (\$95 per ADM) offset by a \$102 per ADM decrease in other local sources of revenue. The increase in General Fund state aid was primarily due to improvements in state general education and special education funding. The increase in General Fund property tax revenue was mainly due to increases in voter-approved operating and capital project referendum levies. Food Service Special Revenue Fund revenue increased \$54 per ADM, due to increased participation. Debt Service Fund revenue increased \$69 per ADM, due to an increase in scheduled debt levies.

The following table reflects similar comparative data available from the MDE for all governmental fund expenditures, excluding the Post-Employment Benefits Debt Service Funds. 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		
	2015	2016	2015	2016	2015	2016	2017
General Fund							
Administration and district support	\$ 941	\$ 960	\$ 951	\$ 958	\$ 1,001	\$ 1,144	\$ 1,166
Elementary and secondary regular instruction	5,301	5,466	5,635	5,849	5,949	6,196	6,390
Vocational education instruction	147	158	136	146	93	108	66
Special education instruction	2,058	2,182	2,196	2,330	2,459	2,732	2,568
Instructional support services	586	622	689	725	382	330	420
Pupil support services	992	1,019	1,072	1,104	1,178	1,217	1,240
Sites and buildings and other	881	890	832	847	1,446	1,655	1,599
Total General Fund – noncapital	<u>10,906</u>	<u>11,297</u>	<u>11,511</u>	<u>11,959</u>	<u>12,508</u>	<u>13,382</u>	<u>13,449</u>
General Fund capital expenditures	581	600	493	532	402	955	302
Total General Fund	<u>11,487</u>	<u>11,897</u>	<u>12,004</u>	<u>12,491</u>	<u>12,910</u>	<u>14,337</u>	<u>13,751</u>
Special revenue funds							
Food Service	528	542	523	539	529	587	617
Community Service	546	577	642	676	294	334	356
Debt Service Fund	1,489	1,522	1,701	1,453	959	919	913
Total expenditures	<u>\$ 14,050</u>	<u>\$ 14,538</u>	<u>\$ 14,870</u>	<u>\$ 15,159</u>	<u>\$ 14,692</u>	<u>\$ 16,177</u>	<u>\$ 15,637</u>
ADM served per MDE School District Profiles Report (current year estimated)					<u>4,491</u>	<u>4,477</u>	<u>4,486</u>
Note: Excludes the 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 \$70.1 million in the governmental funds reflected above in fiscal 2017, a decrease of \$2.3 million (3.1 percent), or \$540 per ADM, from the prior year. General Fund capital expenditures were \$653 per ADM lower than last year, mainly due to decreased capital leasing activity.

