

Management Report

for

Independent School District No. 624
White Bear Lake, Minnesota

June 30, 2019

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PRINCIPALS

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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, Minnesota's (the District) financial statements for the year ended June 30, 2019. 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 26, 2019

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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 TITLE 2 U.S. CODE OF FEDERAL REGULATIONS PART 200, *UNIFORM ADMINISTRATIVE REQUIREMENTS, COST PRINCIPLES, AND AUDIT REQUIREMENTS FOR FEDERAL AWARDS (UNIFORM GUIDANCE)*

We have audited the financial statements of the governmental activities, each major fund, and the aggregate remaining fund information of the District as of and for the year ended June 30, 2019. 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 the Uniform Guidance, as well as certain information related to the planned scope and timing of our audit. We have communicated such information to you verbally and in our audit engagement letter. Professional standards also require that we communicate to you the following information related to our audit.

PLANNED SCOPE AND TIMING OF THE AUDIT

We performed the audit according to the planned scope and timing previously discussed and coordinated 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, 2019:

- We have issued an unmodified opinion on the District's basic financial statements.
- We reported two material weaknesses related to our testing of internal control over financial reporting:
 1. The District has limited segregation of duties in several areas, including the processing cash disbursements and payroll and payroll related transactions. The limited segregation of duties is primarily caused by the limited size of the District's business office staff. One important element of internal accounting controls is an adequate segregation of duties such that no one individual has responsibility to execute a transaction, have physical access to the related assets, and have responsibility or authority to record the transaction. A lack of segregation of duties subjects the District to a higher risk that errors or fraud could occur and not be detected and corrected in a timely manner in the normal course of business.
 2. During the audit of the District, we noted material weaknesses in internal controls over payroll processing, including accurate accounting for federal W-4 filings, timely submissions of timesheets, and the reconciliation of benefits payable.
- 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 did not comply with the types of compliance requirements that could have a direct and material effect on each of its major federal programs. We also reported one matter involving the internal control over compliance and its operation that we consider to be a material weakness in our testing of major federal programs:

For the special education cluster federal program, we noted that the District did not have sufficient controls to ensure adequate and timely documentation of time and effort was created and retained to support salary costs charged to federal programs and ensure compliance with the U.S. Office of Management and Budget's *Uniform Administrative Requirements, Cost Principles, and Audit Requirements for Federal Awards* (Uniform Guidance) allowable costs standards, which resulted in noncompliance.

- We reported no findings based on our testing of the District's compliance with Minnesota laws and regulations.

FOLLOW-UP ON PRIOR YEAR FINDINGS AND RECOMMENDATIONS

As a part of our audit of the District's financial statements for the year ended June 30, 2019, we performed procedures to follow-up on any findings and recommendations that resulted from our prior year audit. We reported the following finding that was corrected by the District in the current year:

- We noted the District did not establish and maintain effective internal control over compliance with requirements applicable to federal programs expenditures, including suspension and debarment requirements applicable to the child nutrition cluster.

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, 2019. However, the District implemented the following governmental accounting standard during the fiscal year ended June 30, 2019:

- Governmental Accounting Standards Board (GASB) Statement No. 88, *Certain Disclosures Related to Debt, Including Direct Borrowings and Direct Placements*, which improved the information disclosed in notes to government financial statements related to debt, including direct borrowings and direct placements. It also clarified which liabilities governments should include when disclosing information related to debt.

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 clearly trivial, and communicate them to the appropriate level of management. There were no misstatements detected as a result of audit procedures that were material, either individually or in the aggregate, to each opinion unit's financial statements taken as a whole.

ACCOUNTING ESTIMATES AND MANAGEMENT JUDGMENTS

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

General education revenue and certain other revenues are computed by applying an allowance per student to the number of students served by the District. Student attendance is accumulated in a state-wide database—MARSS. Because of the complexity of student accounting and because of certain enrollment options, student information is input by other school districts and the MARSS data for the current fiscal year is not finalized until after the District has closed its financial records. General education revenue and certain other revenues are computed using preliminary information on the number of students served in the resident district and also utilizing some estimates, particularly in the area of enrollment options.

Special education state aid includes an adjustment related to tuition billings to and from other school districts for special education services, which are computed using formulas derived by the Minnesota Department of Education (MDE). Because of the timing of the calculations, this adjustment for the current fiscal year is not finalized until after the District has closed its financial records. The impact of this adjustment on the receivable and revenue recorded for state special education aid is calculated using preliminary information available to the District.

The District has recorded a liability in the Statement of Net Position for severance benefits payable for which it is probable employees will be compensated. The "vesting method" used by the District to calculate this liability is based on assumptions involving the probability of employees becoming eligible to receive the benefits (vesting), the potential use of accumulated sick leave prior to termination, and the age at which such employees are likely to retire.

The District has recorded activity for other post-employment benefits (OPEB) and pension benefits. These obligations are calculated using actuarial methodologies described in GASB Statement Nos. 68 and 75. These actuarial calculations include significant assumptions, including projected changes, healthcare insurance costs, proportionate share, investment returns, retirement ages, and employee turnover.

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

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

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

Certain financial statement disclosures are particularly sensitive because of their significance to financial statement users. The disclosures included in the notes to the basic financial statements related to OPEB and pension benefits are particularly sensitive due to the materiality of the liabilities, and the large and complex estimates involved in determining the disclosures.

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

DIFFICULTIES ENCOUNTERED IN PERFORMING THE AUDIT

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

DISAGREEMENTS WITH MANAGEMENT

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

MANAGEMENT REPRESENTATIONS

We have requested certain representations from management that are included in the management representation letter dated November 26, 2019.

MANAGEMENT CONSULTATIONS WITH OTHER INDEPENDENT ACCOUNTANTS

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

OTHER AUDIT FINDINGS OR ISSUES

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

OTHER MATTERS

We applied certain limited procedures to the management's discussion and analysis and the pension and OPEB-related required supplementary information (RSI) that supplements the basic financial statements. Our procedures consisted of inquiries of management regarding the methods of preparing the information and comparing the information for consistency with management's responses to our inquiries, the basic financial statements, and other knowledge we obtained during our audit of the basic financial statements. We did not audit the RSI and do not express an opinion or provide any assurance on the RSI.

We were engaged to report on the supplemental information accompanying the financial statements and the separately issued Schedule of Expenditures of Federal Awards and the 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. Such information has not been subjected to the auditing procedures applied in the audit of the basic financial statements, and accordingly, we do not express an opinion or provide any assurance on it.

