Management Report

for

Independent School District No. 139
Rush City, Minnesota

June 30, 2017

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MMKR
CERTIFIED PUBLIC ACCOUNTANTS

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To the School Board and Management of
Independent School District No. 139
Rush City, Minnesota

We have prepared this management report in conjunction with our audit of Independent School District No. 139, Rush City, 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
October 5, 2017

Malloy, Montague, Karnowski, Radosevich & Co., P.A.
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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 AND *GOVERNMENT AUDITING STANDARDS*

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 and *Government Auditing Standards,* 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 basic financial statements.

- In regard to the District's internal controls over financial reporting, we have reported the following significant deficiency:

    Due to the limited size of the District's office staff, the District has limited segregation of duties in several areas. An ideal system of internal accounting control contemplates an adequate segregation of duties so that no one individual handles a transaction from inception to completion. While we recognize that your organization may not be large enough to permit an adequate segregation of duties in all respects, it is important that you are aware of this condition.

- The results of our testing disclosed no instances of noncompliance required to be reported under *Government Auditing Standards.*

- We have reported the following finding based on our testing of the District's compliance with Minnesota laws and regulations:

    - Our testing procedures performed determined the District did not have adequate collateral coverage for one depository account as of June 30, 2017 as required by Minnesota Statutes § 118A.03.

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, 2017 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 prenumbered receipts, prenumbered 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*, in which we reported no findings as a result of that testing.

GENERAL COMMENTS AND RECOMMENDATIONS

Student Activity Disbursements

The latest version of the *Manual for Activity Fund Accounting* included a change in how check requests must be prepared. Previously, check requests were to be signed by the activity advisor and a student representing the activity. Under the current manual, check requests must be prepared, and approved by a student representative, the advisor, and the building principal (or his/her designee). For elementary student activity accounts, the student representative approval is not required. Approval is evidenced by signatures. We recommend the District review the internal controls and procedures over extracurricular student activity accounts to allow future compliance for all recent changes and ongoing internal control and compliance requirements of the *Manual for Activity Fund Accounting*.

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 ended June 30, 2017:

- Governmental Accounting Standards Board (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 activity for other post-employment benefits (OPEB) and pension benefits. These obligations are calculated using actuarial methodologies described in GASB Statement Nos. 45 and 68. These actuarial calculations include significant assumptions, including projected changes, healthcare insurance costs, investment returns, retirement ages, proportionate share, and employee turnover.

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

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.

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.

DISAGREEMENTS WITH MANAGEMENT

For purposes of this letter, 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 5, 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 remaining 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 and the 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 which accompanies the financial statements but is 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.

UNIFORM FINANCIAL ACCOUNTING AND REPORTING STANDARDS (UFARS) CODING

The chart below provides a description of some of the most common expenditures for each of the program categories listed in the financial statements:

Program Category	Common Expenditures
Administration	School Board, superintendent, principals, and assistant principals
District support services	Human resources, finance and business support, data processing, and legal
Elementary and secondary regular instruction	K–12 education, athletics, and extracurricular activities
Vocational education instruction	Occupational and immediate employment coursework and training
Special education instruction	Special educational instruction
Instructional support services	Curriculum, library, and staff development
Pupil support services	Counseling and guidance, social work, transportation, and health services
Sites and buildings	Building and other facilities construction
Other	Insurance, principal and interest payments, and miscellaneous nonrecurring items