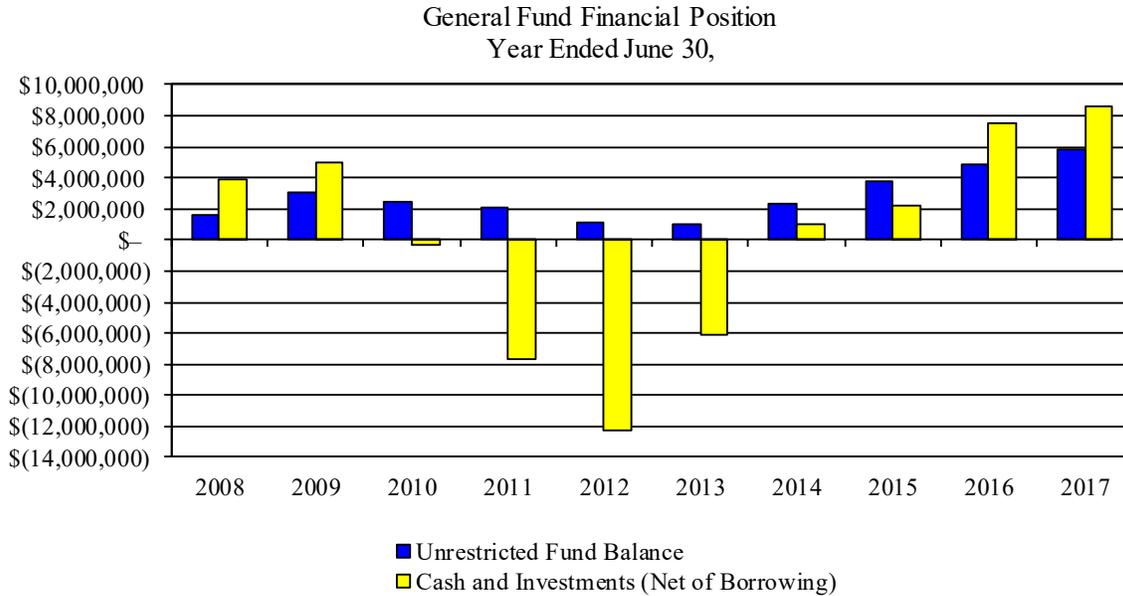
SUMMARY

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 2017 with a total fund balance of \$7,554,115, an increase of \$1,689,269 from the prior year, compared to a budgeted increase of \$35,547. General Fund cash and investments (net of interfund borrowing) at year-end was \$8,620,871, which is an improvement of \$1,089,967 from last year.

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

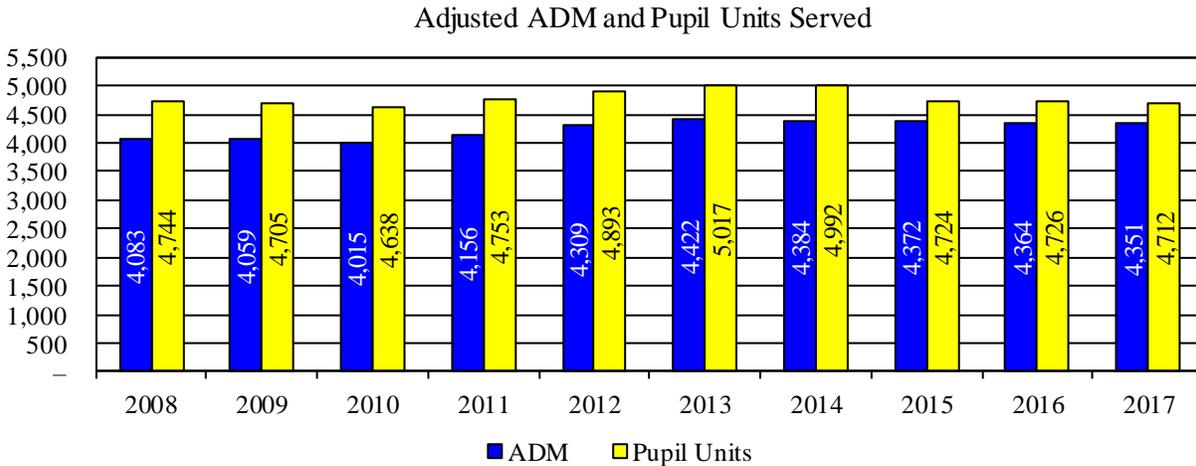
	June 30,				
	2013	2014	2015	2016	2017
Nonspendable fund balances	\$ 302,585	\$ 326,846	\$ 147,063	\$ 103,118	\$ 38,225
Restricted fund balances (1)	(157,173)	(9,072)	360,546	939,658	1,625,505
Unrestricted fund balances					
Assigned	227,762	1,093,890	1,371,388	2,029,882	3,046,457
Unassigned	779,515	1,277,580	2,457,678	2,792,188	2,843,928
Total fund balance	\$ 1,152,689	\$ 2,689,244	\$ 4,336,675	\$ 5,864,846	\$ 7,554,115
Unrestricted fund balances as a percentage of expenditures	1.8%	4.2%	6.6%	7.5%	9.5%
Unassigned fund balances as a percentage of expenditures	1.4%	2.3%	4.2%	4.4%	4.6%

(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.