FUNDING PUBLIC EDUCATION IN MINNESOTA

Due to its complexity, it would be impossible to fully explain the funding of public education in Minnesota within this report. A summary of legislative changes affecting school districts 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.

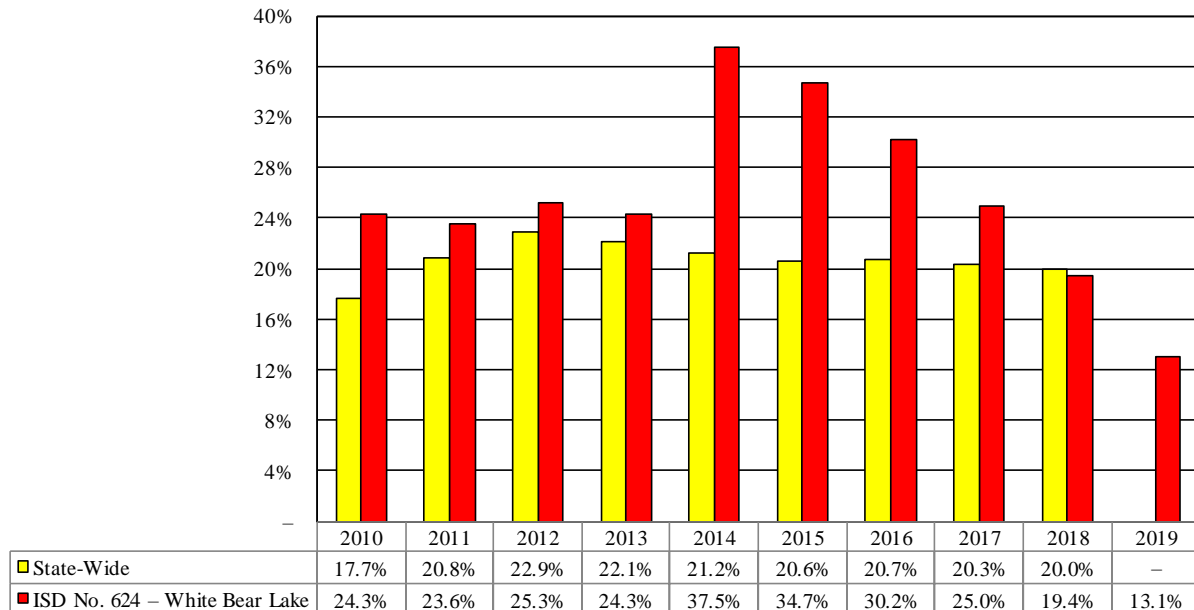
The table below presents a summary of the formula allowance for the past decade and as approved for the next two fiscal years. The amount of the formula allowance and the percentage change from year-to-year excludes temporary funding changes, the “roll-in” of aids that were previously funded separately, and changes that may vary dependent on actions taken by individual districts. The \$529 increase in 2015 was offset by changes to pupil weightings and the general education aid formula that resulted in an increase equivalent to approximately \$105, or 2.0 percent, state-wide.

Fiscal Year Ended June 30,	Formula Allowance	
	Amount	Percent Increase
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 %
2020	\$ 6,438	2.0 %
2021	\$ 6,567	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 unrestricted operating fund balance as a percentage of operating expenditures.

State-Wide Unrestricted Operating Fund Balance
as a Percentage of Operating Expenditures



Note: State-wide information is not available for fiscal 2019.

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 to 20.0 percent at the end of fiscal 2018.

As of June 30, 2018, this ratio was 19.4 percent for the District, as compared to a state-wide average of 20.0 percent. The District's unrestricted operating fund balance as a percentage of operating expenditures was 13.1 percent at the end of the current year.

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

Governmental Funds Revenue per Student (ADM) Served								
	State-Wide		Metro Area		ISD No. 624 – White Bear Lake			
	2017	2018	2017	2018	2017	2018	2019	
General Fund								
Property taxes	\$ 1,933	\$ 2,024	\$ 2,516	\$ 2,638	\$ 2,809	\$ 2,757	\$ 2,956	
Other local sources	515	520	423	433	410	445	465	
State	9,386	9,614	9,387	9,625	8,692	8,879	9,285	
Federal	450	450	480	474	322	310	387	
Total General Fund	12,284	12,608	12,806	13,170	12,233	12,391	13,093	
Special revenue funds								
Food Service	561	559	557	554	544	525	528	
Community Service	628	642	733	752	666	700	750	
Debt Service Fund	1,119	1,128	1,118	1,120	581	521	516	
Total revenue	<u>\$ 14,592</u>	<u>\$ 14,937</u>	<u>\$ 15,214</u>	<u>\$ 15,596</u>	<u>\$ 14,024</u>	<u>\$ 14,137</u>	<u>\$ 14,887</u>	
ADM served per MDE School District Profiles Report (current year estimated)					<u>8,477</u>	<u>8,683</u>	<u>8,730</u>	
Note: Excludes the Capital Projects – Building Construction Fund and Post-Employment Benefits Debt Service Fund.								
Source of state-wide and 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.

The District had revenue of \$129,963,602 in governmental funds reflected above in fiscal 2019, an increase of about \$7,206,885 from the prior year. This increase is related to the increase in the District's General Fund levy, the general education aid formula in fiscal 2019, and an increase in ADM served by the District in fiscal 2019.

The following table reflects similar comparative data available from the MDE for all governmental fund expenditures, excluding the Capital Projects – Building Construction Fund and the 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		Metro Area		ISD No. 624 – White Bear Lake			
	2017	2018	2017	2018	2017	2018	2019	
General Fund								
Administration and district support	\$ 991	\$ 1,031	\$ 996	\$ 1,045	\$ 776	\$ 775	\$ 830	
Elementary and secondary regular instruction	5,539	5,646	5,887	5,976	5,623	5,852	5,890	
Vocational education instruction	166	170	153	154	181	169	204	
Special education instruction	2,225	2,298	2,334	2,418	2,457	2,594	2,726	
Instructional support services	660	658	765	748	756	789	790	
Pupil support services	1,074	1,118	1,165	1,209	1,339	1,419	1,463	
Sites, buildings, and other	906	936	870	896	1,058	1,050	1,134	
Total General Fund – noncapital	11,561	11,857	12,170	12,446	12,190	12,648	13,037	
General Fund capital expenditures	627	658	592	636	334	339	375	
Total General Fund	12,188	12,515	12,762	13,082	12,524	12,987	13,412	
Special revenue funds								
Food Service	550	553	545	545	522	504	522	
Community Service	611	640	713	750	645	708	791	
Debt Service Fund	1,359	1,308	1,323	1,230	597	600	548	
Total expenditures	<u>\$ 14,708</u>	<u>\$ 15,016</u>	<u>\$ 15,343</u>	<u>\$ 15,607</u>	<u>\$ 14,289</u>	<u>\$ 14,799</u>	<u>\$ 15,273</u>	
ADM served per MDE School District Profiles Report (current year estimated)					<u>8,477</u>	<u>8,683</u>	<u>8,730</u>	
Note: Excludes the Capital Projects – Building Construction Fund and Post-Employment Benefits Debt Service Fund.								
Source of state-wide and 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's expenditures per ADM have been slightly below the metro area average in recent years.