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

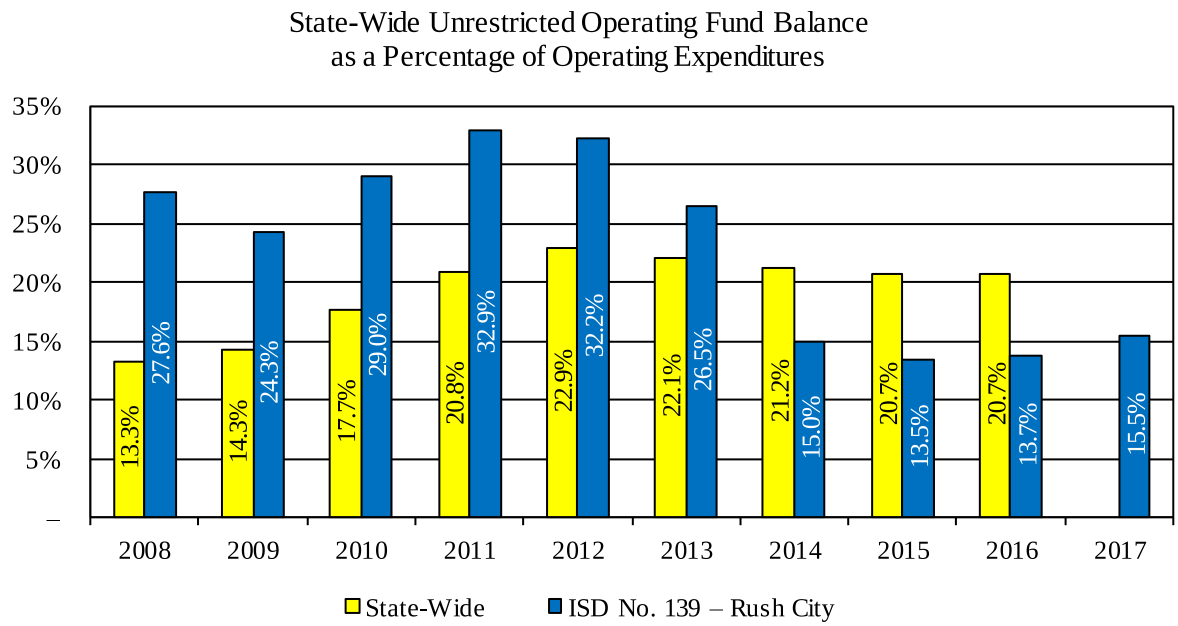
The largest single funding source for Minnesota school districts is basic general education aid. Each year, the Legislature sets a basic formula allowance. Total basic general education revenue is calculated by multiplying the formula allowance by the number of pupil units for which a district is entitled 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 schools. 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.

	Formula Allowance	
Fiscal Year Ended June 30,	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 HEALTH

One of the most common and comparable statistics used to evaluate school district financial health is the 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 15.5 percent at the end of the current year, as compared to 13.7 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 Permanent, Capital Projects – Building Construction, and Post-Employment Benefits Debt Service Funds. Other financing sources, such as proceeds from sales of capital assets, insurance recoveries, bond sales, loans, and interfund transfers, are also excluded.

Governmental Funds Revenue per Student (ADM) Served

	State-Wide		Seven-County Metro Area		ISD No. 139 – Rush City		
	2015	2016	2015	2016	2015	2016	2017
General Fund							
Property taxes	$ 1,657	$ 1,777	$ 2,187	$ 2,342	$ 709	$ 897	$ 969
Other local sources	489	495	387	392	646	775	700
State	8,967	9,271	9,030	9,357	8,326	8,301	8,785
Federal	441	432	447	447	170	148	151
Total General Fund	11,554	11,975	12,051	12,538	9,851	10,121	10,605
Special revenue funds							
Food Service	522	548	516	545	457	470	498
Community Service	551	591	651	692	473	459	529
Debt Service Fund	1,061	1,053	1,127	1,084	1,606	1,575	1,445
Total revenue	$ 13,688	$ 14,167	$ 14,345	$ 14,859	$ 12,387	$ 12,625	$ 13,077
ADM served per MDE School District Profiles Report (current year estimated)					846	858	867

Note: Excludes the Permanent, 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 table above is based on enrollments consistent with those used in the MDE School District Profiles Report, which include extended time ADM, and may differ from ADM reported in other tables.

