Management Report

for

Independent School District No. 624
White Bear Lake, Minnesota
June 30, 2014

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MMKR
CERTIFIED PUBLIC ACCOUNTANTS

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To the Board of Education and Management of
Independent School District No. 624
White Bear Lake, Minnesota

We have prepared this management report in conjunction with our audit of Independent School District No. 624, White Bear Lake Area Schools' (the District) financial statements for the year ended June 30, 2014. The purpose of this report is to communicate information relevant to the financing of public education in Minnesota and to provide comments resulting from our audit process. We have organized this report into the following sections:

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

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

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

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

Minneapolis, Minnesota
November 10, 2014

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AUDIT SUMMARY

The following is a summary of our audit work, key conclusions, and other information that we consider important or that is required to be communicated to the Board of Education, 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 with you in order to obtain sufficient audit evidence and complete an effective audit.

AUDIT OPINIONS 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 one deficiency in the District's internal control over financial reporting that we considered to be a material weakness:
    - The current year financial statements will be adjusted for reimbursement for all unremitted prior year expenses related to other post-employment benefits payable in the form of a prior period adjustment. The necessity of a prior period adjustment is, by nature, a material weakness in internal controls.
- 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 major federal program.
- We reported one deficiency in the internal controls over compliance and its operation that we consider to be a material weakness in our testing of major federal programs:
    - During our audit, we noted the District did not have adequate internal controls in place to ensure adequate documentation of expenditures within the special education cluster (CFDA Nos. 84.027 and 84.173). During our testing, we noted 1 of 40 transactions we tested did not have a signed approval of the disbursement on file.
- We reported no findings based on our testing of the District's compliance with Minnesota laws and regulations.

OTHER COMMENTS AND RECOMMENDATIONS

Use of Public Funds

The Minnesota Attorney General's Office has consistently stated that local governments do not have implied authority to sponsor employee social events simply because they have the express power to compensate employees. Important limitations exist on the use of public funds for employee social and recognition events. Generally, in order to spend money, a local government must have authority to do so. Authority for an expenditure may be specifically stated in a statute or charter, or it may be implied as necessary to do what an express power authorizes.

We noted during our audit procedures that staff members of the District are in need of additional clarification on how to handle certain situations that are guided by this rule. We recommend the District formally review the policies and procedures of the District in this area. We also recommend the District provide additional communication to its employees regarding compliance with these revised policies and procedures.

Monthly Bank Reconciliations

During our testing, we noted that the District does not include in its internal control procedures a formal review and approval of the monthly bank reconciliation. The District is relying on other compensating controls to ensure the bank reconciliation process is completed correctly. It is our recommendation that the District include in its internal control procedures the requirement that at least one individual review and approve the monthly bank reconciliation once it has been prepared.

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 and the Internal Service Fund 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). These obligations are calculated using actuarial methodologies described in Governmental Accounting Standards Board (GASB) Statement No. 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.

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

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

DIFFICULTIES ENCOUNTERED IN PERFORMING THE AUDIT

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

DISAGREEMENTS WITH MANAGEMENT

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

MANAGEMENT REPRESENTATIONS

We have requested certain representations from management that are included in the management representation letter dated November 10, 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, and the Schedule of Employer Contributions for the Other Post-Employment 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 accompanying the financial statements and the separately issued Schedule of Expenditures of Federal Awards and Uniform Financial Accounting and Reporting Standards (UFARS) Compliance Table, which are not RSI. With respect to this supplementary information, we made certain inquiries of management and evaluated the form, content, and methods of preparing the information to determine that the information complies with accounting principles generally accepted in the United States of America, the method of preparing it has not changed from the prior period, and the information is appropriate and complete in relation to our audit of the financial statements. We compared and reconciled the supplementary information to the underlying accounting records used to prepare the financial statements or to the financial statements themselves.

We were not engaged to report on the introductory section and statistical section which accompany the financial statements but are not RSI. We did not audit or perform other procedures on this other information and we do not express an opinion or provide any assurance on it.