The District spent approximately \$133,342,553 in the governmental funds reflected above in fiscal 2019, an increase of \$4,854,190 (3.8 percent) from the prior year. General Fund operating expenditures (excluding capital) increased \$389 per student; mainly in administration and district support (\$55 per pupil), special education (\$132 per pupil), and sites, buildings, and other (\$84 per pupil). Community Service Special Revenue Fund expenditures also increased \$83 per pupil, mostly for salaries and benefits for employees to support growing programs.

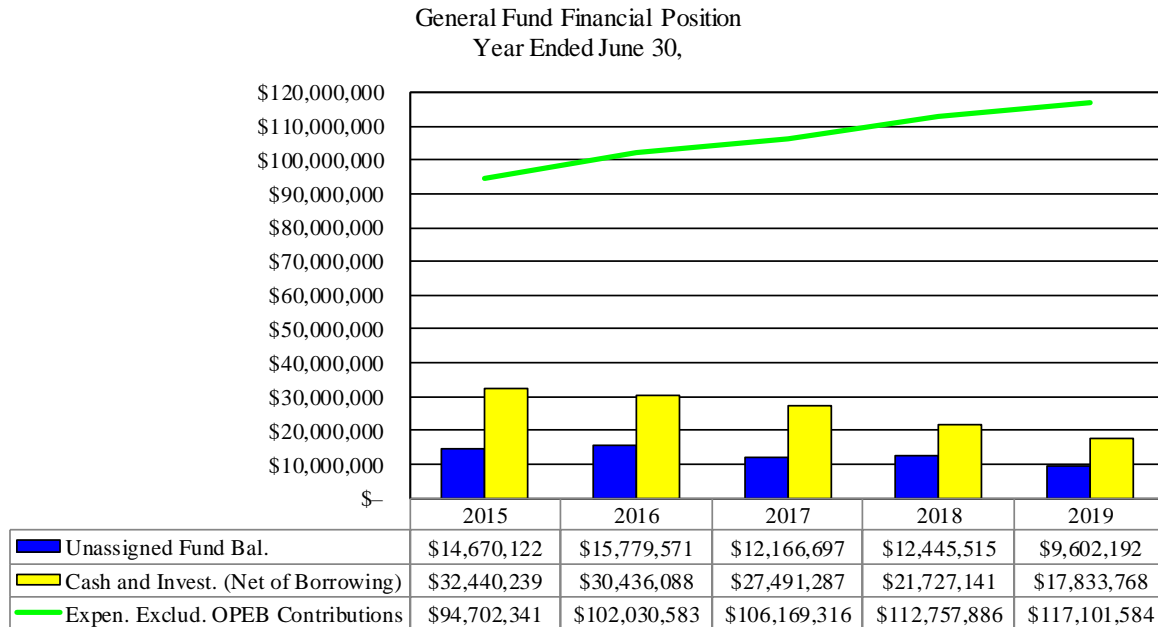
SUMMARY

Funding for Minnesota school districts generally has not kept pace with inflation and an increasing need for services, despite recent enhancements to the basic general education state aid formula and other categorical aids. This has often increased districts reliance on local revenue sources like voter-approved operating referenda and user fees to maintain programs. Many districts are also beginning to experience delays in collecting property tax revenues, due to higher abatements, as more commercial property taxpayers are appealing the assessed values of brick-and-mortar facilities, due to rapid expansion of e-commerce. School boards and district administrators continue to face many challenges in providing the best education within the limits of 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 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 2019 with a General Fund cash balance of \$17,833,768 (net of borrowing and interfund receivables and payables), a decrease of \$3,893,373 from the previous year. Unassigned fund balance at year-end, excluding restricted account deficits, was \$9,602,192, a decrease of \$2,843,323.

Legislatively-approved changes in the metering of state aid payments to school districts and in the tax shift significantly impacted cash and investment balances in certain years presented in the graph above.

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

	Year Ended June 30,				
	2015	2016	2017	2018	2019
Nonspendable fund balances	\$ 156,537	\$ 97,470	\$ 315,203	\$ 515,138	\$ 407,677
Restricted fund balances (1)	(252,933)	1,133,918	2,098,896	1,341,737	3,723,893
Unrestricted fund balances					
Assigned	12,917,616	10,494,185	10,458,808	5,572,835	3,344,748
Unassigned	14,670,122	15,779,571	12,166,697	12,445,515	9,602,192
Total fund balance	<u>\$ 27,491,342</u>	<u>\$ 27,505,144</u>	<u>\$ 25,039,604</u>	<u>\$ 19,875,225</u>	<u>\$ 17,078,510</u>
Unassigned fund balances as a percentage of expenditures	<u>15.5%</u>	<u>15.5%</u>	<u>11.5%</u>	<u>11.0%</u>	<u>8.2%</u>
(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.					