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

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

The District earned $11,337,648 in the governmental funds reflected above in fiscal 2017, an increase of $504,589 (4.7 percent) from the prior year. Total revenue per ADM served increased by $452 (3.6 percent) per student. The increase in the basic formula allowance as discussed earlier, improved special education funding, and participation in the Alternative Compensation Program contributed to the overall revenue growth in the General Fund. Debt Service Fund sources were down, with a decrease in approved debt levies and investment earnings as determined by approved debt financing plans and timing of refunding transactions.

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

Governmental Funds Expenditures per Student (ADM) Served

	State-Wide		Seven-County Metro Area		ISD No. 139 – Rush City		
	2015	2016	2015	2016	2015	2016	2017
General Fund							
Administration and district support	$ 941	$ 960	$ 951	$ 958	$ 1,041	$ 1,130	$ 1,119
Elementary and secondary regular instruction	5,301	5,466	5,635	5,849	4,259	4,229	4,164
Vocational education instruction	147	158	136	146	140	179	148
Special education instruction	2,058	2,182	2,196	2,330	1,653	1,760	1,881
Instructional support services	586	622	689	725	614	608	706
Pupil support services	992	1,019	1,072	1,104	559	599	661
Sites and buildings and other	881	890	832	847	1,050	1,248	1,277
Total General Fund – noncapital	10,906	11,297	11,511	11,959	9,316	9,753	9,956
General Fund capital expenditures	581	600	493	532	597	233	315
Total General Fund	11,487	11,897	12,004	12,491	9,913	9,986	10,271
Special revenue funds							
Food Service	528	542	523	539	474	474	497
Community Service	546	577	642	676	509	477	565
Debt Service Fund	1,489	1,522	1,701	1,453	1,600	1,716	1,500
Total expenditures	$ 14,050	$ 14,538	$ 14,870	$ 15,159	$ 12,496	$ 12,653	$ 12,833
ADM served per MDE School District Profiles Report (current year estimated)					846	858	867

Note: Excludes the Permanent, 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's expenditures per ADM have been below both the metro area and state-wide averages in recent years. Administration and district support have been above average due to additional costs for fiscal host services provided to the St. Croix River Education District (SCRED) for a fee.

The District spent $11,125,835 in the governmental funds reflected above in fiscal 2017, an increase of $270,116 (2.5 percent) from the prior year. On a per student basis, this represents an increase of $180 (1.4 percent). General Fund expenditures increased $285 per student, spread across several programs presented above with the largest increase in special education instruction ($121 per student) followed by instructional support services ($98 per student). Capital spending in the General Fund increased by $82 per student compared to the prior year. Debt Service Fund expenditures decreased $216 per student due to decreased issue costs and interest associated with refunding transactions in the prior year.