FUNDING PUBLIC EDUCATION IN MINNESOTA

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

BASIC GENERAL EDUCATION REVENUE

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

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

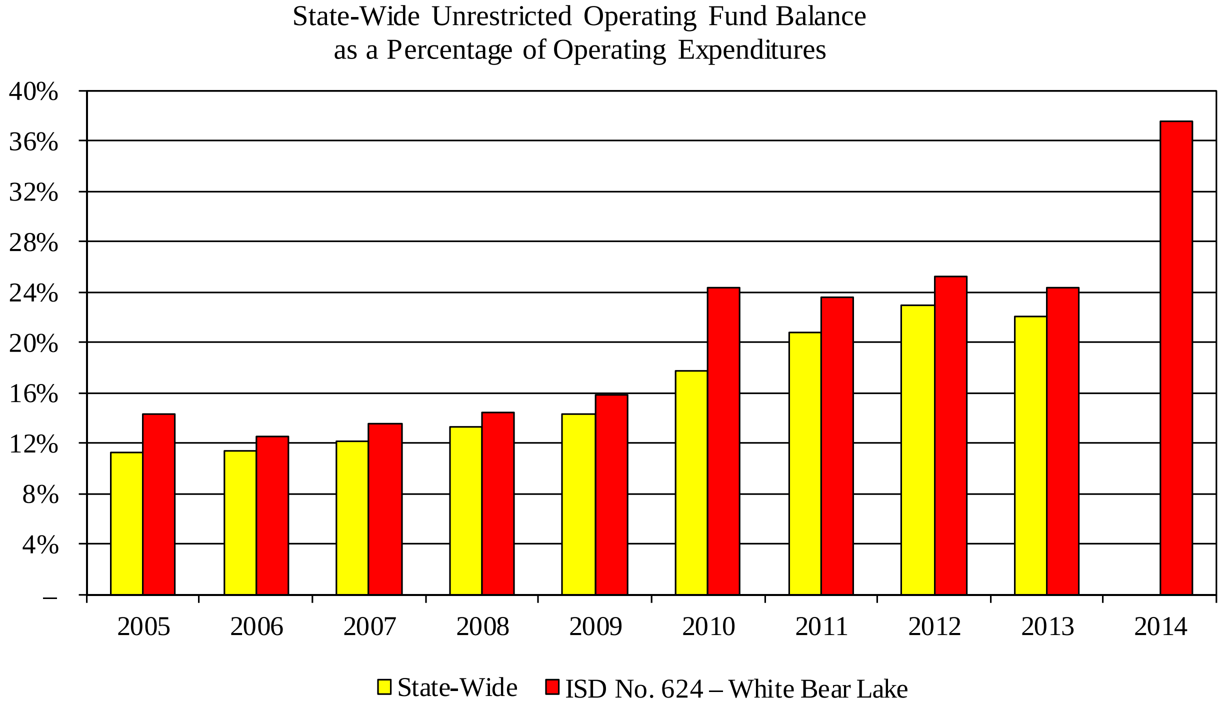
Fiscal Year Ended June 30,	Formula Allowance Amount	Formula Allowance Percent Increase
2005	$ 4,601	– %
2006	$ 4,783	4.0 %
2007	$ 4,974	4.0 %
2008	$ 5,074	2.0 %
2009	$ 5,124	1.0 %
2010	$ 5,124	– %
2011	$ 5,124	– %
2012	$ 5,174	1.0 %
2013	$ 5,224	1.0 %
2014	$ 5,302	1.5 %
2015	$ 5,831	2.0 % *

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

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

STATE-WIDE SCHOOL DISTRICT FINANCIAL 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, school district unrestricted fund balance has been increasing as a percentage of operating expenditures on a state-wide basis 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 24.3 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 37.5 percent at the end of the current year.

The significant increase in fund balance in fiscal 2014 is related to a prior period adjustment described later in this report.

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. 624 – White Bear Lake		
	2012	2013	2012	2013	2012	2013	2014
General Fund							
Property taxes	$ 1,550	$ 1,608	$ 2,019	$ 2,101	$ 2,544	$ 2,629	$ 1,593
Other local sources	448	444	378	372	127	151	199
State	7,920	8,112	7,949	8,138	7,187	7,554	8,927
Federal	588	489	621	519	445	346	350
Total General Fund	10,506	10,653	10,967	11,130	10,303	10,680	11,069
Special revenue funds							
Food Service	488	495	483	495	491	502	517
Community Service	525	535	633	647	577	630	568
Debt Service Fund	1,088	1,079	1,180	1,172	1,065	1,128	1,102
Total revenue	$ 12,607	$ 12,762	$ 13,263	$ 13,444	$ 12,436	$ 12,940	$ 13,256
ADM served per MDE School District Profiles Report (current year estimated)					8,144	8,095	8,133

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

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

The ADM served used in the table above and on the following page is based on enrollments consistent with those used in the MDE School District Profiles Report, which include extended time and shared time ADM, and may differ from the ADM reported elsewhere in this report.

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

The District had revenue of $107.8 million in governmental funds reflected above in fiscal 2014, an increase of $3.1 million (2.9 percent) from the prior year. Most of this increase was in state revenue due to an increase in the general education formula and an increase in special education entitlements. Total revenue per ADM served increased by $316 for similar reasons.

