Management Report

for

Independent School District No. 273
Edina, Minnesota
June 30, 2014

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MMKR
CERTIFIED PUBLIC
ACCOUNTANTS

PRINCIPALS
Thomas M. Montague, CPA
Thomas A. Karnowski, CPA
Paul A. Radosevich, CPA
William J. Lauer, CPA
James H. Eichten, CPA
Aaron J. Nielsen, CPA
Victoria L. Holinka, CPA

To the School Board of
Independent School District No. 273
Edina, Minnesota

We have prepared this management report in conjunction with our audit of Independent School District No. 273, Edina, 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
October 9, 2014

Malloy, Montague, Karnowski, Radosevich, & Co., P.A.
5353 Wayzata Boulevard • Suite 410 • Minneapolis, MN 55416 • Telephone: 952-545-0424 • Telefax: 952-545-0569 • www.mmkr.com

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AUDIT SUMMARY

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

OUR RESPONSIBILITY UNDER AUDITING STANDARDS GENERALLY ACCEPTED IN THE UNITED STATES OF AMERICA, *GOVERNMENT AUDITING STANDARDS*, AND 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:
    - Two of forty disbursements tested were not paid within thirty-five days of the receipt of the goods or services, or receipt of the invoice for goods or services, as required by state statute.

EXTRACURRICULAR STUDENT ACTIVITY ACCOUNTS

In accordance with Minnesota Statutes, the District's School Board has elected not to exercise control over the transactions of the extracurricular student activity accounts maintained at various district sites. Consequently, the cash receipts and disbursements of the District's extracurricular student activity accounts are reported in a separate set of financial statements, rather than being reported within the District's General Fund. We have issued an opinion on these separate financial statements, stating that they fairly present the cash balances and cash receipts and disbursements of these accounts as of and for the year ended June 30, 2014 on the cash basis of accounting. Our opinion was qualified for a limitation related to the completeness of cash receipts reported.

We reported one deficiency involving internal control over financial reporting for the District's extracurricular student activities that we consider to be a material weakness. The District reports student activities on a cash basis, and has not established procedures to assure that all cash collections are recorded in the accounting records. Procedures such as the use and reconciliation of pre-numbered receipts, pre-numbered admission tickets for events, and inventory controls over items sold for fundraisers would help strengthen the controls in this area.

We also issued a report on compliance with the Minnesota Department of Education's (MDE) *Manual for Activity Fund Accounting* (MAFA), in which we reported no findings.

OTHER RECOMMENDATIONS

During our testing of district receipts and disbursements, we noted three instances where the District recorded the transaction by "netting" a disbursement against a related revenue account or netting a receipt against a related expenditure account. For example, in one case an admission collected for a school event was coded against an expenditure account related to the event rather than in the revenue account for admissions and gate receipts. Under accounting principles generally accepted in the United States of America, receipts and disbursements should generally not be netted unless to do otherwise would clearly overstate the District's revenues or expenditures.

FOLLOW-UP ON PRIOR YEAR 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. During our 2013 audit, we noted that the District utilizes several methods paying vendor invoices electronically for which there was no means of obtaining the required signed statutory declaration that the claim is just, correct, and has not been paid previously. The District has subsequently reviewed its procedures for claims paid electronically and implemented a number of procedural changes to assure the required statutory declaration is being obtained whenever possible.

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 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 October 9, 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 Schedule of Funding Progress 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.