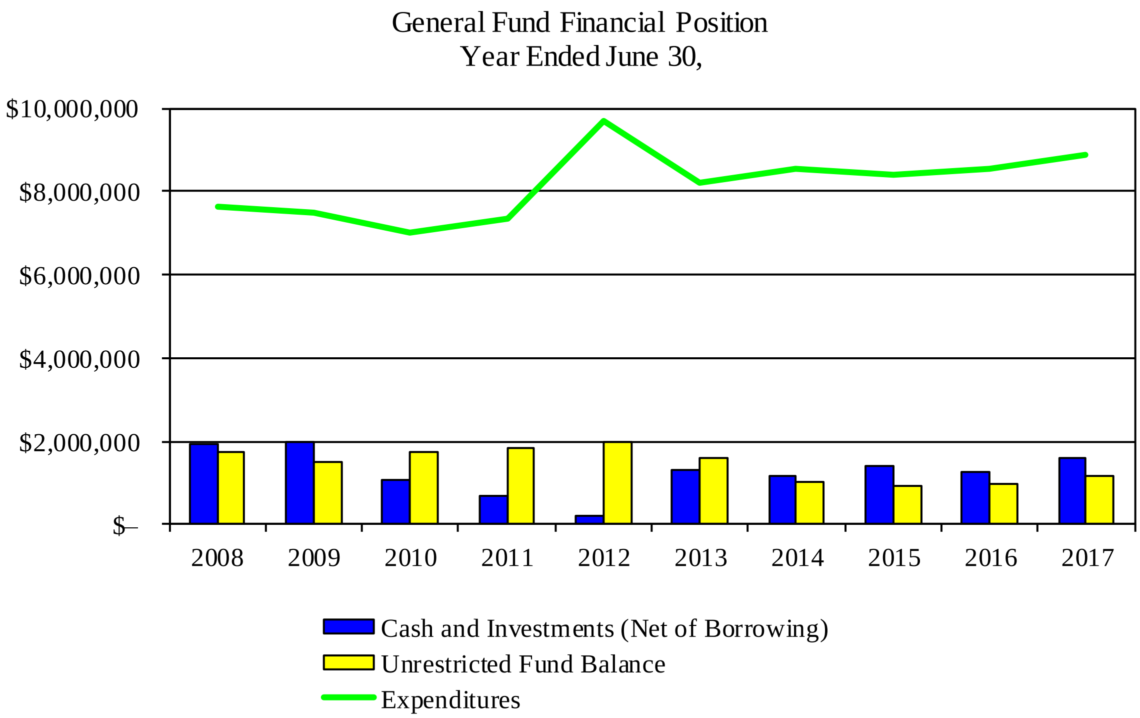
SUMMARY

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

FINANCIAL TRENDS OF YOUR DISTRICT

GENERAL FUND FINANCIAL POSITION

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



The District ended fiscal year 2017 with a General Fund cash balance of $1,596,893, an increase of $312,421. Unrestricted fund balance at year-end was $1,186,427, an increase of $209,273. The spike in 2012 expenditures reflects the $1,930,000 capital outlay for the SCRED facility in that year.

Changes in the metering of state aid payments to school districts and in the tax shift, as legislatively approved, has significantly impacted cash and investment balances in the years presented in the above graph.

GENERAL FUND COMPONENTS OF FUND BALANCE

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

	Fiscal Year				
	2013	2014	2015	2016	2017
Nonspendable fund balances	$ 99,759	$ –	$ –	$ –	$ 749
Restricted fund balances (1)	3,584	(86,505)	(107,641)	(31,920)	31,874
Unrestricted fund balances					
Assigned	673,568	10,500	61,781	4,500	118,274
Unassigned	946,715	1,001,970	873,946	972,654	1,068,153
Total fund balances	$ 1,723,626	$ 925,965	$ 828,086	$ 945,234	$ 1,219,050
Unrestricted fund balances as a percentage of total expenditures	19.7%	11.9%	11.2%	11.4%	13.3%
Unassigned fund balances as a percentage of total expenditures	11.5%	11.7%	10.4%	11.4%	12.0%