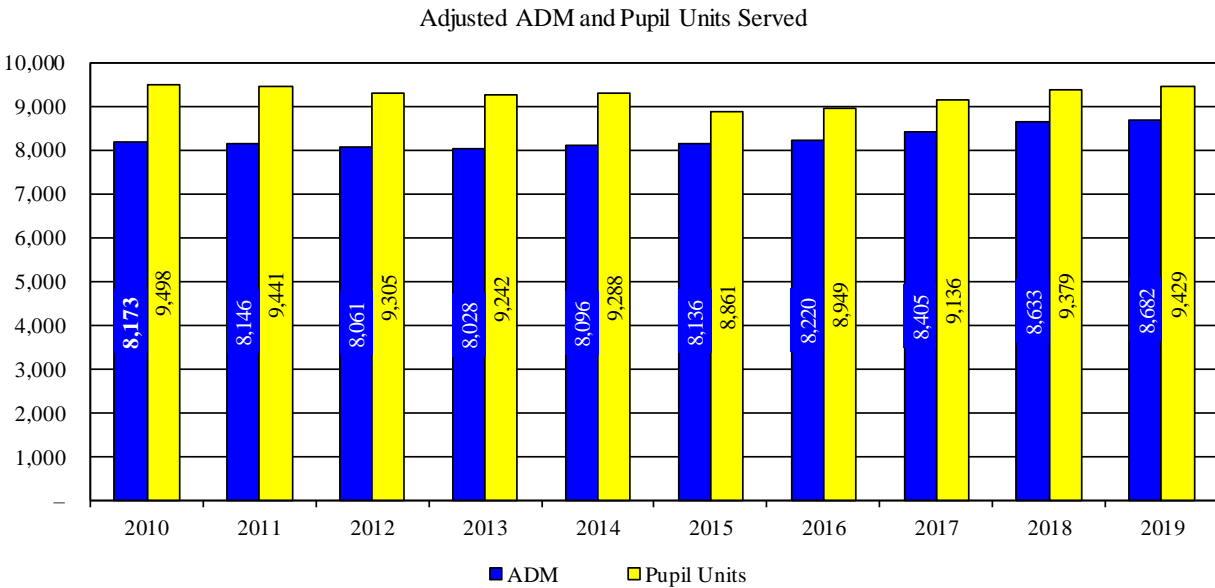
The table above reflects the total General Fund unassigned fund balance and percentages, which differs from those used in the previous discussion of state-wide fund balances, which are based on a state formula.

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.

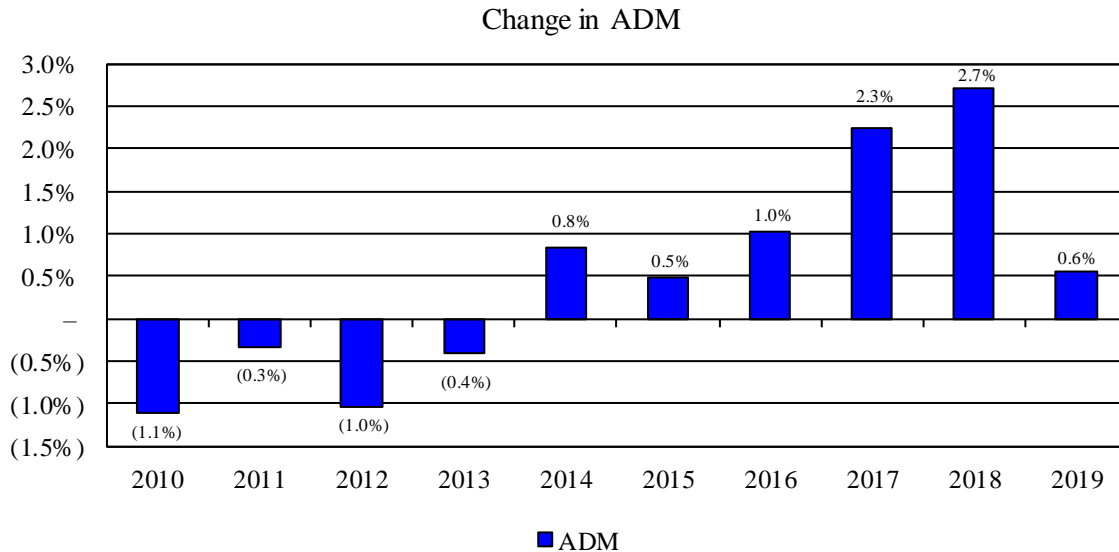
The Board of Education has formally adopted a fund balance policy regarding the unassigned fund balance for the General Fund. The policy states that the District will strive to maintain a minimum unassigned General Fund balance of between 12.5 percent and 16.7 percent of the annual budget, which equates to a range of 1.5 to 2 months of operating expenditures. At June 30, 2019, the unassigned fund balance of the General Fund was 8.2 percent of total fiscal 2019 expenditures, or 4.3 weeks of operating expenditures.

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:



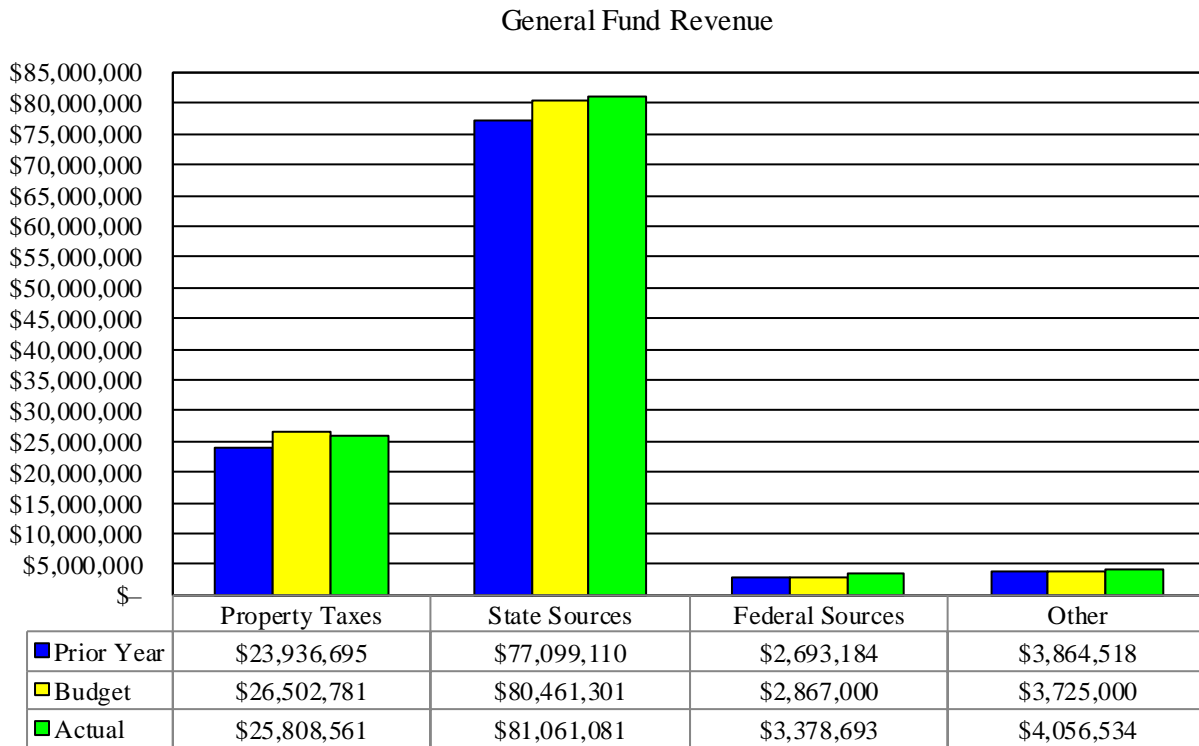
The change in pupil units for 2015 includes the effect of legislative reductions to pupil units.