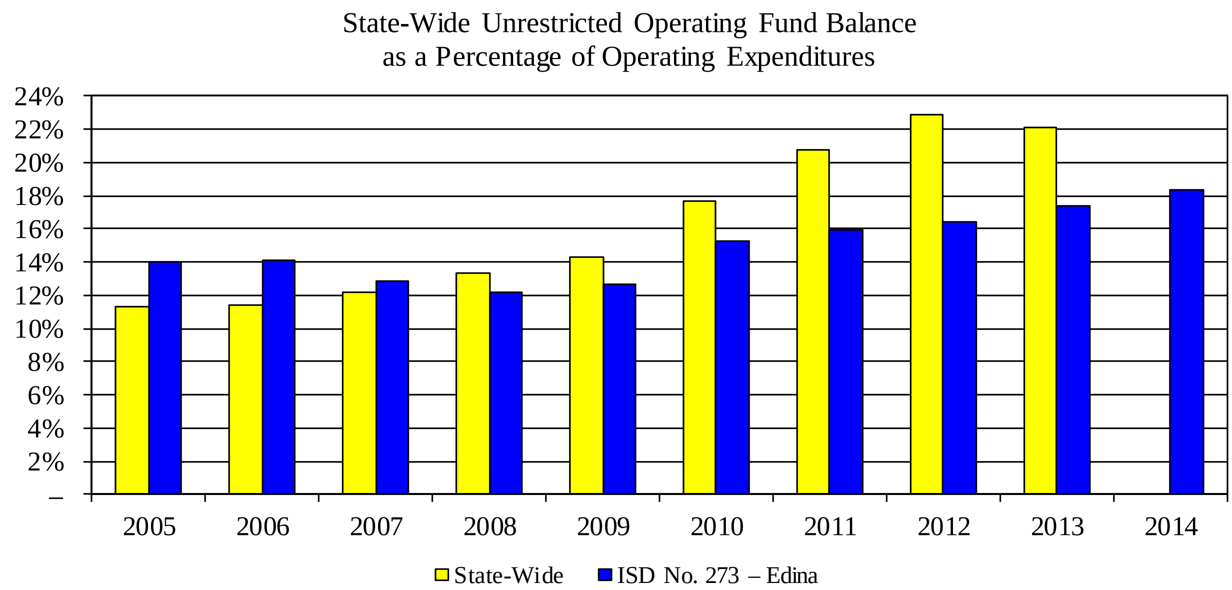
	Formula Allowance	
Fiscal Year Ended June 30,	Amount	Percent Increase
2005	$ 4,601	– %
2006	$ 4,783	4.0 %
2007	$ 4,974	4.0 %
2008	$ 5,074	2.0 %
2009	$ 5,124	1.0 %
2010	$ 5,124	– %
2011	$ 5,124	– %
2012	$ 5,174	1.0 %
2013	$ 5,224	1.0 %
2014	$ 5,302	1.5 %
2015	$ 5,831	2.0 % *

* 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 HEALTH

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



Note: State-wide information is not available for fiscal 2014.

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

Even with limited funding increases, Minnesota school districts have generally been maintaining a higher unrestricted fund balance as a percentage of operating expenditures in recent years. This trend is the result of many factors, including districts reducing operating expenditures, adapting to funding restrictions, efforts to maintain fund balance for cash flow purposes, and in some cases community support in the form of operating referendums.

As of June 30, 2013, this ratio was 17.4 percent for the District, as compared to a state-wide average of 22.1 percent. The District's unrestricted operating fund balance as a percentage of operating expenditures was 18.3 percent at the end of the current year.

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

Governmental Funds Revenue per Student (ADM) Served

	State-Wide		Seven-County Metro Area		ISD No. 273 – Edina		
	2012	2013	2012	2013	2012	2013	2014
General Fund							
Property taxes	$ 1,550	$ 1,608	$ 2,019	$ 2,101	$ 2,848	$ 3,240	$ 1,259
Other local sources	448	444	378	372	330	296	306
State	7,920	8,112	7,949	8,138	7,040	7,409	9,055
Federal	588	489	621	519	400	200	214
Total General Fund	10,506	10,653	10,967	11,130	10,618	11,145	10,834
Special revenue funds							
Food Service	488	495	483	495	392	394	386
Community Service	525	535	633	647	860	880	928
Debt Service Fund	1,088	1,079	1,180	1,172	1,249	1,213	823
Total revenue	$ 12,607	$ 12,762	$ 13,263	$ 13,444	$ 13,119	$ 13,632	$ 12,971
ADM served per MDE School District Profiles Report (current year estimated)					8,360	8,408	8,472

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

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

ADM used in the tables above and on the following page are consistent with those used in the MDE School District Profiles Report, which includes 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 $109.9 million in the governmental funds reflected above in fiscal 2014, a decrease of $4.7 million (4.1 percent) from the prior year. Total revenue decreased by $661 per ADM from the previous year. In the General Fund, tax revenue decreased $1,981 per ADM and state aid revenue increased $1,646 per ADM, mainly due to a $12.7 million change in the tax shift, which shifts funding between taxes and state aids but is revenue neutral in total. The District also began accounting for its capital project referendum levy ($4.6 million for fiscal 2014) in the Capital Projects – Building Construction Fund rather than the General Fund. Debt Service Fund revenue decreased by $390 per ADM due to a decrease of almost $3.3 million in the District's debt service 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.

