Management Report

for

Independent School District No. 139
Rush City, Minnesota

June 30, 2016

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

We have prepared this management report in conjunction with our audit of Independent School District No. 139's (the District) financial statements for the year ended June 30, 2016. The purpose of this report is to communicate information relevant to the financing of public education in Minnesota and to provide comments resulting from our audit process. We have organized this report into the following sections:

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

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

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

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

Minneapolis, Minnesota
October 19, 2016

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AUDIT SUMMARY

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

OUR RESPONSIBILITY UNDER AUDITING STANDARDS GENERALLY ACCEPTED IN THE UNITED STATES OF AMERICA AND *GOVERNMENT AUDITING STANDARDS*

We have audited the financial statements of the governmental activities, each major fund, and the aggregate remaining fund information of the District as of and for the year ended June 30, 2016, and the related notes to the financial statements. Professional standards require that we provide you with information about our responsibilities under auditing standards generally accepted in the United States of America and *Government Auditing Standards*, as well as certain information related to the planned scope and timing of our audit. We have communicated such information to you verbally and in our audit engagement letter. Professional standards also require that we communicate to you the following information related to our audit.

PLANNED SCOPE AND TIMING OF THE AUDIT

We performed the audit according to the planned scope and timing previously discussed and coordinated in order to obtain sufficient audit evidence and complete an effective audit.

AUDIT OPINION AND FINDINGS

Based on our audit of the District's financial statements for the year ended June 30, 2016:

- We have issued an unmodified opinion on the District's basic financial statements.

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

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

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

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

Extracurricular Student Activity Accounts

In accordance with Minnesota Statutes, the District's School Board has elected not to exercise control over the transactions of the extracurricular student activity accounts maintained at various district sites. Consequently, the cash receipts and disbursements of the District's extracurricular student activity accounts are reported in a separate set of financial statements, rather than being reported within the District's General Fund. We have issued an opinion on these separate financial statements, stating that they fairly present the cash balances and cash receipts and disbursements of these accounts as of and for the year ended June 30, 2016 on the cash basis of accounting. Our opinion was qualified for a limitation related to the completeness of cash receipts reported.

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

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

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, 2016.

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.

Difficulties Encountered in Performing the Audit

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

Corrected and Uncorrected Misstatements

Professional standards require us to accumulate all known and likely misstatements identified during the audit, other than those that are clearly trivial, and communicate them to the appropriate level of management. Where applicable, management has corrected all such misstatements. In addition, none of the misstatements detected as a result of audit procedures and corrected by management, when applicable, were material, either individually or in the aggregate, to each opinion unit's financial statements taken as a whole.

ACCOUNTING ESTIMATES AND MANAGEMENT JUDGMENTS

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

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

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

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

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

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

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

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

DISAGREEMENTS WITH MANAGEMENT

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

MANAGEMENT REPRESENTATIONS

We have requested certain representations from management that are included in the management representation letter dated October 19, 2016.

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.

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 MATTERS

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

We were engaged to report on the supplemental information and the Uniform Financial Accounting and Reporting Standards (UFARS) Compliance Table accompanying the financial statements which are not RSI. With respect to this supplementary information, we made certain inquiries of management and evaluated the form, content, and methods of preparing the information to determine that the information complies with accounting principles generally accepted in the United States of America, the method of preparing it has not changed from the prior period, and the information is appropriate and complete in relation to our audit of the financial statements. We compared and reconciled the supplementary information to the underlying accounting records used to prepare the financial statements or to the financial statements themselves.

We were not engaged to report on the introductory section which accompanies the financial statements but is not RSI. Such information has not been subjected to the auditing procedures applied in the audit of the basic financial statements and, accordingly, we do not express an opinion or provide any assurance on it.

UNIFORM FINANCIAL ACCOUNTING AND REPORTING STANDARDS (UFARS) CODING

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

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

FUNDING PUBLIC EDUCATION IN MINNESOTA

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

BASIC GENERAL EDUCATION REVENUE

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

The table below presents a summary of the formula allowance for the past decade and as approved for the 2017 fiscal year. The amount of the formula allowance and the percentage change from year to year excludes non-comparable changes such as temporary funding increases, the "roll-in" of aids that were previously funded separately, potential reductions due to levying less than the maximum student achievement levy rate, and the one-time replacement of a portion of general education aid with federal fiscal stabilization funds in fiscal 2010.