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.

Adjusted ADM served by the District increased 49 ADM from the prior year to 8,682 served in the current year.

GENERAL FUND REVENUE

The following graph summarizes the District's General Fund revenue for 2019:



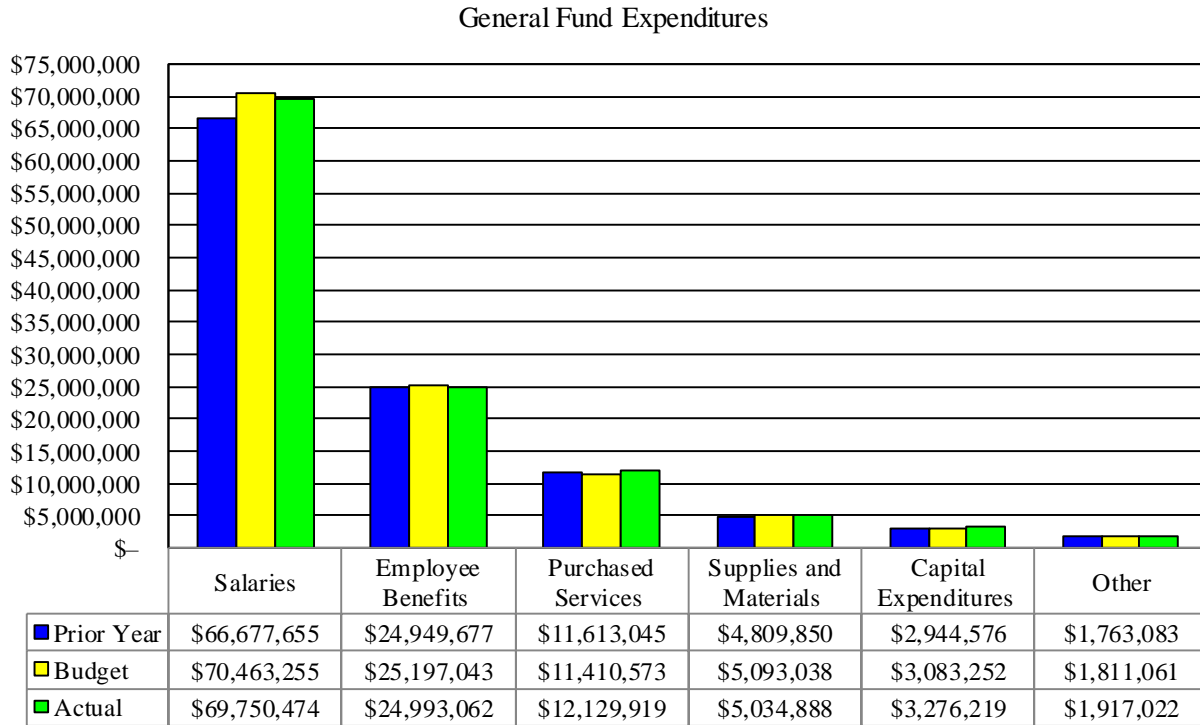
Total General Fund revenues for 2019 were \$114,304,869, an increase of \$6,711,362 from the prior year, and \$748,787 over budget.

Revenues were over budgeted amounts in state aids and federal aids. State aids exceeded budgeted amounts by \$599,780, as state special education aid exceeded projected amounts. Federal revenues exceeded budgeted amounts by \$511,693, mainly in special education federal program grants. This was offset by property tax revenues being below budget by \$694,220, due to higher than expected tax abatements and levy pass-through dollars to other local governments.

Revenue increased from the prior year, mainly due to additional property tax revenues totaling \$1,871,866, due to levy increases in the current year. State aid revenue increased \$3,961,971, resulting from increases in student population and increases in the general education aid formula.

GENERAL FUND EXPENDITURES

The following graph summarizes the District's General Fund expenditures for 2019:



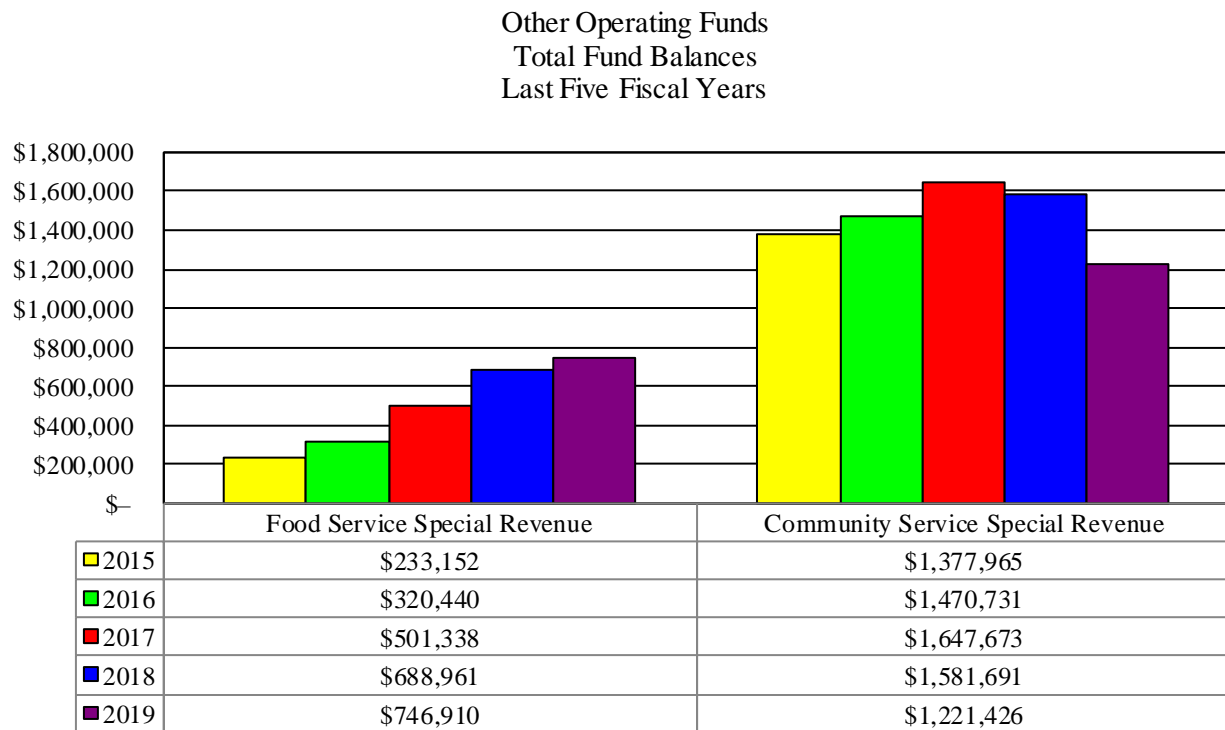
Total General Fund expenditures for 2019 were \$117,101,584, an increase of \$4,343,698 (3.9 percent) from the prior year, and \$43,362 over budget.