Governmental Funds Expenditures per Student (ADM) Served

	State-Wide		Seven-County Metro Area		ISD No. 273 – Edina		
	2012	2013	2012	2013	2012	2013	2014
General Fund							
Administration and district support	$ 823	$ 849	$ 805	$ 837	$ 673	$ 663	$ 716
Elementary and secondary regular instruction	4,866	4,982	5,103	5,273	5,005	5,216	5,291
Vocational education instruction	138	138	136	132	38	44	42
Special education instruction	1,866	1,909	2,004	2,055	1,864	1,906	1,987
Instructional support services	459	477	537	562	720	599	575
Pupil support services	895	919	957	991	877	905	891
Sites, buildings, and other	802	850	755	800	920	1,245	961
Total General Fund – noncapital	9,849	10,124	10,297	10,650	10,097	10,578	10,463
General Fund capital expenditures	462	509	410	469	304	451	261
Total General Fund	10,311	10,633	10,707	11,119	10,401	11,029	10,724
Special revenue funds							
Food Service	486	500	480	500	377	388	376
Community Service	526	535	630	646	856	890	924
Debt Service Fund	1,337	1,234	1,312	1,322	1,229	1,568	803
Total expenditures	$ 12,660	$ 12,902	$ 13,129	$ 13,587	$ 12,863	$ 13,875	$ 12,827
ADM served per MDE School District Profiles Report (current year estimated)					8,360	8,408	8,472

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 $108.7 million in the governmental funds reflected above in fiscal 2014, a decrease of $8.0 million (6.9 percent) from the prior year. On a per ADM basis, this represents a decrease of $1,048. General Fund expenditures decreased $305 per ADM; mainly in sites, buildings, and other ($284 per ADM) and capital expenditures ($190 per ADM), due to the change in accounting for the District's capital technology levy. Debt service expenditures also decreased $765 per ADM, as debt service interest costs were inflated the last two years by a 2011 crossover refunding bond issue that retired $55.6 million of the District's outstanding bonds in fiscal 2013.

SUMMARY

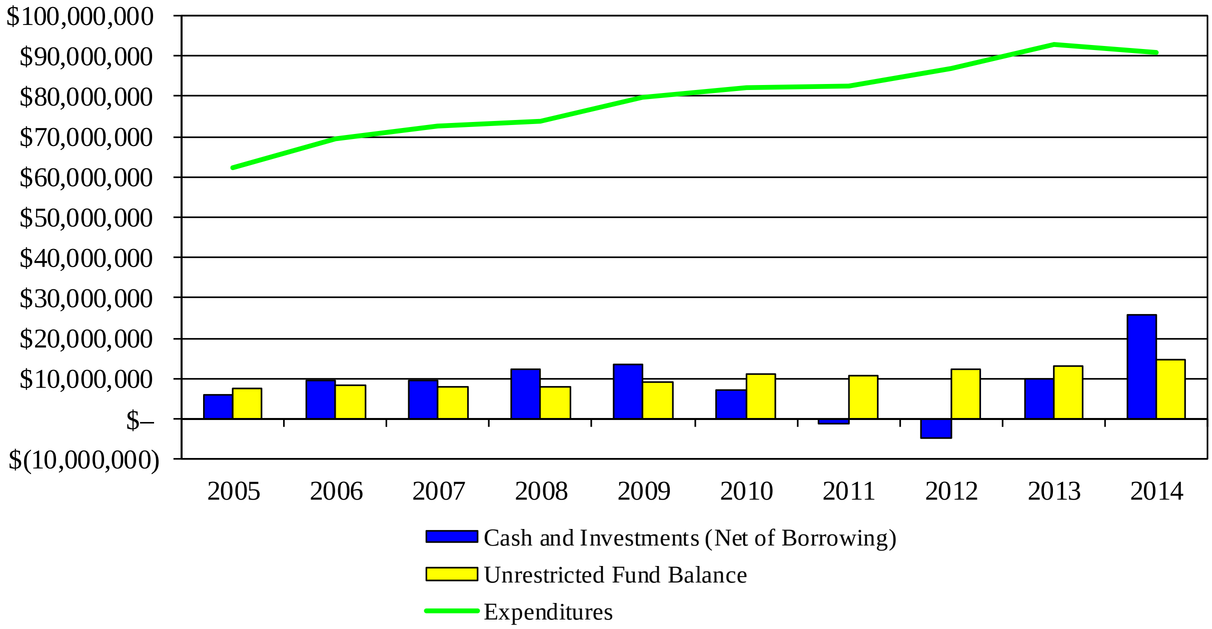
The funding for and financial position of Minnesota school districts has fluctuated significantly over the past several years due to a number of factors, including those discussed above. This situation continues to present a challenge for school boards, administrators, and management of these districts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

FINANCIAL TRENDS OF YOUR DISTRICT

GENERAL FUND FINANCIAL POSITION

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

General Fund Financial Position
Year Ended June 30,



The District ended fiscal year 2014 with a General Fund cash balance of $25,962,148 (net of interfund receivables and payables), an increase of $15,868,967 from the previous year. This change was primarily due to the state buy-down of the tax shift and a change in the metering of state aid payments. Unrestricted fund balance at year-end was $14,547,652, an increase of $1,457,365.