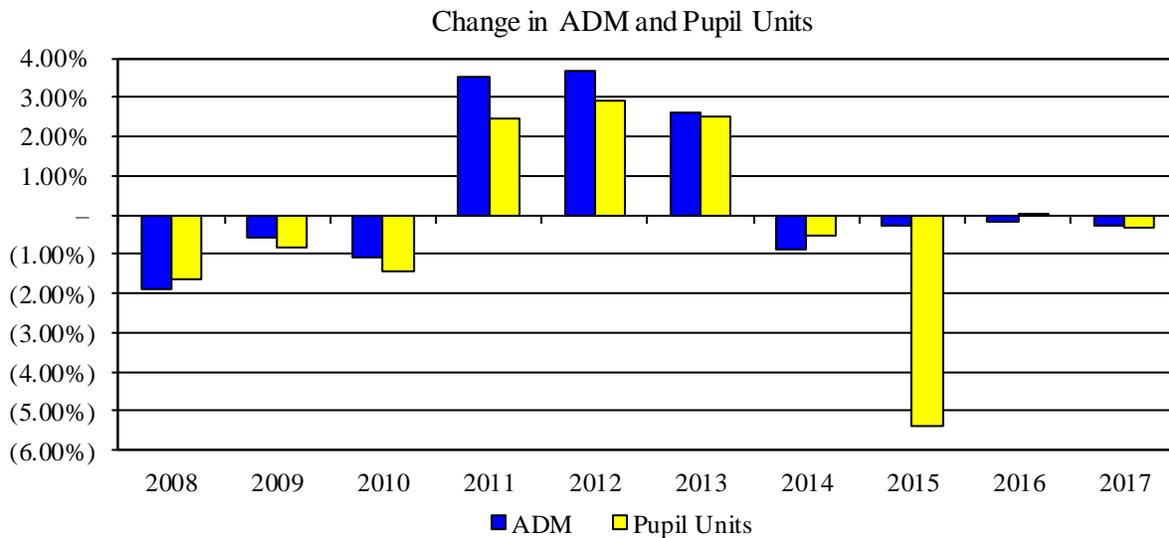
Unassigned fund balance as a percentage of expenditures is one key measure of a school district's financial health. The resources represented by this fund balance are critical to a district's ability to maintain adequate cash flow throughout the year, to retain its programs, and to cushion against the impact of unexpected costs or funding shortfalls. At June 30, 2017, the unassigned fund balance in the General Fund represented 4.6 percent of annual expenditures, or slightly over two 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 ADM change from year to year, and the relationship of the resulting pupil units:

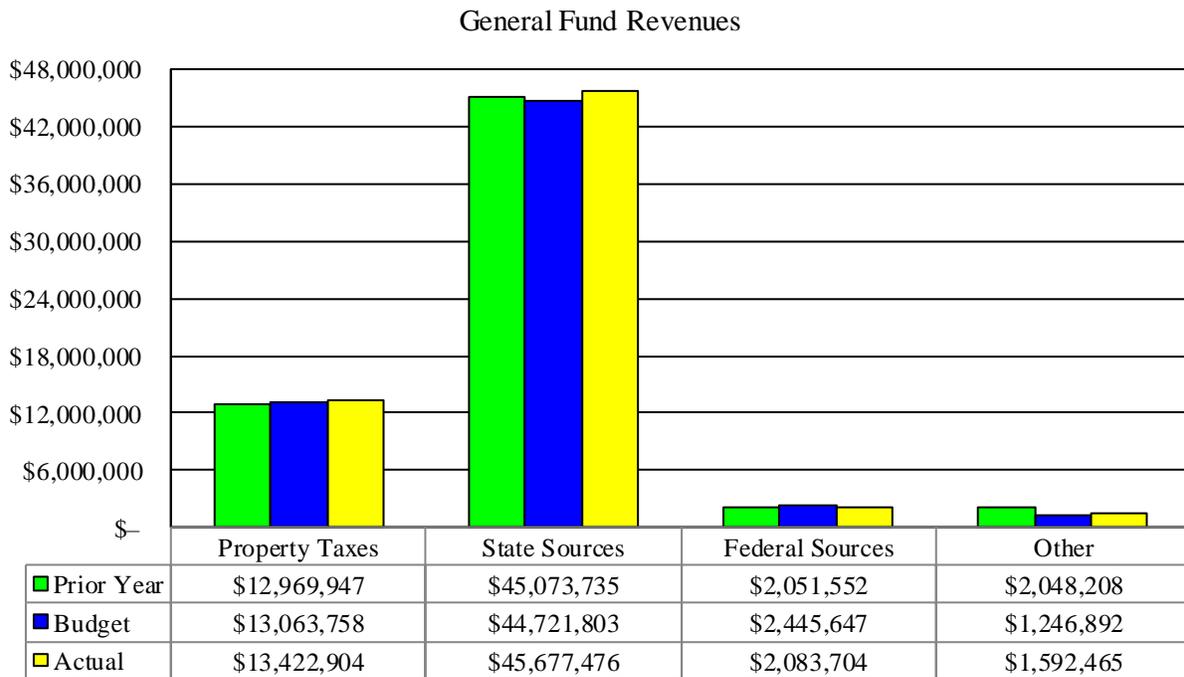


ADM is a measure of students attending class, which is then converted to pupil units (the base for determining revenue) using a statutory formula. Not only is the original budget based on ADM estimates, the final audited financial statements are based on updated, but still estimated, ADM since the counts 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 2017 is estimated to be 4,351, a decrease of 13 (or about 0.3 percent) from the prior year. The pupil units generated from this ADM were approximately 4,712, a decrease of 14 (or about 0.3 percent) from the prior year.

GENERAL FUND REVENUES

The following graph summarizes the District's General Fund revenues for 2017:



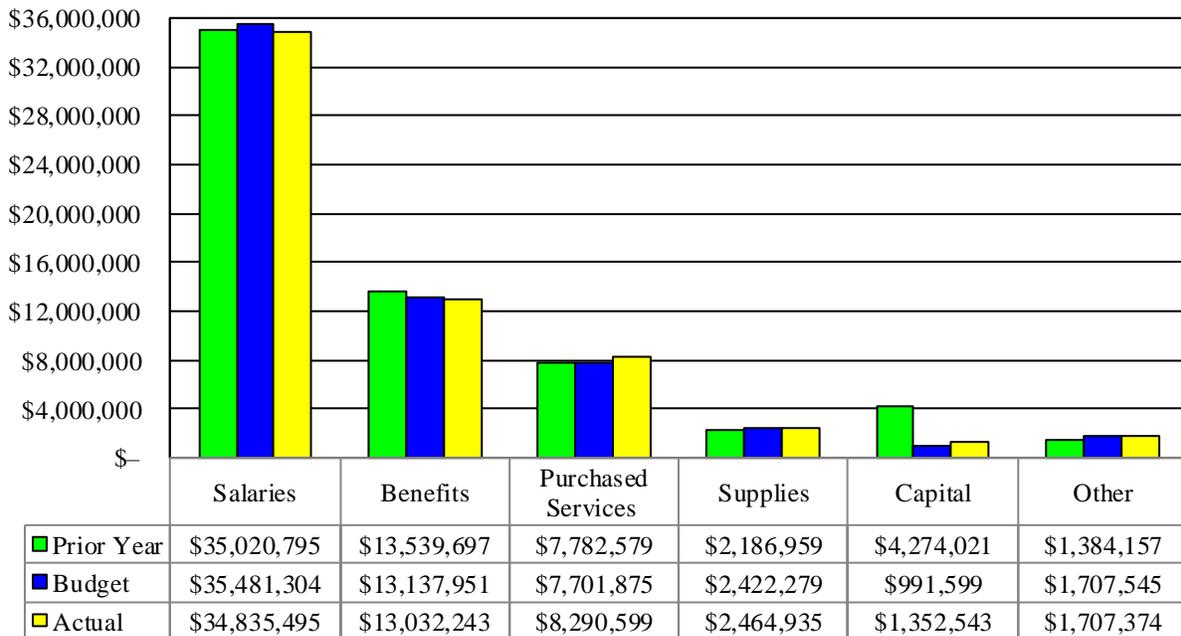
Total General Fund revenues were \$62,776,549 for the year ended June 30, 2017, which was \$1,298,449 (2.1 percent) over the final budget. Property tax revenue was over budget by \$359,146, due to cancellations and abatements coming in under the District's estimate. Revenue from state sources was over budget by \$955,673, primarily in general education and special education aid due to budgeting conservatively and not factoring in the funding formula increases. Federal revenue was under budget by \$361,943, mainly in federal special education funding. Revenue from other local sources, including investment income, gifts, bequests, tuition, and rental income, were \$345,573 over budget. The District budgets conservatively in this area given the unpredictable nature of these revenue sources.