Expenditures were over budgeted amounts by only \$43,362. Expenditures were under budget, mainly in salaries totaling \$712,781, mainly in elementary and secondary regular instruction. The is offset by purchased services being over budget by \$719,346, mainly in transportation and sites and buildings costs.

Expenditures increased from the prior year, mainly in salaries totaling \$3,072,819. Increases in staffing in elementary and secondary regular instruction and special education instruction in the current year, in addition to annual salary increases, are the main reasons for this increase. Purchased services also increased in the current year totaling \$516,874, mainly for transportation needs.

OTHER FUNDS OF THE DISTRICT

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



Food Service Special Revenue Fund

The District's Food Service Special Revenue Fund experienced a \$57,949 increase in fund balance. The District budgeted for a \$131,330 decrease in fund balance.

Community Service Special Revenue Fund

The District's Community Service Special Revenue Fund ended the year with expenditures exceeding revenues decreasing fund balance by \$360,265, compared to a budgeted decrease of \$158,590.

Capital Projects – Building Construction Fund

The Capital Projects – Building Construction Fund is accounting for the costs of capital projects related to long-term facilities maintenance bonds issued by the District. These projects were authorized by the Board of Education and through approval of the District's Long-Term Facilities Maintenance Program by the MDE. Total bond proceeds of about \$4,100,000 were utilized in fiscal 2019.

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 fund:

	2015	2016	2017	2018	2019
Operating revenue					
Contributions from governmental funds	\$ —	\$ —	\$ —	\$ —	\$ —
Operating expenses					
Post-employment severance benefits	148,363	24,128	143,408	667,410	188,566
Operating income (loss)	(148,363)	(24,128)	(143,408)	(667,410)	(188,566)
Nonoperating revenue					
Investment earnings	80,058	47,842	29,200	24,054	25,908
Income (loss) before transfers	(68,305)	23,714	(114,208)	(643,356)	(162,658)
Transfers out	—	(1,340,000)	—	—	—
Change in net position	(68,305)	(1,316,286)	(114,208)	(643,356)	(162,658)
Net position					
Beginning of year	1,401,320	1,333,015	16,729	(97,479)	(740,835)
End of year	<u>\$ 1,333,015</u>	<u>\$ 16,729</u>	<u>\$ (97,479)</u>	<u>\$ (740,835)</u>	<u>\$ (903,493)</u>

The assets held in this fund at June 30, 2019 totaled \$1,169,349, and will be used to pay the District's liability for severance totaling \$2,072,842 as of June 30, 2019.

Self-Insured Health Benefits Internal Service Fund

The following table presents the activity reported for the past five fiscal years in this fund:

	2015	2016	2017	2018	2019
Operating revenue					
Contributions from governmental funds	\$ 6,264,105	\$ 12,746,805	\$ 13,469,529	\$ 14,513,994	\$ 15,153,666
Operating expenses					
Self-insured benefits	6,622,605	11,865,965	14,906,042	13,789,790	13,849,119
Operating income (loss)	(358,500)	880,840	(1,436,513)	724,204	1,304,547
Nonoperating revenue					
Investment earnings	311	1,912	5,681	7,300	46,732
Change in net position	(358,189)	882,752	(1,430,832)	731,504	1,351,279
Net position					
Beginning of year	—	(358,189)	524,563	(906,269)	(174,765)
End of year	<u>\$ (358,189)</u>	<u>\$ 524,563</u>	<u>\$ (906,269)</u>	<u>\$ (174,765)</u>	<u>\$ 1,176,514</u>

The Self-Insured Health Benefits Internal Service Fund is used to account for health insurance offered by the District to its employees as a self-insured plan. The fund ended the year with a surplus fund balance of \$1,176,514.

Self-Insured Dental Benefits Internal Service Fund

The Self-Insured Dental Benefits Fund is used to account for dental insurance offered by the District to its employees as a self-insured plan. The fund ended the year with a fund balance surplus of \$85,919.

Post-Employment Benefits Trust Fund Fiduciary Fund

The District established a Post-Employment Benefits Trust 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, 2019 totaled \$33,046,282. This trust 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, 2017, which was rolled forward to June 30, 2019, 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, the plan was 185 percent funded, which is based on an actuarial accrued liability for benefits of \$17,901,709 and the actuarial value of assets within the irrevocable trust fund of \$33,046,282. The assets in the trust fund exceeded the OPEB accrued liability reported in the actuarial study by \$15,144,573 at June 30, 2019.

GOVERNMENT-WIDE FINANCIAL STATEMENTS

The District's financial statements include fund-based information that focuses on budgetary compliance, and the sufficiency of the District's current assets to finance its current liabilities. The governmental reporting model also requires the inclusion of two government-wide financial statements designed to present a clear picture of the District as a single, unified entity. These government-wide financial statements provide information on the total cost of delivering educational services, including capital assets and long-term liabilities.