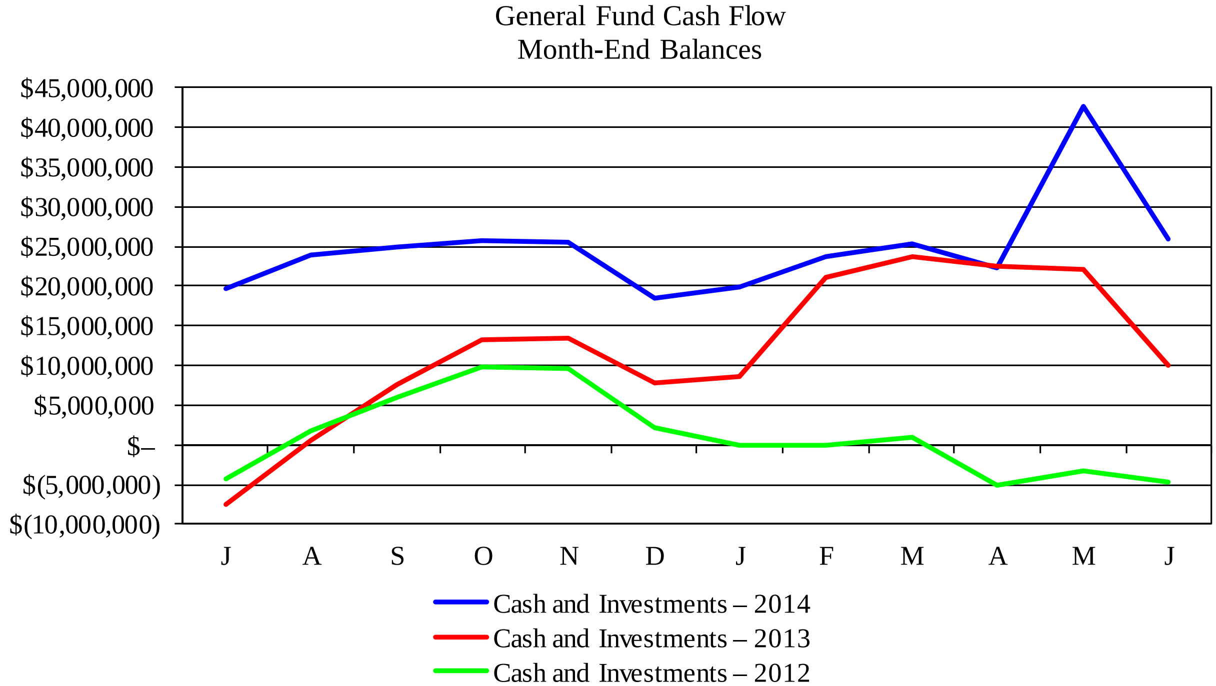
The following table presents the components of the General Fund balance for the past five years:

	June 30,				
	2010	2011	2012	2013	2014
Nonspendable fund balances	$ –	$ 815,358	$ 561,282	$ 734,483	$ 79,058
Restricted fund balances (1)	(944,675)	(879,026)	(229,765)	285,148	984,793
Unrestricted fund balances					
Committed	–	1,523,051	2,424,609	2,465,889	2,562,543
Assigned	3,743,327	3,931,164	3,333,975	3,395,384	3,347,101
Unassigned	7,374,289	5,331,566	6,451,685	7,229,014	8,638,008
Total fund balance	$ 10,172,941	$ 10,722,113	$ 12,541,786	$ 14,109,918	$ 15,611,503
Unrestricted fund balances as a percentage of expenditures	13.9%	13.1%	14.8%	14.1%	16.0%
Unassigned fund balances as a percentage of expenditures	9.2%	6.5%	7.8%	7.8%	9.5%

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

The table above reflects the total General Fund unrestricted fund balance and percentages, which differs from those used in the previous discussion of state-wide fund balances, which are based on a state formula. The resources represented by this fund balance are critical to a district's ability to maintain adequate cash flow throughout the year, to retain its programs, and to cushion against the impact of unexpected costs or funding shortfalls. At June 30, 2014, unrestricted fund balance in the General Fund represented 16.0 percent of annual expenditures, or just over eight weeks of operations assuming level spending throughout the year.