General Fund total revenues were \$633,107 higher than the previous year. Property taxes were \$452,957 higher than last year, mainly due to increases in voter-approved operating and capital project referendum levies. Revenues from state aids were \$603,741 higher than last year. Increased state funding for general education and special education funding contributed to this increase. Revenue from federal sources increased \$32,152. Revenue from other local sources was \$455,743 lower than last year, due to a decrease in E-rate revenues, as there were fewer technology infrastructure upgrades compared to the prior year.

GENERAL FUND EXPENDITURE

The following graph presents the District's General Fund expenditures for 2017:

General Fund Expenditures

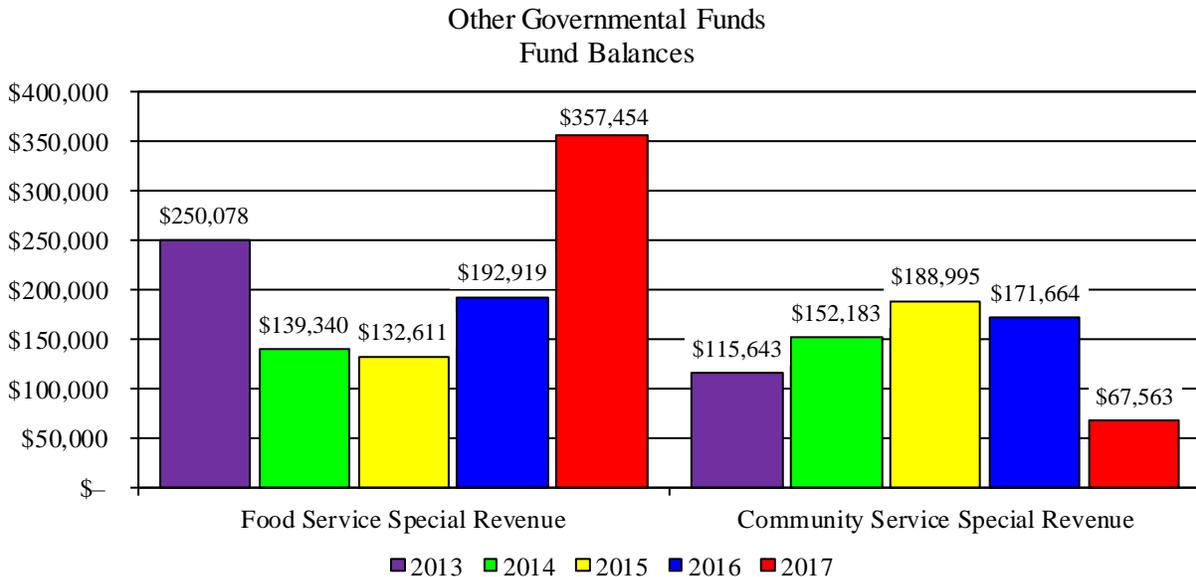


Total General Fund expenditures for 2017 were \$61,683,189, a decrease of \$2,505,019 from the prior year. Salary and benefit costs were \$692,754 lower than last year, due to decreased special education needs, and a reduction in pension benefits related to the state contribution for the Teachers Retirement Association (TRA) pension plan, which the MDE has directed to be reported in the “other” expenditure category this year. Capital expenditures decreased \$2,921,478, due to the unusually large amount of buses and technology equipment purchased through capital leases in the prior year.