Revenue neutral adjustments attributable to the legislatively-approved tax shift have significantly impacted the recognition of property tax and state sources by year, presented in the table above.

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. 624 – White Bear Lake		
	2012	2013	2012	2013	2012	2013	2014
General Fund							
Administration and district support	$ 823	$ 849	$ 805	$ 837	$ 738	$ 762	$ 738
Elementary and secondary regular instruction	4,866	4,982	5,103	5,273	4,686	4,869	5,131
Vocational education instruction	138	138	136	132	113	101	102
Special education instruction	1,866	1,909	2,004	2,055	2,090	2,264	2,277
Instructional support services	459	477	537	562	544	507	593
Pupil support services	895	919	957	991	853	933	960
Sites, buildings, and other	802	850	755	800	972	1,007	1,060
Total General Fund – noncapital	9,849	10,124	10,297	10,650	9,995	10,444	10,861
General Fund capital expenditures	462	509	410	469	415	869	1,215
Total General Fund	10,311	10,633	10,707	11,119	10,410	11,313	12,076
Special revenue funds							
Food Service	486	500	480	500	492	506	517
Community Service	526	535	630	646	650	672	547
Debt Service Fund	1,337	1,234	1,312	1,322	1,103	1,212	1,059
Total expenditures	$ 12,660	$ 12,902	$ 13,129	$ 13,587	$ 12,656	$ 13,704	$ 14,199
ADM served per MDE School District Profiles Report (current year estimated)					8,144	8,095	8,133

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 District had expenditures of approximately $115.5 million in the governmental funds reflected above in fiscal 2014, an increase of about $4.5 million from the prior year. On a per student basis, this represents an increase of $495. Expenditures increased $346 per student in the General Fund capital expenditures, mainly due to the issuance of a capital lease of $8 million during the year. General Fund operating expenditures increased $417 per student mainly in elementary and secondary regular instruction for salaries and benefits.

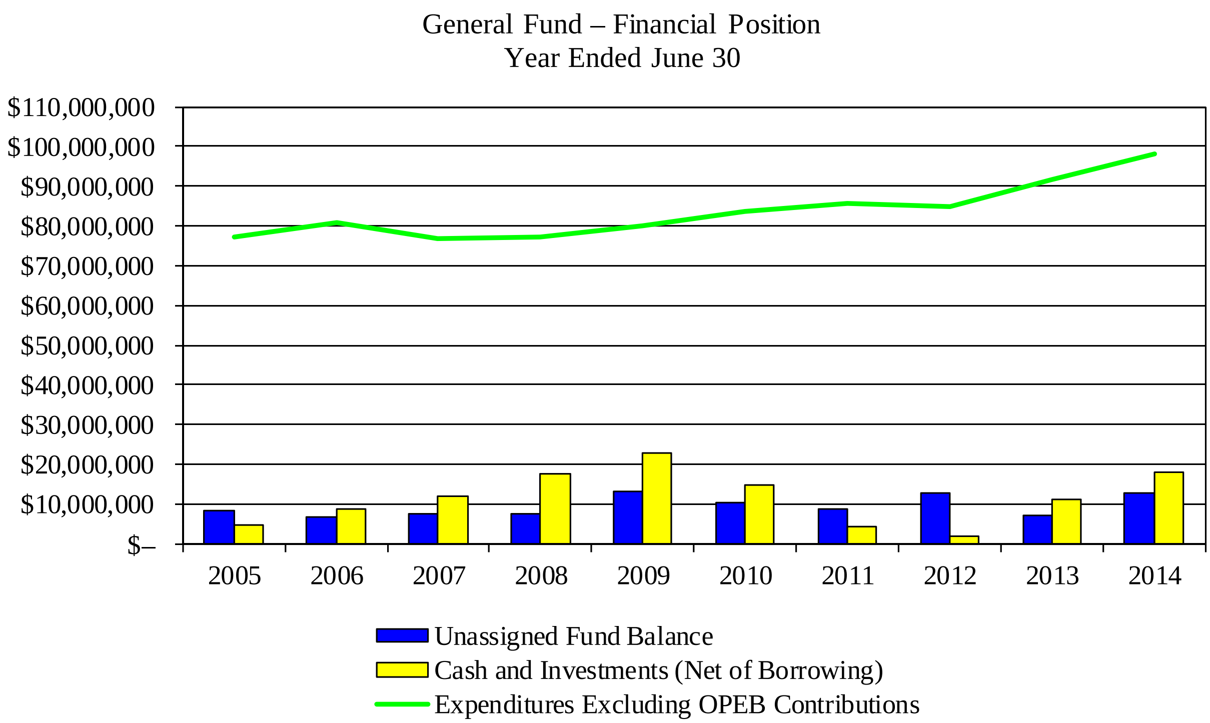
SUMMARY

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 volume of financial activity. Unassigned fund balance and cash balance are typically used as indicators of financial health, while annual expenditures measure the size of the operation.