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:

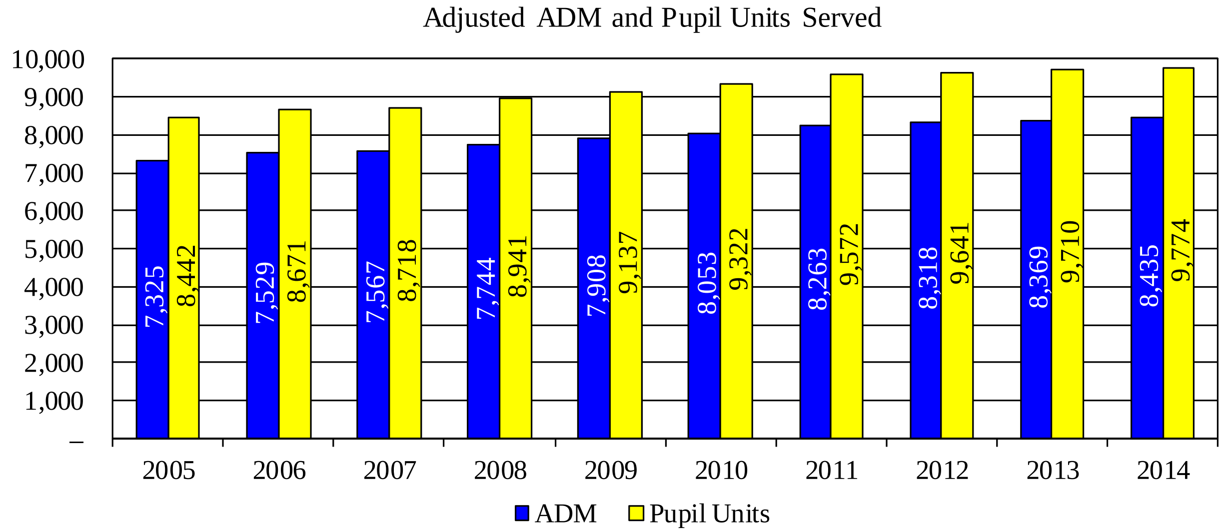


The graph above shows the peaks and valleys of the General Fund cash and investments balance (net of borrowing and interfund balances) on a monthly basis. The swing between its high and low month-end cash balances was about $24.3 million for fiscal 2014.

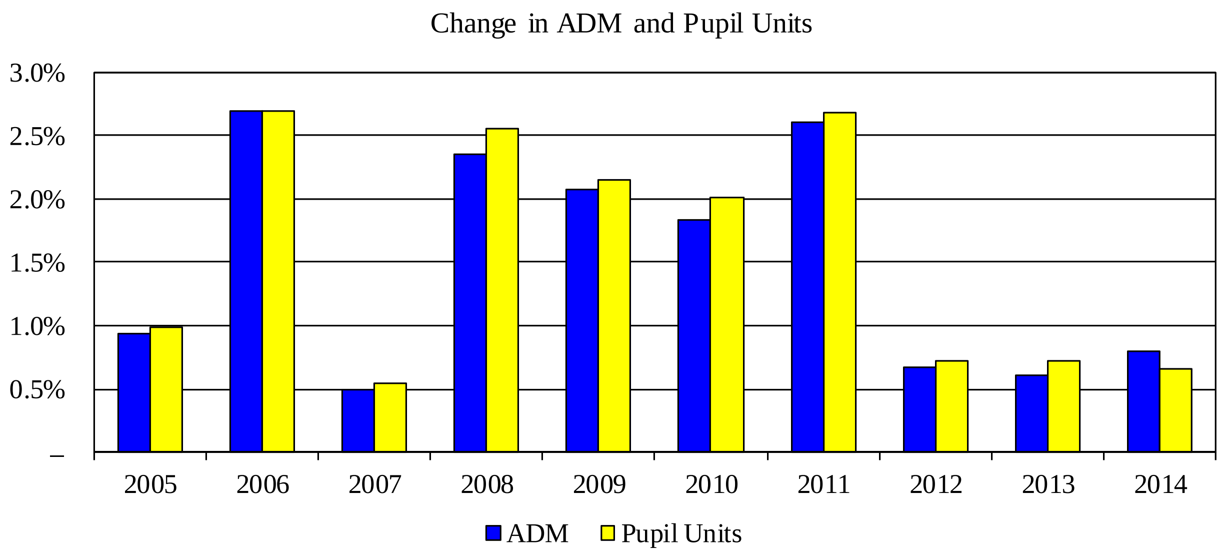
Legislative changes in the tax shift and state aid payment schedules used to help balance the state budget have a significant effect the cash flow of Minnesota school districts. In fiscal 2012, the state holdback on aids normally paid on a 90–10 schedule was up to 40 percent, and the tax shift was at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