General Fund expenditures for 2017 were over budget by \$240,636 in total. Salary and benefit expenditures were \$751,517 under budget, primarily due to the expectation of serving more special education students than actually were served during the year. Purchased service costs were \$588,724 over budget, mainly due to transportation costs exceeding projections. Capital expenditures were over budget by \$360,944, mainly due to the purchase of cleaning equipment and buses using capital leases, for which the District does not budget.

OTHER FUNDS OF THE DISTRICT

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



Food Service Special Revenue Fund

The Food Service Special Revenue Fund ended the year with a total fund balance of \$357,454, an increase of \$164,535 from the prior year, compared to a decrease of \$10,949 projected in the budget. Revenues of \$2,931,839 exceeded budget by \$345,075, mainly in federal reimbursement revenue and meal sales. Expenditures were \$2,768,574, which exceeded budget by \$170,861, primarily in salaries to meet the demand of more students eating breakfast and lunch at the schools, as well as supplies and other food costs to serve these additional meals.

Community Service Special Revenue Fund

The Community Service Special Revenue Fund ended the year with a total fund balance of \$67,563, a decrease of \$104,101, compared to a balanced budget. Revenues of \$1,493,901 were under budget by \$318,682, due to the District experiencing less growth in program participation than expected. Expenditures for the year were \$1,598,002, which was \$214,581 less than budget, mainly in salaries and purchased services needed for community education programming.

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, 2017, the Debt Service Fund had a fund balance of \$6,803,019, an increase of \$6,422,898 from the prior year. Of the year-end fund balance, \$6,462,609 represents assets held in escrow for a crossover debt refunding. The District sold two refunding issues during the year that will reduced future debt service interest costs by about \$2.3 million.

Internal Service Funds

The District maintains two internal service funds to account for and finance the uninsured risk of loss for its employee medical and dental insurance plans. At June 30, 2017, the District has a net position of \$3,868,569 accumulated to finance future medical and dental 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 \$313,310 for benefits that would have otherwise been paid from the District's governmental funds. At year-end, the trust's net position of \$10,552,554 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,		Increase (Decrease)
	2017	2016	
Net position – governmental activities			
Total fund balances – governmental funds	\$ 14,782,151	\$ 6,609,550	\$ 8,172,601
Capital assets, less accumulated depreciation	48,742,808	51,160,465	(2,417,657)
Bonds and capital leases	(48,644,397)	(45,411,839)	(3,232,558)
Pension liabilities, net of deferments	(54,457,104)	(36,185,030)	(18,272,074)
OPEB liability, net of deferments	(14,444,607)	718,508	(15,163,115)
Other	1,282,741	(539,318)	1,822,059
Total net position – governmental activities	<u>\$ (52,738,408)</u>	<u>\$ (23,647,664)</u>	<u>\$ (29,090,744)</u>
Net position			
Net investment in capital assets	\$ 21,335,810	\$ 20,029,484	\$ 1,306,326
Restricted	2,123,728	1,308,712	815,016
Unrestricted	<u>(76,197,946)</u>	<u>(44,985,860)</u>	<u>(31,212,086)</u>
Total net position	<u>\$ (52,738,408)</u>	<u>\$ (23,647,664)</u>	<u>\$ (29,090,744)</u>

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

Total net position decreased by \$29,090,744 during fiscal 2017. As presented in the table above, this change was primarily in unrestricted net position. The District reported a \$15,243,652 change in accounting principle for the implementation of new pension and OPEB accounting standards that reduced unrestricted net position when compared to the prior year. The change in the District's proportionate share of the Public Employees Retirement Association (PERA) and Teachers Retirement Association (TRA) state-wide pension obligations also caused unrestricted net position to decrease in the current year.