The District ended fiscal year 2014 with a General Fund cash balance of $17,862,754, an increase of $6,834,931 from the previous year. This change was primarily due to the change in the metering of state aid payments in fiscal 2014. The unassigned fund balance at year-end was $12,888,284, an increase of $4,854,944. The General Fund continues to experience a stable fund balance position.

The net change to fund balance of the General Fund decreased $567,828. This decline compares to a budgeted decline in fund balance of $6,283,000. This result was due to revenue exceeding budgeted amounts by $4,075,384 and expenditures (including other financing sources and uses) being less than budget by $1,639,788. More information on these variances are described later in this report.

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

	Year Ended June 30,				
	2010	2011	2012	2013	2014
Nonspendable fund balances	$ 479,163	$ 586,628	$ 219,984	$ 1,255,743	$ 188,940
Restricted fund balances (1)	3,120,086	3,148,469	2,106,435	1,022,955	(297,733)
Unrestricted fund balances					
Assigned	6,474,495	7,818,797	6,697,066	8,955,687	15,588,049
Unassigned	10,551,796	8,882,644	11,115,223	7,295,063	12,888,284
Total fund balance	$ 20,625,540	$ 20,436,538	$ 20,138,708	$ 18,529,448	$ 28,367,540
Unassigned fund balances as a percentage of expenditures	12.6%	10.4%	13.1%	8.0%	13.1%

(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 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.

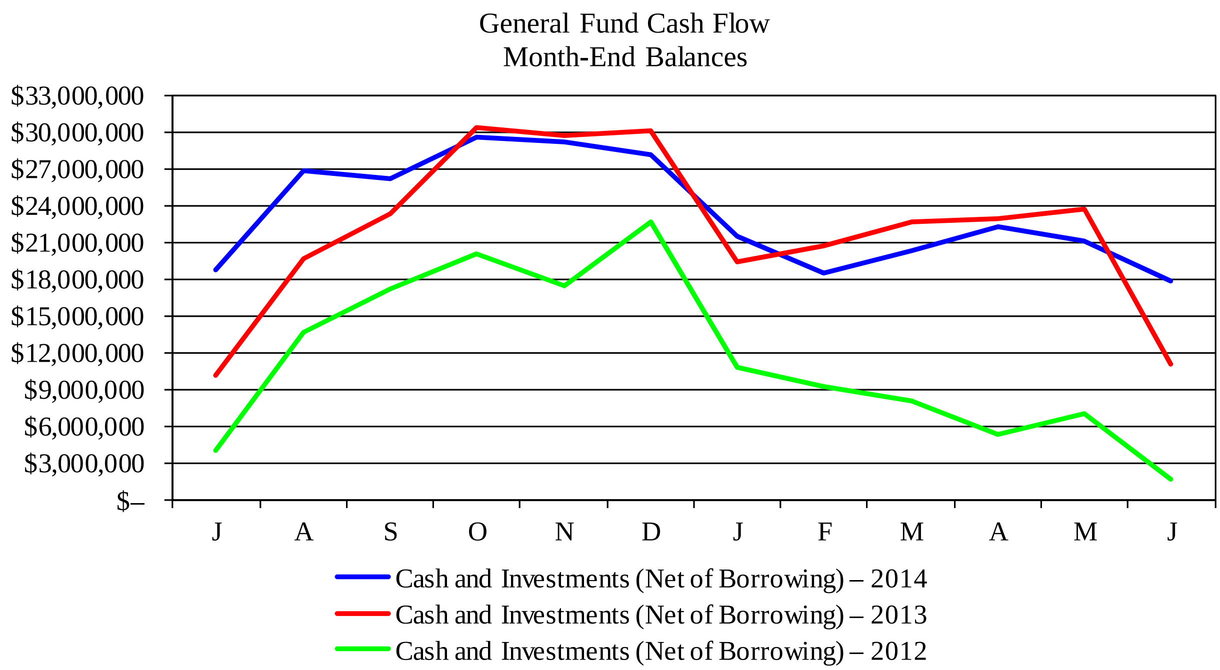
The Board of Education has formally adopted a fund balance policy regarding the minimum unassigned fund balance for the General Fund. The policy states that the District will strive to maintain a minimum unassigned General Fund balance of five weeks of operating expenditures. At June 30, 2014, the unassigned fund balance of the General Fund was 13.1 percent of total fiscal 2014 expenditures, or 6.8 weeks of operating expenditures.