Theoretically, net position represents district resources available for providing services after its debts are settled. However, those resources are not always in expendable form, or there may be restrictions on how some of those resources can be used. Therefore, this statement divides net position into three components: net investment in capital assets, restricted, and unrestricted. The following table presents a summarized reconciliation of the District's governmental fund balances to net position, and the separate components of net position for the last two years:

	June 30,		Increase
	2018	2019	(Decrease)
Net position – governmental activities			
Total fund balances – governmental funds	\$ 41,252,400	\$ 34,265,922	\$ (6,986,478)
Net OPEB plan related assets	15,194,803	14,227,968	(966,835)
Total capital assets, less accumulated depreciation	59,754,326	59,871,392	117,066
Total long-term liabilities, excluding			
net pension liabilities	(97,605,548)	(88,114,403)	9,491,145
Net pension related liabilities	(120,865,545)	(95,430,778)	25,434,767
Accrued interest payable	(1,395,823)	(1,576,402)	(180,579)
Other	(926,133)	453,346	1,379,479
Total net position – governmental activities	<u><u>\$ (104,591,520)</u></u>	<u><u>\$ (76,302,955)</u></u>	<u><u>\$ 28,288,565</u></u>
Net position			
Net investment in capital assets	\$ 1,189,216	\$ 1,586,630	\$ 397,414
Restricted	5,107,192	6,877,281	1,770,089
Unrestricted	<u>(110,887,928)</u>	<u>(84,766,866)</u>	<u>26,121,062</u>
Total net position	<u><u>\$ (104,591,520)</u></u>	<u><u>\$ (76,302,955)</u></u>	<u><u>\$ 28,288,565</u></u>

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

Total net position increased by \$28,288,565. The decrease in the General Fund balance and the decrease in the District's share of the Public Employees Retirement Association (PERA) and the Teachers Retirement Association (TRA) pension plans, mainly contributed to the change in unrestricted net position in the current year.

The increase in the restricted net position was mainly in amounts restricted for capital asset acquisition.

The District's net investment in capital assets increased \$397,414 in 2019. 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.

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LEGISLATIVE SUMMARY

The 2019 Legislature passed education and tax bills that included appropriation increases of between \$563 million and \$593 million for K–12 education over the fiscal year (FY) 2020–2021 biennium, with the majority of the additional appropriations being added to the general education and special education funding formulas. The following is a brief summary of specific legislative changes from the 2019 session or previous legislative sessions impacting Minnesota school districts in future years.

General Education Revenue – The Legislature approved annual increases of 2 percent to the basic general education formula allowance for the FY 2020–2021 biennium. The per pupil allowance will increase \$126 to \$6,438 for FY 2020, and another \$129 to \$6,567 for FY 2021. Other small additions to general education funding were approved to: provide permanent funding for early middle college programs serving students under the age of 22; extend the opportunity to participate in post-secondary enrollment options – career and technical education programs to nonpublic students in the 10th grade; and provide transportation for pregnant teens and teen moms attending established programs that provide parent training and quality on-site child care.

Compensatory Revenue – The portion of compensatory revenue required to be used for extended time activities increased from 1.7 percent of total compensatory revenue for FY 2018 to 3.5 percent in FY 2019, and will increase to 3.5 percent plus the annual percentage change in the basic general education thereafter.

Early Learning – The Legislature appropriated funding to maintain the 4,000 Voluntary Pre-Kindergarten (VPK) and School Readiness Plus program seats currently set to expire after FY 2019, through FY 2020 and FY 2021. Students in these programs will not be used in declining enrollment revenue calculations for FY 2022, and will not be used to drive FY 2022 compensatory revenue for sites where VPK funding is discontinued after FY 2021, due to the reduction in the number of funded seats.

Special Education Revenue – The 2019 education bill included a number of enhancements to special education funding designed to hold the state average cross subsidy per pupil constant at the FY 2019 level of \$820 per average daily membership (ADM) for FY 2020 and FY 2021. The changes included:

- Establishing a new component of the state special education funding formula, known as cross subsidy reduction aid, beginning in FY 2020. Cross subsidy reduction aid will equal a percentage of each district's "initial cross subsidy" for the prior fiscal year, with the percentages set at 2.60 percent for FY 2020 and 6.43 percent for FY 2021. Initial cross subsidy is defined as the district's nonfederal special education costs including transportation, less state special education aid after tuition adjustments and general education aid attributable to students receiving special education services outside of the regular classroom for at least 60.00 percent of the school day. Charter schools are not eligible for cross subsidy reduction aid.
- Updating the pupil-driven portion of the initial special education aid formula to use FY 2018 data beginning in FY 2021, rather than continuing to use 2011 data adjusted for inflation.
- Phasing out the special education aid cap over two years, with the cap eliminated for FY 2021 and beyond. For FY 2020, the cap increases to the greater of the FY 2019 cap, or the sum of 56 percent of FY 2019 program costs plus 100 percent of FY 2019 special education transportation costs and the tuition adjustment.
- Reducing the tuition rate paid by the resident school district for open enrolled special education students served by another district or charter school from 90 percent of unfunded costs to 85 percent for FY 2020, and 80 percent for FY 2021 and later. Charter schools will be eligible for additional special education aid from the state to fully offset the impact of the tuition rate change.

- Reducing the hold harmless guarantee by changing the formula to reduce reliance on the FY 2016 base year so that districts where special education expenditures have fallen or grown slowly since FY 2016 do not benefit disproportionately from the hold harmless guarantee compared to other districts. The hold harmless (minimum aid) guarantee for FY 2020 will be limited to 90.0 percent of FY 2019 regular program costs, plus 100.0 percent of special education transportation costs, plus the tuition adjustment. The percentage of FY 2019 regular program costs used to calculate the hold harmless will decrease to 85.0 percent for FY 2021, 80.0 percent for FY 2022, and 75.0 percent for FY 2023. In addition, the annual inflation adjustment used to calculate the hold harmless will be reduced by 0.2 percent annually from the 4.6 percent factor used in FY 2019 until the adjustment reaches 2.0 percent.

Safe Schools Supplemental Aid – A one-time appropriation of \$30 million was made for Safe Schools Supplemental Aid in FY 2020, contingent upon the closing balance of the state’s General Fund for FY 2019 exceeding the balance projected at the end of the 2019 legislative session. If the balance exceeds the projection by \$63 million, the entire \$30 million will be appropriated. If the balance exceeds the projection by between \$33 and \$63 million, the amount over \$33 million will be appropriated. The aid would be allocated among school districts and charter schools based on their respective share of state-wide adjusted ADM for FY 2018. Districts would be required to restrict the use of the funding for the same purposes as the safe schools levy. Charter schools would be required to restrict the use for the same purposes as the safe schools levy or for building lease costs not covered by charter school lease aid.

School Building Bond Agricultural Tax Credit – Effective for taxes beginning with the payable 2018 levy (FY 2019), a tax credit on all property classified as agricultural (excluding the house, garage, and one acre of an agricultural homestead) was provided equal to 40 percent of the tax on the property attributable to school district building bond levies. The appropriation for this tax credit is \$34.8 million for FY 2019, \$45.2 million for FY 2020, and \$52.5 million for FY 2021. The 2019 Legislature increased the credit percentage to 50 percent for the levy payable in 2020, 55 percent for payable in 2021, 60 percent for payable in 2022, and 70 percent for payable in 2023 and thereafter.