The District's net investment in capital assets increased \$1,306,326 this year. The change in this category of net position typically depends on the relationship between the rate at which the District is adding additional capital assets, the rate capital assets are being depreciated, and how that compares to the rate at which the District is repaying the debt issued to purchase or construct those assets. The increase in restricted net position was primarily in resources restricted for future capital spending.

LEGISLATIVE SUMMARY

The 2017 legislative session established public education funding appropriations for the 2018–2019 fiscal biennium totaling \$483.3 million. The following is a brief summary of specific legislative changes from the 2017 session or previous legislative sessions impacting Minnesota school districts in future years.

Basic General Education Revenue – The 2017 Legislature approved annual increases of 2.00 percent to the basic general education formula allowance for the 2018–2019 biennium. The per pupil allowance will increase \$121 to \$6,188 for fiscal year (FY) 2018, and another \$124 to \$6,312 for FY 2019.

Compensatory Revenue – The \$5 million allocation for compensatory pilot grants in FY 2017 was permanently added to the allocation for regular compensatory revenue beginning in FY 2018. Beginning in FY 2018, a portion of compensatory revenue will be required to be used for extended time activities. The requirement will be 1.70 percent of total compensatory revenue for FY 2018, and 3.50 percent in FY 2019 and beyond.

Transportation Sparsity Revenue – Beginning in FY 2018, transportation sparsity revenue increases annually by 18.20 percent of the difference between 1) the lessor of a district’s actual regular and excess transportation costs for the previous fiscal year, or 105.00 percent, of those costs for the preceding year, and 2) the sum of 4.66 percent of the district’s basic transportation revenue, transportation sparsity revenue, and charter school transportation adjustment for the previous year. For charter schools, the adjustment to transportation sparsity is equal to the applicable school district’s per pupil adjustment.

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

- The creation of a new School Readiness Plus (SR+) program for FY 2018 and FY 2019 only, with the following student eligibility requirements:
 - A child who is four years of age as of September 1, and who demonstrates one or more risk factors is eligible to participate in the program free of charge,
 - A child who is four years of age as of September 1, and who does not demonstrate any risk factors is eligible to participate on a fee-for-service basis, and
 - A district must adopt a sliding fee schedule for students not demonstrating risk factors, but must waive the fee for students unable to pay.
- Changing the Voluntary Pre-Kindergarten (VPK) cap from a limit on the total state aid entitlement to a limit on the number of participants, as follows:
 - A combined cap of 6,160 participants for VPK and SR+ for FY 2018,
 - A combined cap of 7,160 participants for VPK and SR+ for FY 2019, and
 - A cap of 3,160 participants for VPK for FY 2020 and later (SR+ program sunsets).
- All applications submitted in January to renew an existing FY 2017 VPK program will be funded first (3,160 slots). Applications for expanded VPK programs, and new VPK or SR+ programs will be ranked and approved based on various criteria. The number of new participants allowed in each new or expanded program will depend on how the programs are ranked.

Long-Term Facilities Maintenance Revenue – Beginning in FY 2017, deferred maintenance, health and safety, and alternative facilities programs were rolled into a new long-term facilities maintenance revenue program. Revenue for FY 2017 was \$193 per adjusted pupil unit (APU); multiplied by the lessor of one, or the ratio of the district’s average building age to 35 years. Funding will increase to \$292 per APU for FY 2018 and \$380 per APU for FY 2019, multiplied by the same building age factor.

Home Visiting Revenue – For FY 2018 (Pay 17 tax levy), home visiting program revenue is increased from \$1.60 to \$3.00, multiplied by the population under age 5 residing in a district on September 1 of the last school year. The levy will be equalized using a factor of \$17,250 per APU.