The table above reflects the total General Fund unassigned 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 District recognized a prior period adjustment in fiscal 2014 to properly report OPEB expenditures reported in prior periods. OPEB expenditures reported by the District in fiscal years 2009 to 2011 by the General Fund are being reimbursed by the Post-Employment Benefits Trust Fund in fiscal 2014 totaling $10,405,920. During the 2009 to 2011 fiscal years, it was determined the District would finance these costs from the General Fund. In fiscal 2014, the District determined these costs are best financed by the Post-Employment Benefits Trust Fund. As a result, the General Fund is being reimbursed for these costs. The adjustment changed the beginning net position in the District's government-wide financial statements, the beginning fund balance in its General Fund, and the beginning net position in the District's Post-Employment Benefits Trust Fund financial statements by $10,405,920 as of July 1, 2013.

General Fund Cash Flow

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

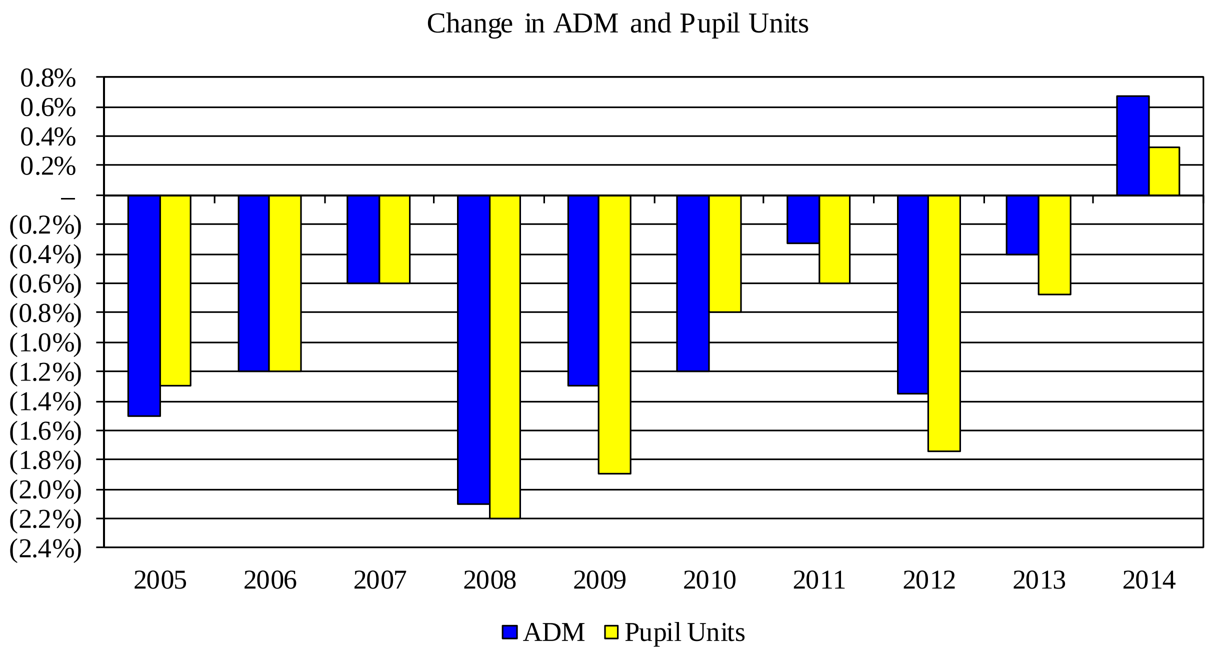


The graph above shows the peaks and valleys of the General Fund cash and investments balance (net of borrowing and interfund balances) on a monthly basis. The swing between its high and low month-end cash balances was about $11.8 million for fiscal 2014.