Forecast Adjustments – Forecast article adjustments to FY 2019 appropriations (including final payments from FY 2018 and current payments for FY 2019) were approved to match the February 2019 forecast amount for each affected program. This eliminated the potential proration of forecasted program aids, including special education aid, for FY 2018 and FY 2019, due to the veto of the 2018 omnibus budget bill.

Operating Referendum / Local Optional Revenue – Effective for the tax levy payable in FY 2021, the operating referendum and local operational revenue (LOR) levies were simplified by transferring \$300 per pupil unit (PU) of referendum revenue to LOR, thereby eliminating the board-approved referendum levy and increasing the LOR levy authority to \$724 per PU. The referendum cap is reduced by the \$300 per PU transferred to LOR. The annual recalculation of referendum allowances approved prior to FY 2014 based on the amount of LOR a district opts to receive is also eliminated. Inflation adjusted referendum authority transferred to LOR will continue to be adjusted for the life of the referendum. This change is revenue neutral for all districts.

Operating Referendum Equalization – Effective for the tax levy payable in FY 2021, the equalizing factor for Tier 2 of the referendum (New Tier 1) is increased from \$510,000 to \$567,000. This is expected to provide \$9.4 million of property tax relief to taxpayers, and result in \$600,000 of additional referendum state aid for charter schools.

Pension Benefit Reforms – The 2018 pension bill included a number of reforms to the various defined benefit pension plans across the state, including the plans administered by the Teachers Retirement Association (TRA), St. Paul Teachers Retirement Fund Association (SPTRFA), and the Public Employees Retirement Association (PERA). Employer contribution rates were increased for the TRA plan (a total increase of 1.25 percent phased in over a 6-year period beginning in FY 2019) and the SPTRFA plan (a total increase of 2.50 percent phased in over a 6-year period beginning in FY 2019). Employee contribution rates were also increased by 0.25 percent beginning in FY 2024 for the TRA plan and beginning in FY 2023 for the SPTRFA plan. The pension adjustment component of the general education aid formula was increased by an amount equal to the product of the salaries paid to members of these two plans times the district's pension adjustment rate for the fiscal year to help offset the cost of the employer contribution increases.

Board Control of Extracurricular Student Activities – In order to align the Uniform Financial Accounting and Reporting Standards with the new requirements of Governmental Accounting Standards Board Statement No. 84, effective for FY 2020 school boards are required to take charge of and control the financial transactions related to all extracurricular student activity accounts. This eliminates the previously available alternative for school boards to allow these accounts to operate outside of board control, and thereby be accounted for and reported outside of the district's funds.

Disposal of Surplus Computers – Authorizes a school district to sell or give a surplus computer to a charitable organization for educational use, or to currently enrolled district students who intend to enroll the following year.

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ACCOUNTING AND AUDITING UPDATES

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 Minnesota Department of Education has also issued guidance for implementing this standard, which will impact the reporting of extracurricular student activity accounts previously not under board control, and potentially other fiduciary funds, beginning in the 2019–2020 fiscal year.

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.

GASB STATEMENT NO. 90, MAJORITY EQUITY INTEREST—AN AMENDMENT OF GASB STATEMENTS NO. 14 AND NO. 61

The primary objectives of this statement are to improve the consistency and comparability of reporting a government's majority equity interest in a legally separate organization and to improve the relevance of financial statement information for certain component units.

It specifies that a majority equity interest in a legally separate organization should be reported as an investment if a government's holding of the equity interest meets the definition of an investment. It further specifies that such investments should generally be measured using the equity method, unless it is held by a special-purpose government engaged only in fiduciary activities, a fiduciary fund, or an endowment (including permanent and term endowments) or permanent fund, in which case the majority equity interest should be measured at fair value.

All other holdings of a majority equity interest in a legally separate organization that do not meet the definition of an investment result in the government being financially accountable for the legally separate organization and, therefore, the government should report that organization as a component unit, and should report an asset related to the majority equity interest using the equity method.

This statement also requires that a component unit in which a government has a 100 percent equity interest account for its assets, deferred outflows of resources, liabilities, and deferred inflows of resources at acquisition value at the date the government acquired a 100 percent equity interest in the component unit. Transactions presented in flows statements of the component unit in that circumstance should include only transactions that occurred subsequent to the acquisition.

The requirements of this statement are effective for reporting periods beginning after December 15, 2018. Earlier application is encouraged. The requirements should be applied retroactively, except for the provisions related to reporting a majority equity interest in a component unit and reporting a component unit if the government acquires a 100 percent equity interest, which should be applied prospectively.

GASB STATEMENT NO. 91, *CONDUIT DEBT OBLIGATIONS*

The primary objectives of this statement are to provide a single method of reporting conduit debt obligations by issuers and eliminate diversity in practice associated with (1) commitments extended by issuers, (2) arrangements associated with conduit debt obligations, and (3) related note disclosures. This statement achieves those objectives by clarifying the existing definition of a conduit debt obligation; establishing that a conduit debt obligation is not a liability of the issuer; establishing standards for accounting and financial reporting of additional commitments and voluntary commitments extended by issuers and arrangements associated with conduit debt obligations; and improving required note disclosures.

A conduit debt obligation is defined as a debt instrument having all of the following characteristics:

- There are at least three parties involved: (1) an issuer, (2) a third party obligor, and (3) a debt holder or a debt trustee.
- The issuer and the third party obligor are not within the same financial reporting entity.
- The debt obligation is not a parity bond of the issuer, nor is it cross-collateralized with other debt of the issuer.
- The third party obligor or its agent, not the issuer, ultimately receives the proceeds from the debt issuance.
- The third party obligor, not the issuer, is primarily obligated for the payment of all amounts associated with the debt obligation (debt service payments).

This statement also addresses arrangements, often characterized as leases, that are associated with conduit debt obligations. In those arrangements, capital assets are constructed or acquired with the proceeds of a conduit debt obligation and used by third party obligors in the course of their activities.

This statement requires issuers to disclose general information about their conduit debt obligations, organized by type of commitment, including the aggregate outstanding principal amount of the issuers' conduit debt obligations and a description of each type of commitment. Issuers that recognize liabilities related to supporting the debt service of conduit debt obligations also should disclose information about the amount recognized and how the liabilities changed during the reporting period.

The requirements of this statement are effective for reporting periods beginning after December 15, 2020. Earlier application is encouraged.

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