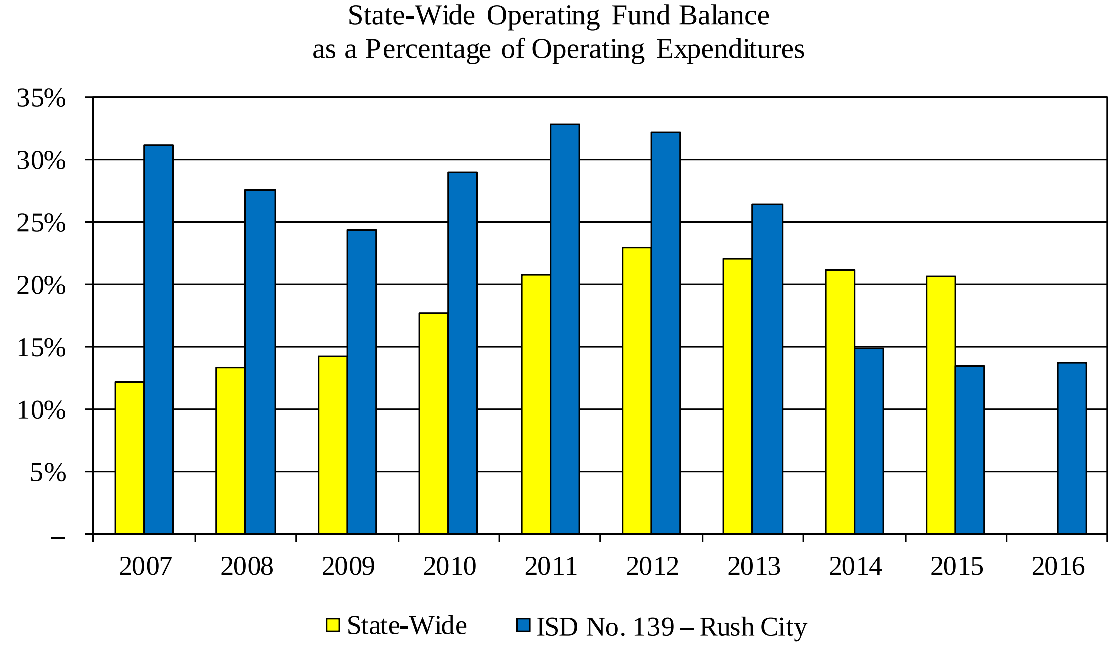
	Formula Allowance	
Fiscal Year Ended June 30,	Amount	Percent Increase
2007	$ 4,974	4.0 %
2008	$ 5,074	2.0 %
2009	$ 5,124	1.0 %
2010	$ 5,124	– %
2011	$ 5,124	– %
2012	$ 5,174	1.0 %
2013	$ 5,224	1.0 %
2014	$ 5,302	1.5 %
2015	$ 5,831	2.0 % *
2016	$ 5,948	2.0 %
2017	$ 6,067	2.0 %

* The $529 increase in 2015 was 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 operating fund balance as a percentage of operating expenditures.



Note: State-wide information is not available for fiscal 2016.

The calculation above reflects only the 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.

Since the financially turbulent 2008–2009 biennium, Minnesota school districts have generally been maintaining a higher unrestricted fund balance as a percentage of operating expenditures. This trend reflects districts' efforts to limit budget cuts, retain educational programs, and maintain adequate operating cash flow during a period of uncertain funding. It was accomplished by districts reducing or limiting operating expenditures, adapting to funding restrictions, and in some cases community support in the form of operating referendums. As the state's economic condition has stabilized the last few years, this trend appears to be gradually reversing, with the state average gradually decreasing the last three years.

As of June 30, 2015, this ratio, as calculated by the MDE, was 13.5 percent for the District, as compared to a state-wide average of 20.6 percent. The District's operating fund balance as a percentage of operating expenditures was 13.7 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 Permanent, Capital Projects – Building Construction, and Post-Employment Benefits Debt Service Funds. Other financing sources, such as proceeds from sales of capital assets, insurance recoveries, bond sales, loans, and interfund transfers, are also excluded.