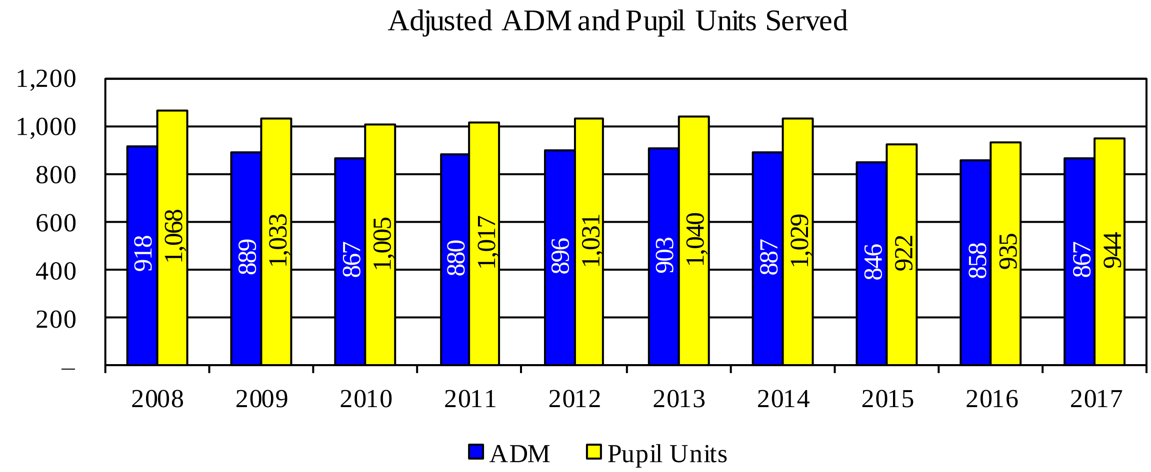
(1) Includes deficits in restricted fund balance accounts allowed to accumulate deficits under UFARS, which are part of unassigned fund balance on the accounting principles generally accepted in the United States of America-based financial statements.

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.

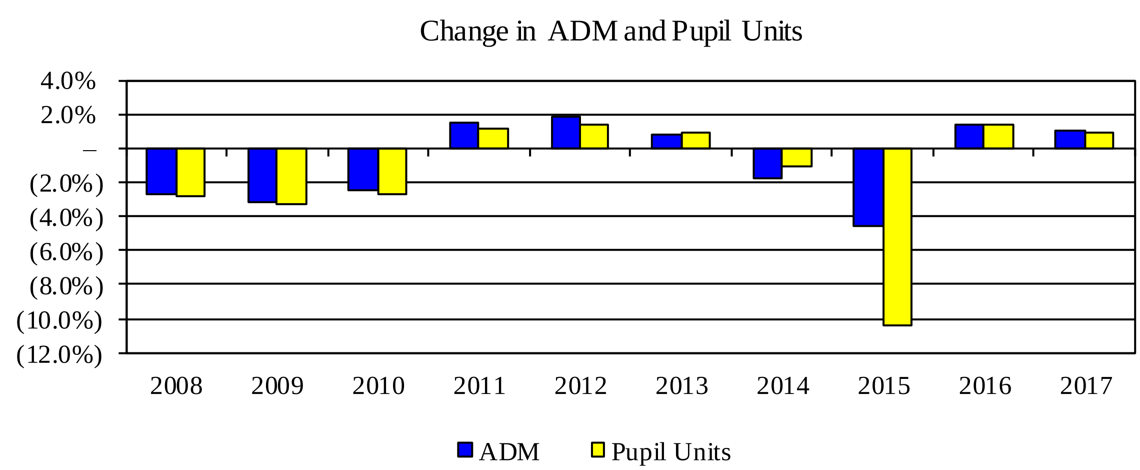
The School Board has formally adopted a fund balance policy regarding the minimum fund balance. The policy establishes that the District will strive to maintain a minimum unassigned general operating fund balance of 15.0 percent of the general operating expenditures for each fiscal year. If the balance will decrease below 15.0 percent, the administration shall apprise the School Board of this prior to budget adoption. If the balance will decrease below 10 percent, the School Board will initiate certain measures to ensure that the balance does not fall below this level. As of June 30, 2017, the District has calculated a fund balance percentage of 13.3 percent, as intended in the fund balance policy as interpreted by the District.

AVERAGE DAILY MEMBERSHIP (ADM) AND PUPIL UNITS

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



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



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

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

The District served an estimated ADM of 867 in 2017, an increase of 9 (1 percent) over last year.