Legislative changes in the tax shift and state aid payment schedules used to help balance the state budget have a significant effect on the cash flow of Minnesota school districts. In fiscal 2012, the state holdback on aids normally paid on a 90–10 schedule was up to 40 percent, and the tax shift was at 48.6 percent of non-debt services 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 payment 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 shows the rate of change in ADM served by the District from year to year, along with the change in the resulting pupil units:

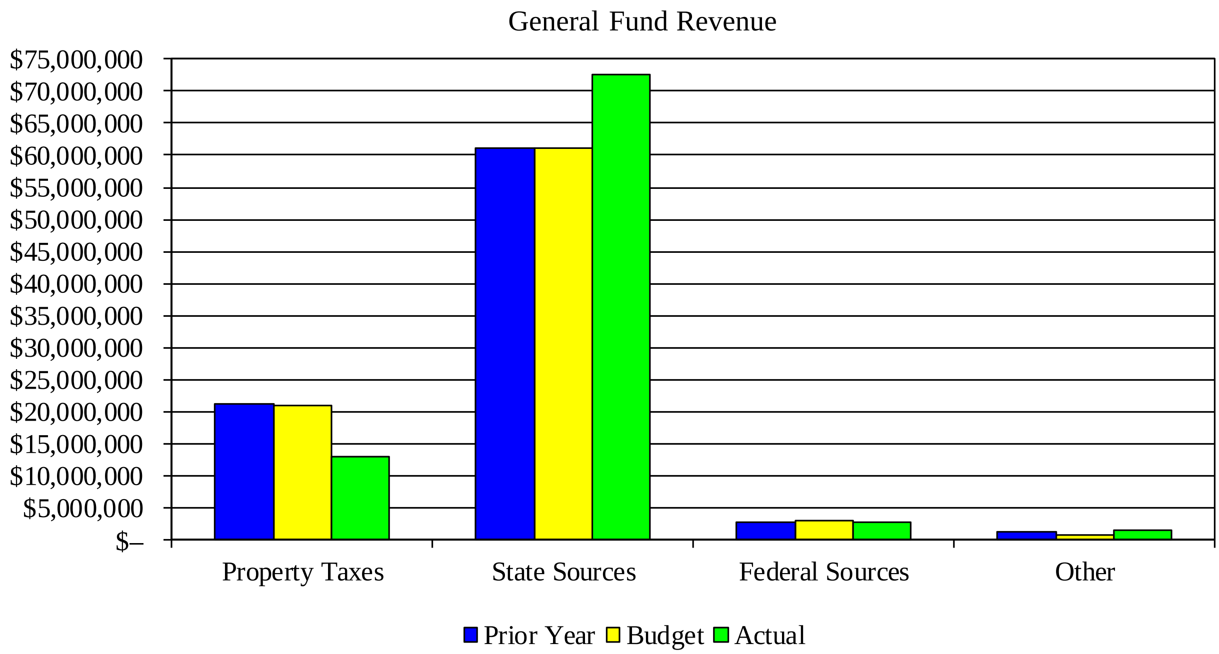


ADM is a measure of students attending class, which is then converted to pupil units (the base for determining revenue) using a statutory formula. Not only is the original budget based on ADM estimates, the final audited financial statements are based on updated, but still estimated, ADM since the counts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

ADM served by the District increased 54 ADM from the prior year to 8,082 served in the current year.

GENERAL FUND REVENUE

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



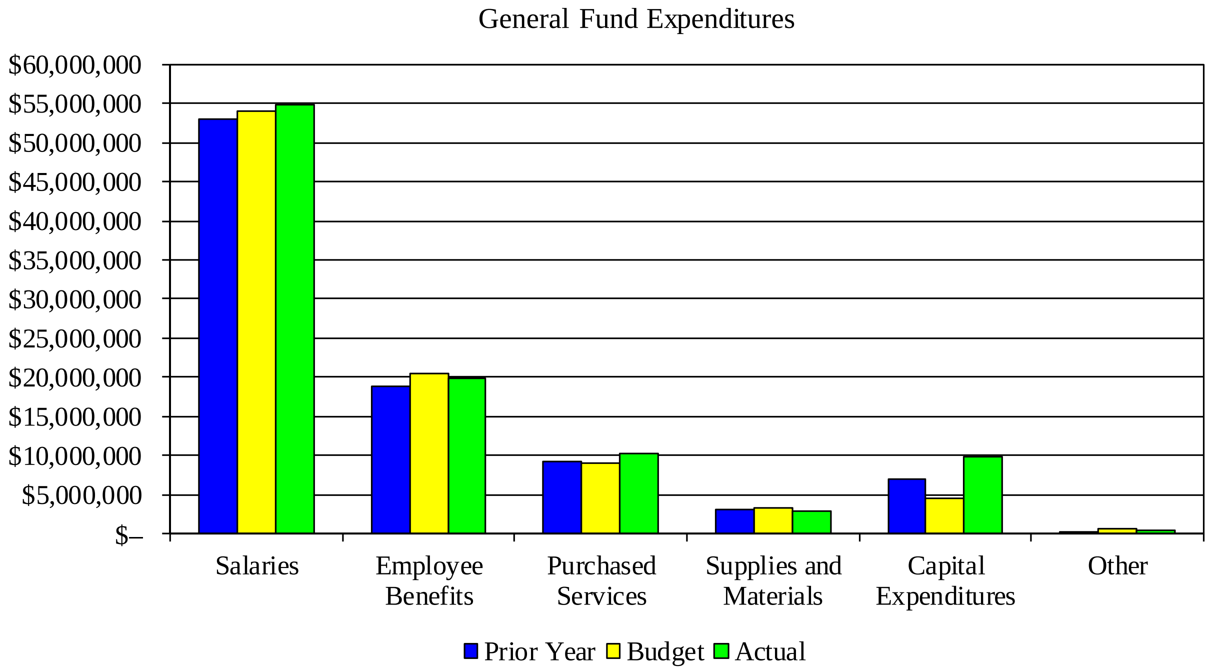
Total General Fund revenues for 2014 were $90,022,384, an increase of $3,578,027, or 4.1 percent, from the prior year, and $4,075,384, or 4.7 percent, over budget. State sources exceeded budget by $2,389,737, primarily in the special education program area. The variance in state special education aid was mainly attributable to prior year clean up settlements exceeding accrued receivables, as tuition adjustments ended up more favorable than projected.