AVERAGE DAILY MEMBERSHIP AND PUPIL UNITS

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



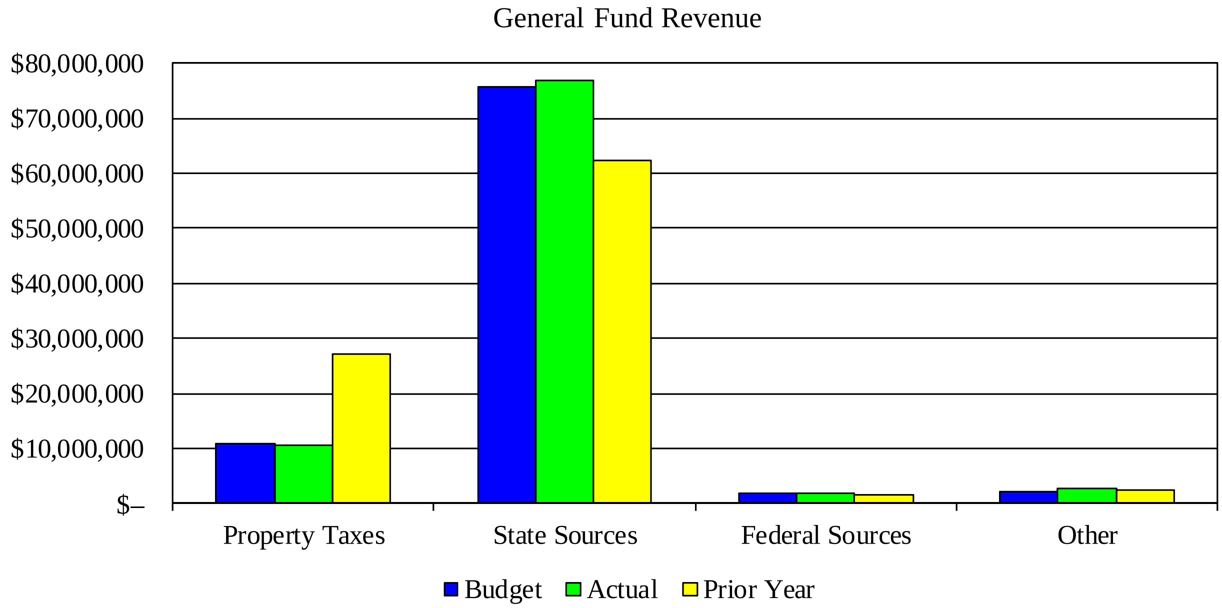
The following graph shows the rate of change in ADM served by the District from year-to-year, along with the change in the resulting pupil units:



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

Adjusted ADM served by the District increased 66 ADM from the prior year to 8,435 served in the current year. The District continues to experience stable growth in the number of students it serves. This is due, in part, to the trend of significant ADM gains the District has generated through open enrollment. In fiscal 2014, the District served approximately 96.4 percent of its resident students, and served 1,242 nonresident ADM attending the District through open enrollment.