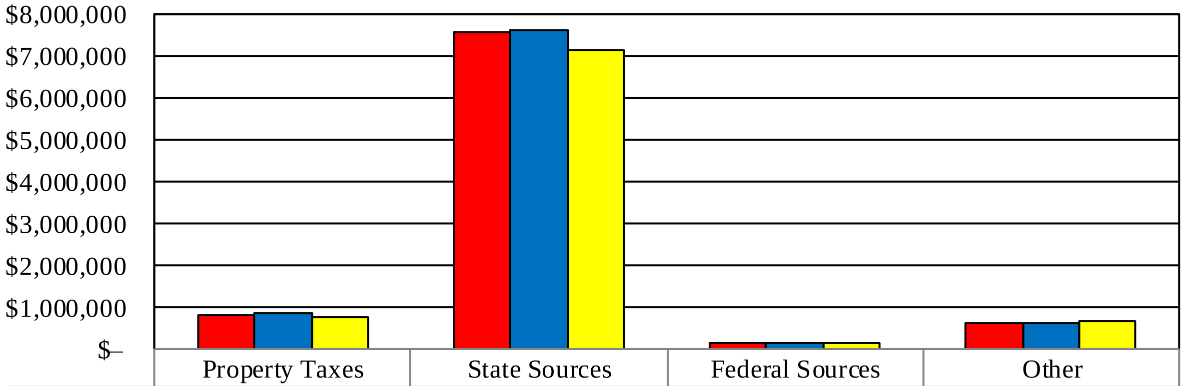
ADM is weighted as follows in computing pupil units:

Fiscal	Pre-Kindergarten	Handicapped Kindergarten	Half-Day Kindergarten	Full-Day Kindergarten	Elementary 1–3	Elementary 4–6	Secondary
2008 through 2014	1.250	1.000	0.612	0.612	1.115	1.060	1.300
2015 through 2017	1.000	1.000	0.550	1.000	1.000	1.000	1.200

GENERAL FUND REVENUES

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

General Fund Revenue



	Property Taxes	State Sources	Federal Sources	Other
Budget	$826,392	$7,550,647	$119,920	$624,350
Actual	$840,019	$7,616,271	$131,034	$607,137
Prior Year	$770,000	$7,122,432	$126,708	$665,170

Current year revenues totaling $9,194,461 were over budget by $73,152 (0.8 percent), and were $510,151 (5.9 percent) higher than the prior year.

The variance to budget was mainly in state sources, which were $65,624 over budget. Conservative budgeting for state special education sources and pension benefits passed through the District caused actual revenues to exceed budget.

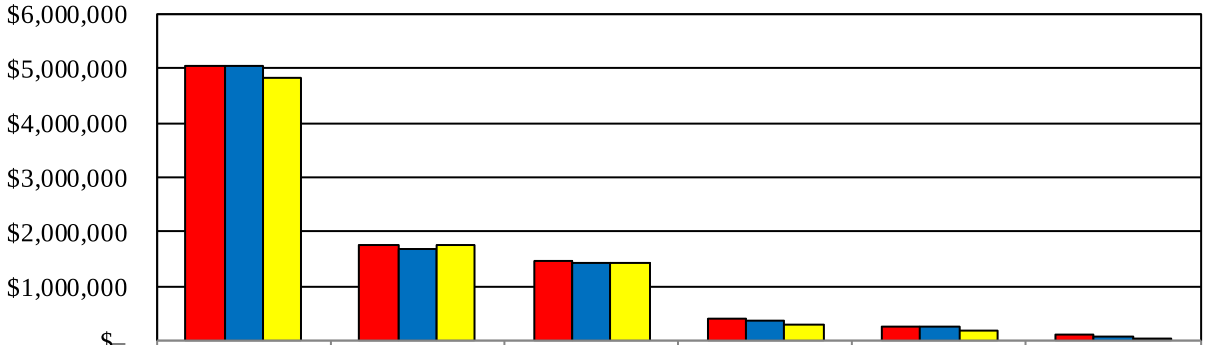
The increase from the prior year was spread across nearly all of the above sources, with other sources decreasing slightly from last year. Property tax sources increased over the prior year as approved through the levy certification process. The increase in state sources included the increase in the basic formula allowance, special education funding sources, and participation in the alternative compensation program as previously discussed.