Revenue increases were mainly due to increases in the general education and state special education formulas. These revenue categories increased $2.5 million in fiscal 2014.

This graph also reflects $9,576,753 of change for the tax shift between state aids and tax sources that offset dollar-for-dollar in the current year.

GENERAL FUND EXPENDITURES

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



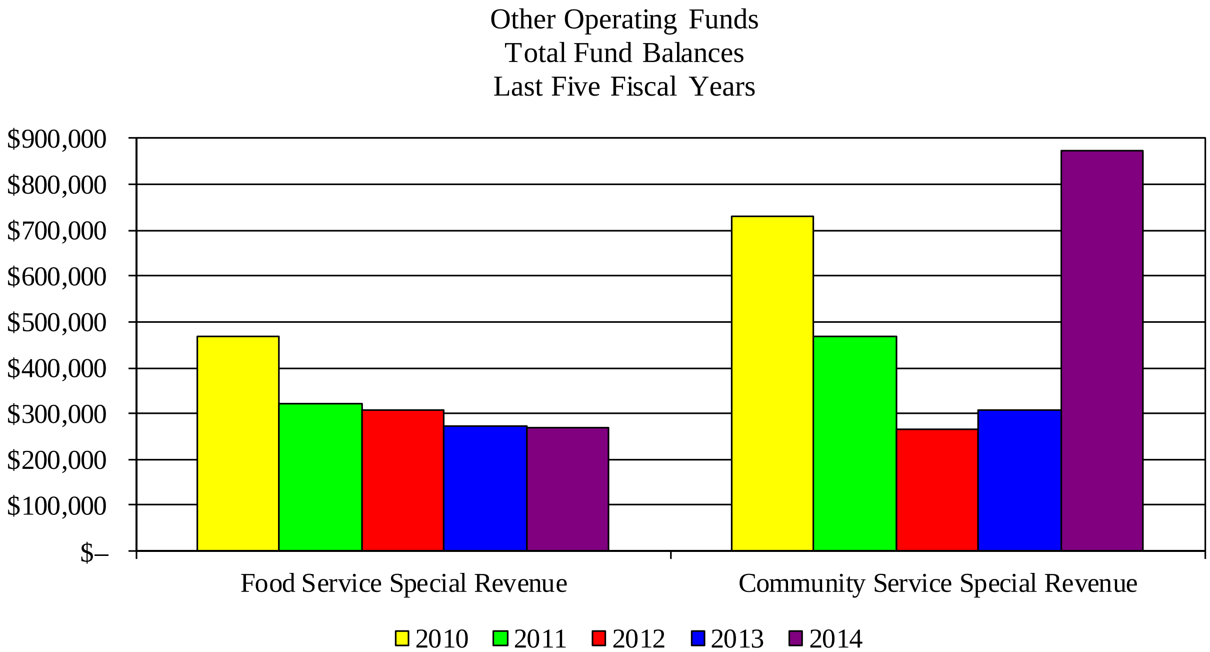
Total General Fund expenditures for 2014 were $98,202,842, an increase of $6,627,375 (7.2 percent) from the prior year, and $6,358,842 over budget.

District expenditures were over budgeted amounts mostly in capital expenditures and purchased services by $5,426,299 and $1,151,673, respectively. Capital expenditures were over budget due to the issuance of an $8,000,000 capital lease for building construction, which is reported in the financial statements as an other financing source. When this is taken into account, capital expenditures were less than anticipated by $2,573,701. Purchased services were mainly over budget for sites and buildings costs.