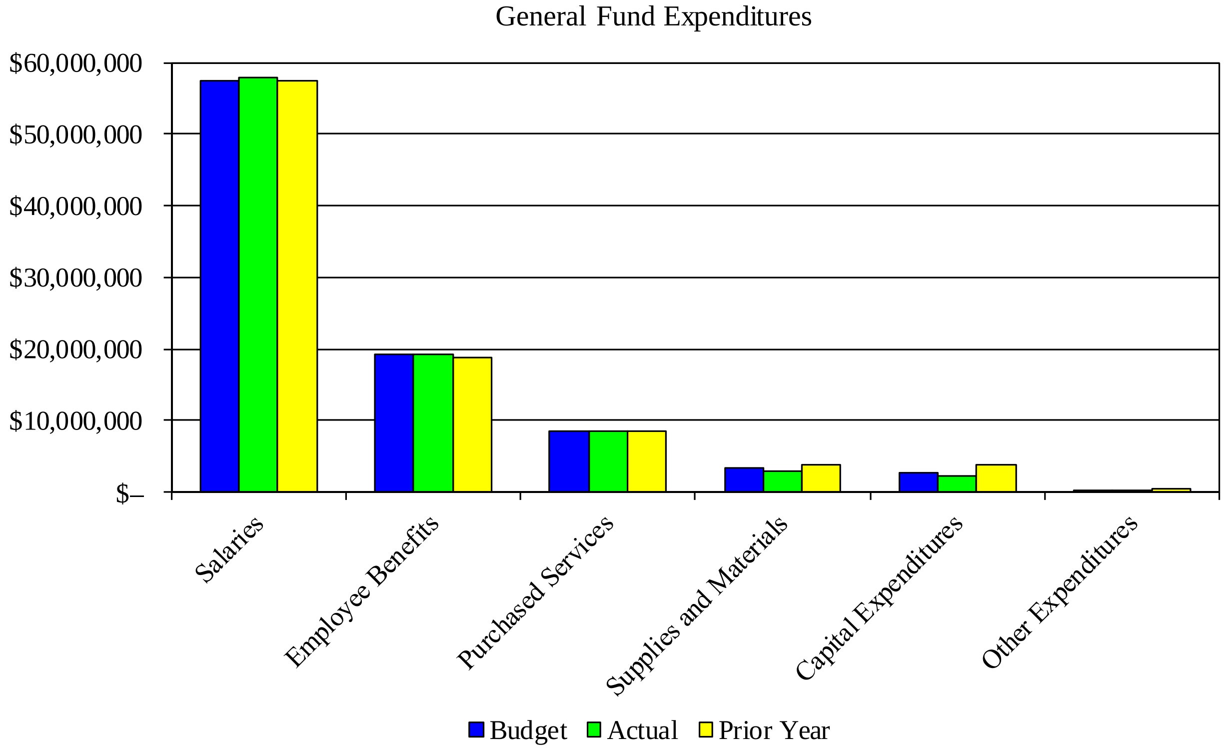
The following graph summarizes the District's General Fund revenue for 2014:



Total General Fund revenues were $91,780,232 for the year ended June 30, 2014, which was $1,042,264 (1.1 percent) over the final budget. State revenues were over budget by $888,031, mainly in special education state aid. Revenues from other local sources (including gifts, bequests, tuition, rental, and investment income) were $354,883 over budget, due to conservative budgeting for these revenues, which are difficult to project.

General Fund total revenues were $1,924,541 (2.1 percent) less than the previous year. The decrease was primarily caused by the change in accounting for the capital projects levy, as previously discussed. The change in revenue between property taxes and state aids from year to year was the result of the state buy-down of the tax shift.

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

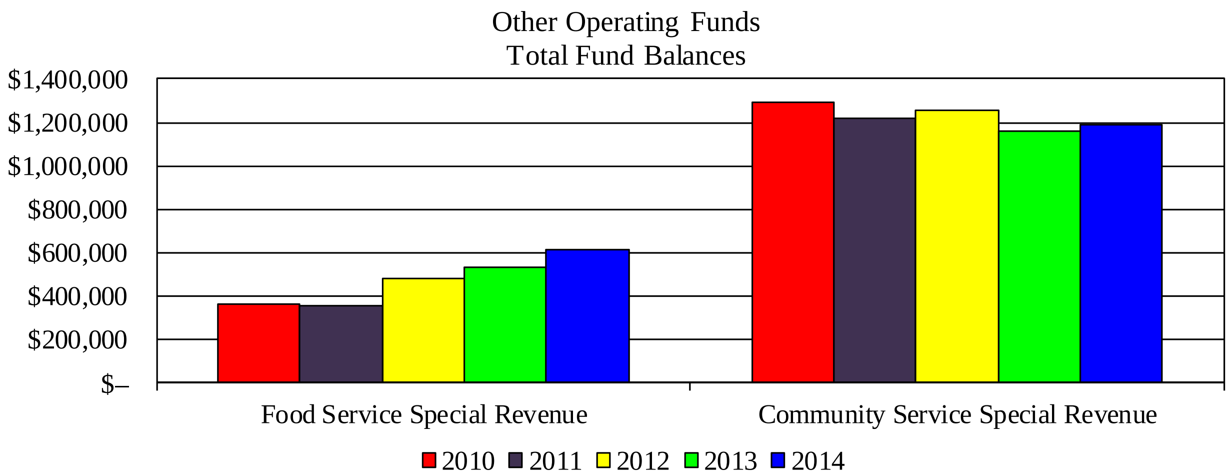


Total General Fund expenditures were $90,858,247 for the year ended June 30, 2014, which was $692,783 (0.8 percent) under the final budget. Salaries were $475,532 over budget, due to higher retiree severance and substitute teacher usage than anticipated. Supplies and materials were $613,205 under budget, mainly in the elementary and secondary regular instruction program area due to spending related to available grants and allocations being less than anticipated. Capital expenditures were also $505,694 under budget due to capital project savings and site allocation carryovers.