The graph above reflects the concentration of state sources (82.8 percent) followed by property taxes (9.1 percent) received to finance General Fund operations.

GENERAL FUND EXPENDITURES

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

General Fund Expenditures



	Salaries	Employee Benefits	Purchased Services	Supplies and Materials	Capital Expenditures	Other Expenditures
Budget	$5,054,217	$1,774,486	$1,453,887	$418,591	$262,176	$101,414
Actual	$5,049,876	$1,696,287	$1,438,793	$377,223	$272,860	$69,476
Prior Year	$4,830,724	$1,762,056	$1,429,435	$302,564	$199,931	$42,692

Current year expenditures of $8,904,515 were under budget by $160,256 (1.8 percent), and were $337,113 (3.9 percent) more than the prior year.

As presented in the graph above, expenditures were less than projected in most categories and spread across all programs. The largest under spending was in employee benefits (primarily within special education) partially due to budgeted positions going unfilled during the year.

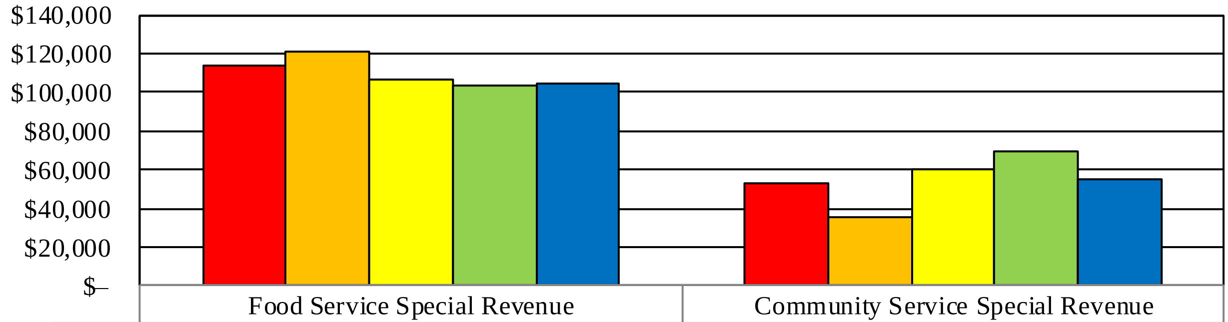
Expenditure increases were primarily due to planned program enhancements and contractual salary and benefit increases. The District's participation in the Alternative Compensation Program in the current year contributed to the increase in salary and related benefit costs. Within pupil support services, the District had an increase in capital expenditures, due to the purchase of a bus in the current year.

Salaries and employee benefits, which account for 75.8 percent of General Fund spending, were $153,383 (2.3 percent) over the prior year and $82,540 (1.2 percent) under 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.

Other Operating Funds
Total Fund Balances



	Food Service Special Revenue	Community Service Special Revenue
2013	$113,629	$52,635
2014	$121,126	$35,028
2015	$106,490	$59,772
2016	$103,113	$69,052
2017	$104,180	$54,834

Food Service Special Revenue Fund

The District's Food Service Special Revenue Fund recognized an increase in fund balance of $1,067 in 2017, compared to a budgeted decrease of $7,496. Revenues were more than anticipated in the budget by $24,839, while expenditures were over budget by $16,276. Total fund balance of $104,180 equals 24.2 percent of its annual expenditures totaling $430,972.

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

Community Service Special Revenue Fund

The District's Community Service Special Revenue Fund recognized a fund balance decrease of $14,218, compared to a budgeted decrease of $19,777. Revenues were over budget by $41,776, while expenditures were above appropriations by $25,497. The District's General Fund transferred $16,880 to this operation, which was $10,720 less than planned in the budget. Total fund balance of $54,834 represents 11.2 percent of the fund's expenditures totaling $489,569.