Expenditures were more than the prior year due to higher costs in capital expenditures ($2,849,837) and salaries and benefits ($1,846,804). Capital expenditures increased related to the issuance of the capital lease for building construction and increased capital outlay for sites and buildings. Salaries and benefit increases were from pay raises, modest hiring of new staff members, and increases in the related benefits.

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 experienced a $1,170 decrease in fund balance, which was under the projected budget by the same amount.

This operation has maintained a healthy fund balance for several years and has also been able to assist in funding a portion of several capital improvements to food service facilities. The District should continue to 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 experienced an increase in fund balance of $564,751 for the year ended June 30, 2014, which was $525,751 more than the planned increase in fund balance of $39,000 in the budget. This was due to higher than budgeted participation fees of $539,331.

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

At June 30, 2014, this fund has a year-end balance of $262,115, which is restricted for the alternative facilities program.

Debt Service Fund

The funding of debt service is controlled in accordance with each outstanding debt issue's financing plan.

Severance Obligations Internal Service Fund

The following table presents the activity reported for the past five fiscal years in this Internal Service Fund:

	2010	2011	2012	2013	2014
Operating revenue					
Contributions from governmental funds	$ 403,654	$ 451,530	$ 250,366	$ 699,593	$ –
Operating expenses					
Post-employment severance benefits	511,838	270,372	128,233	282,291	31,515
Operating income (loss)	(108,184)	181,158	122,133	417,302	(31,515)
Nonoperating revenue					
Investment earnings	104,243	113,217	112,792	113,537	103,473
Change in net position	(3,941)	294,375	234,925	530,839	71,958
Net position					
Beginning of year	273,164	269,223	563,598	798,523	1,329,362
End of year	$ 269,223	$ 563,598	$ 798,523	$ 1,329,362	$ 1,401,320

The District underwent an actuarial study dated July 1, 2013 to determine its severance benefit liabilities based on current contracts and employees in place. A number of variables and estimates are used to determine this liability as of year-end as mentioned earlier in this report. The assets held in this fund at June 30, 2014 totaled $3,557,696 and will be used to pay the District's liability for severance totaling $2,156,376 as of June 30, 2014.

Post-Employment Benefits Trust Fund – Fiduciary Fund

The District established a Post-Employment Benefits Trust Fund – Fiduciary Fund to finance post-employment health benefit liabilities. The District established this fund in fiscal 2009 through the issuance of $40,085,000 in bonds. These funds are held in trust restricted for the payment of OPEB liabilities. The net position held in this fund at June 30, 2014 totaled $35,186,367 and will be used by the District in future years to finance the OPEB obligations of the District.

ANALYSIS OF OPEB FUNDING

The District underwent an actuarial study dated July 1, 2013 to determine the District's post-employment health benefit liabilities based on current contracts and employees in place.

This pension plan is funded by the District's Post-Employment Benefits Irrevocable Trust Fund, which is reported in the District's financial report as a fiduciary fund. As of the most recent actuarial study dated July 1, 2013, the plan was 187 percent funded, which is based on an actuarial accrued liability for benefits of $23,194,160 and the actuarial value of assets within the irrevocable trust fund of $43,353,213. The assets in the trust fund exceeded the OPEB accrued liability reported in the actuarial study by $20,159,053 at July 1, 2013.

During the year ended June 30, 2014, the District did utilize over $10 million of the trust as part of the prior period adjustment described earlier.

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 GASB Statement No. 34 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, the statement divides the 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 three years:

	June 30,		
	2012	2013	2014
Net position – governmental activities			
Total fund balances – governmental funds	$ 55,860,386	$ 23,103,298	$ 32,026,749
Negative net OPEB obligation	41,216,996	40,397,681	39,542,822
Total capital assets, less accumulated depreciation	57,875,702	59,686,247	66,071,601
Total long-term liabilities	(125,939,000)	(96,344,161)	(96,930,344)
Accrued interest payable	(1,875,723)	(1,747,968)	(1,587,968)
Unamortized premiums	(3,519,477)	(3,049,526)	(2,635,931)
Other	1,128,251	2,262,185	1,910,471
Total net position – governmental activities	$ 24,747,135	$ 24,307,756	$ 38,397,400
Net position			
Net investment in capital assets	$ 1,630,228	$ 2,130,306	$ 5,813,967
Restricted	2,601,876	1,132,318	3,061,846
Unrestricted	20,515,031	21,045,132	29,521,587
Total net position	$ 24,747,135	$ 24,307,756	$ 38,397,400

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

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 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 (as described above for GASB Statement No. 67). 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 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.