Total General Fund expenditures were $1,868,254 (2.0 percent) less than the prior year. Salaries and benefits were $703,612 (0.9 percent) higher than last year due to contractual and inflationary increases. The largest decreases were in supplies and materials ($911,318) and capital expenditures ($1,580,764), which primarily resulted from the change in accounting for the District's capital project levy.

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 District's Food Service Special Revenue Fund ended fiscal 2014 with a fund balance increase of $87,771, compared to a budgeted decrease of $23,225. Food service revenue was $3,271,491, which was under budget by $96,534, mainly in other – primarily meals sales. Expenditures were $3,183,720, under budget by $207,530, mainly in purchased services and supplies. Revenues and expenditures were both lower due to the District having five less days of school due to winter weather-related closings. The ending fund balance of $616,411 in this fund represents 19.4 percent of current year expenditures.

Community Service Special Revenue Fund

The District's Community Service Special Revenue Fund ended fiscal 2014 with a fund balance increase of $26,706, compared to a budgeted surplus of $32,731. Revenues were $7,857,781, which exceeded budget by $182,755. Most of this variance was in tuition and fees due to increased program participation and the collection of fees for participants that normally would not have paid funded by the District's new "Give and Go" program. Expenditures were $7,831,075, over budget by $188,780, mainly in salaries. The ending fund balance of $1,188,788 in this fund represents 15.2 percent of current year expenditures.

Over the years, we have emphasized to our clients that food service and community service operations should be self-sustaining, and should not become an additional burden on general education funds. The District has been able to maintain healthy, stable fund balances in both funds.

Capital Projects – Building Construction Fund

The Capital Projects – Building Construction Fund experienced a fund balance decrease of $5,053,231 in fiscal 2014, compared to a budgeted decrease of $4,802,947. Most of the decrease resulted from spending down remaining proceeds from the District's 2013 alternative facilities bond issue. The year-end fund balance includes: $18,087 restricted for certificate of participation projects; $3,688,167 restricted for alternative facilities program purposes; and $281,570 restricted for capital projects levy projects.

Debt Service Fund

The funding of debt service is controlled in accordance with each outstanding debt issue's financing plan. At June 30, 2014, this fund had a fund balance of $947,081 available for future debt service needs.

Internal Service Fund

The Internal Service Fund is considered a proprietary fund and is used to account for dental insurance offered by the District to its employees as a self-insured plan. The net position of this fund increased $66,643 in fiscal 2014, ending the year with a balance of $358,455.

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)
Net position – governmental activities			
Total fund balances – governmental funds	$ 22,351,607	$ 25,617,429	$ (3,265,822)
Total capital assets, net of depreciation	104,275,768	96,663,281	7,612,487
Total long-term liabilities	(80,539,420)	(81,491,053)	951,633
Other adjustments	159,152	(543,151)	702,303
Total net position – governmental activities	$ 46,247,107	$ 40,246,506	$ 6,000,601
Net position			
Net investment in capital assets	$ 36,988,080	$ 31,185,673	$ 5,802,407
Restricted	2,885,430	1,934,927	950,503
Unrestricted	6,373,597	7,125,906	(752,309)
Total net position	$ 46,247,107	$ 40,246,506	$ 6,000,601

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 fund balance can only be spent for food service program costs). The unrestricted category consists mainly of the General Fund unrestricted fund balances, offset against noncapital long-term obligations such as severance payable.

Total net position increased $6,000,601 in fiscal 2014. The District's net investment in capital assets increased $5,802,407. The change in this category of net position is typically determined by the relationship between the depreciation of capital assets and the repayment of the debt issued to construct or acquire the assets. The increase in fiscal 2014 was also impacted by the acquisition of capital assets funded through alternative facilities or capital project referendum tax levies, rather than through the issuance of debt. Restricted increased by $950,503, primarily in net position restricted for capital asset acquisition. Unrestricted net position decreased $752,309, mainly due to the increasing unfunded liabilities for long-term OPEB and pension benefits.

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.

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