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

Capital Projects – Building Construction Fund

The Capital Projects – Building Construction Fund ended the year with a fund balance increase of $764,938, compared to a $905,000 increase anticipated in the budget. Capital outlay expenditures were more than budget due to the timing of project costs. At year-end, the District reported $764,938 restricted for long-term facilities maintenance after issuing $1,075,000 in bonds in the current year.

Debt Service Fund

The funding of debt service is controlled in accordance with each outstanding debt issue's financing plan. It is important to remember that resources of the Debt Service Fund are restricted to the payment of outstanding debt obligations of the District.

Total fund balance in the Debt Service Fund decreased by $9,810 in the current year, compared to the $22,067 increase anticipated in the budget. As of June 30, 2017, fund balance in the Debt Service Fund totaling $290,837 is available to meet future debt service requirements.

Permanent Fund

During fiscal 2017, the Permanent Fund recognized a slight fund balance decrease of $1,235, ending the year with $511,137 in total fund balance. Of this total fund balance, $511,000 is considered permanently restricted.

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, 2017	June 30, 2016	Increase (Decrease)
Net position – governmental activities			
Total fund balances – governmental funds	$ 2,944,976	$ 1,930,418	$ 1,014,558
Total capital assets, net of depreciation	16,910,983	17,188,581	(277,598)
Total long-term debt, excluding pensions	(13,524,571)	(13,518,510)	(6,061)
PERA and TRA pension adjustments	(7,050,517)	(4,839,616)	(2,210,901)
Other adjustments	1,557,036	1,631,001	(73,965)
Total net position – governmental activities	$ 837,907	$ 2,391,874	$ (1,553,967)
Net position			
Net investment in capital assets	$ 5,572,858	$ 5,250,185	$ 322,673
Restricted	1,089,500	1,066,261	23,239
Unrestricted	(5,824,451)	(3,924,572)	(1,899,879)
Total net position	$ 837,907	$ 2,391,874	$ (1,553,967)

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 or severance payable and net pension liabilities.

Total net position decreased by $1,553,967 during fiscal 2017. As presented in the table above, this change was primarily in unrestricted net position. The change in the District's proportionate share of the Public Employees Retirement Association and the Teachers Retirement Association pension obligations caused unrestricted net position to decrease in the current year.

The District's net investment in capital assets increased $322,673 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 for amounts restricted for debt service.

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 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 1.7 percent of total compensatory revenue for FY 2018, and 3.5 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 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 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. 75, *ACCOUNTING AND FINANCIAL REPORTING FOR POSTEMPLOYMENT BENEFITS OTHER THAN PENSIONS*

The primary objective of this statement is to improve accounting and financial reporting by state and local governments for post-employment benefits other than pensions (other post-employment benefits or OPEB). It also improves information provided by state and local governmental employers about financial support for OPEB that is provided by other entities. This statement replaces the requirements of GASB Statement Nos. 45 and 57. GASB Statement No. 74 establishes new accounting and financial reporting requirements for OPEB plans.

This statement establishes standards for recognizing and measuring liabilities, deferred outflows of resources, deferred inflows of resources, and expense/expenditures. For defined benefit OPEB, this statement identifies the methods and assumptions that are required to be used to project benefit payments, discount projected benefit payments to their actuarial present value, and attribute that present value to periods of employee service. Note disclosure and required supplementary information requirements about defined benefit OPEB also are addressed. This statement is effective for fiscal years beginning after June 15, 2017. Earlier application is encouraged.

Similar to changes implemented for pensions, this statement requires the liability of employers and nonemployer contributing entities to employees for defined benefit OPEB (net OPEB liability) to be measured as the portion of the present value of projected benefit payments to be provided to current active and inactive employees that is attributed to those employees' past periods of service (total OPEB liability), less the amount of the OPEB plan's fiduciary net position.

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.

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