Debt Service Equalization – Beginning in FY 2018, the equalizing factors for debt service levies are indexed at 1) Tier 1 – the greater of \$4,430, or 55.33 percent, of the state average adjusted net tax capacity per APU, or 2) Tier 2 – the greater of \$8,000, or 100.00 percent, of the state average adjusted net tax capacity per APU.

Procedural Changes or Clarifications Related to Funding –

- Operating referendum notices can be delivered by any type of mail, no longer required to be by first class mail.
- For nonpublic pupil aid the definition of “textbook” is modified to include an online book with an annual subscription cost and the definition of “software or other educational technology” is modified to include registration fees for online advanced placement courses.
- Charter schools are allowed to include students participating in postsecondary enrollment options in their pupil count for generating building lease aid.

Payments to Nonoperating Funds – Beginning in FY 2018, the payment schedule for state aids for nonoperating funds (e.g., debt service equalization) has been changed from 12 monthly installments throughout the fiscal year to six monthly installments from July through December.

Nutrition Contracts – The Legislature amended the law governing school district contracts to provide for an exception to the requirement limiting school district contracts to two years, with an option for an additional two years. A contract between a school board and a food service management company that complies with Code of Federal Regulations, Title 7, Section 210.16, may be renewed annually after its initial term for not more than four years.

School Building Bond Agricultural Tax Credit – Effective for taxes payable in 2018 (FY 2019), a property tax credit on all property classified as agricultural (excluding the house, garage, and one acre of an agricultural homestead) is provided equal to 40.00 percent of the tax on the property attributable to school district building bond levies.

Lead in School Drinking Water –

- Requires the commissioners of health and education to develop a model plan to test for lead in school drinking water.
- Requires school districts and charter schools to adopt the model plan or an alternative plan to test school water for lead at least every five years.
- A school district must begin testing by July 1, 2018 and complete testing for all schools within five years.
- Allows school districts to include lead testing and remediation in their 10-year facilities plans and to use long-term facilities maintenance revenue for lead testing and remediation.
- Requires school districts and charter schools to make lead testing results available to the public and to notify parents that this information is available.

Review and Comment – Directs the commissioner of education to include comments from district residents in the review and comment on capital project proposals. School boards are required to hold a public meeting to review the commissioner’s review and comment on a proposal before the bond election.

ACCOUNTING AND AUDITING UPDATES

GASB STATEMENT NO. 83, *CERTAIN ASSET RETIREMENT OBLIGATIONS*

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

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

GASB STATEMENT NO. 84, *FIDUCIARY ACTIVITIES*

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

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

GASB STATEMENT NO. 85, *OMNIBUS 2017*

The objective of this statement is to address issues that have been identified during implementation and application of certain GASB statements. The statement addresses a variety of topics, including issues related to blending component units, goodwill, fair value measurement and application, and post-employment benefits (pensions and OPEB). The statement is meant to enhance consistency in the application of recent accounting and financial reporting standards. The requirements of this statement are effective for reporting periods beginning after June 15, 2017.

GASB STATEMENT NO. 86, *CERTAIN DEBT EXTINGUISHMENT ISSUES*

Current GASB guidance requires that debt be considered defeased in substance when the debtor irrevocably places cash or other monetary assets acquired with refunding debt proceeds in a trust to be used solely for satisfying scheduled payments of both principal and interest of the defeased debt. This new standard establishes essentially the same requirements for when a government places cash and other monetary assets acquired with only existing resources in an irrevocable trust to extinguish the debt.

The primary objective of this statement is to improve consistency in accounting and financial reporting for in-substance defeasance of debt by providing guidance for transactions in which cash and other monetary assets acquired with only existing resources—resources other than the proceeds of refunding debt—are placed in an irrevocable trust for the sole purpose of extinguishing debt. This statement also improves accounting and financial reporting for prepaid insurance on debt that is extinguished and notes to financial statements for debt that is defeased in substance. The requirements of this statement are effective for reporting periods beginning after June 15, 2017.

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.