Governmental Funds Revenue per Student (ADM) Served

	State-Wide		Seven-County Metro Area		ISD No. 139 – Rush City		
	2014	2015	2014	2015	2014	2015	2016
General Fund							
Property taxes	$ 972	$ 1,657	$ 1,285	$ 2,187	$ 328	$ 709	$ 895
Other local sources	480	489	397	387	604	646	773
State	9,036	8,967	9,257	9,030	7,676	8,326	8,282
Federal	458	441	480	447	178	170	147
Total General Fund	10,946	11,554	11,419	12,051	8,786	9,851	10,097
Special revenue funds							
Food Service	504	522	500	516	464	457	469
Community Service	553	551	667	651	450	473	458
Debt Service Fund	1,090	1,061	1,187	1,127	1,539	1,606	1,572
Total revenue	$ 13,093	$ 13,688	$ 13,773	$ 14,345	$ 11,239	$ 12,387	$ 12,596
ADM served per MDE School District Profiles Report (current year estimated)					887	846	860

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

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

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

The mix of local and state revenues vary from year to year primarily based on funding formulas and the state's financial condition. The mix of revenue components from district to district varies due to factors such as the strength of property values, mix of property types, operating and bond referendums, enrollment trends, density of population, types of programs offered, and countless other criteria. Revenue neutral adjustments attributable to the legislatively-approved tax shift have significantly impacted the recognition of property tax and state sources by year, as presented in the table above.

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

The District earned $10,833,059 in the governmental funds reflected above in fiscal 2016, an increase of $353,031 (3.4 percent) from the prior year. Total revenue per ADM served increased by $209 (1.7 percent) per student. The increase in the basic formula allowance and additional operating levy, along with additional sources passed through for pension benefits, contributed to the overall revenue growth in the General Fund totaling $246 per student.

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

Governmental Funds Expenditures per Student (ADM) Served

	State-Wide		Seven-County Metro Area		ISD No. 139 – Rush City		
	2014	2015	2014	2015	2014	2015	2016
General Fund							
Administration and district support	$ 882	$ 941	$ 886	$ 951	$ 964	$ 1,041	$ 1,127
Elementary and secondary regular instruction	5,091	5,301	5,408	5,635	3,849	4,259	4,219
Vocational education instruction	140	147	130	136	157	140	179
Special education instruction	1,987	2,058	2,144	2,196	1,576	1,653	1,756
Instructional support services	536	586	630	689	547	614	606
Pupil support services	950	992	1,019	1,072	579	559	597
Sites and buildings and other	881	881	843	832	1,128	1,050	1,245
Total General Fund – noncapital	10,467	10,906	11,060	11,511	8,800	9,316	9,729
General Fund capital expenditures	512	581	442	493	816	597	232
Total General Fund	10,979	11,487	11,502	12,004	9,616	9,913	9,961
Special revenue funds							
Food Service	513	528	512	523	456	474	473
Community Service	556	546	674	642	540	509	476
Debt Service Fund	1,469	1,489	1,636	1,701	1,520	1,600	1,712
Total expenditures	$ 13,517	$ 14,050	$ 14,324	$ 14,870	$ 12,132	$ 12,496	$ 12,622
ADM served per MDE School District Profiles Report (current year estimated)					887	846	860

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

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

Expenditure patterns also vary from district to district for various reasons. Factors affecting the comparison include the growth cycle or maturity of the District, average employee experience, availability of funding, population density, and even methods of allocating costs. The differences from program to program reflect the District's particular character, such as its community service programs, as well as the fluctuations from year to year for such things as capital expenditures.

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

The District spent $10,855,719 in the governmental funds reflected above in fiscal 2016, an increase of $284,704 (2.7 percent) from the prior year. On a per student basis, this represents an increase of $126 (1.0 percent). General Fund expenditures increased $48 per student, spread across several programs presented above with the largest increase in sites and buildings and other ($195 per student) followed by special education instruction ($103 per student). Capital spending in the General Fund decreased by $365 per student compared to the prior year. Debt Service Fund expenditures increased $112 per student due to increased issue costs associated with refunding bonds issued in the current year.

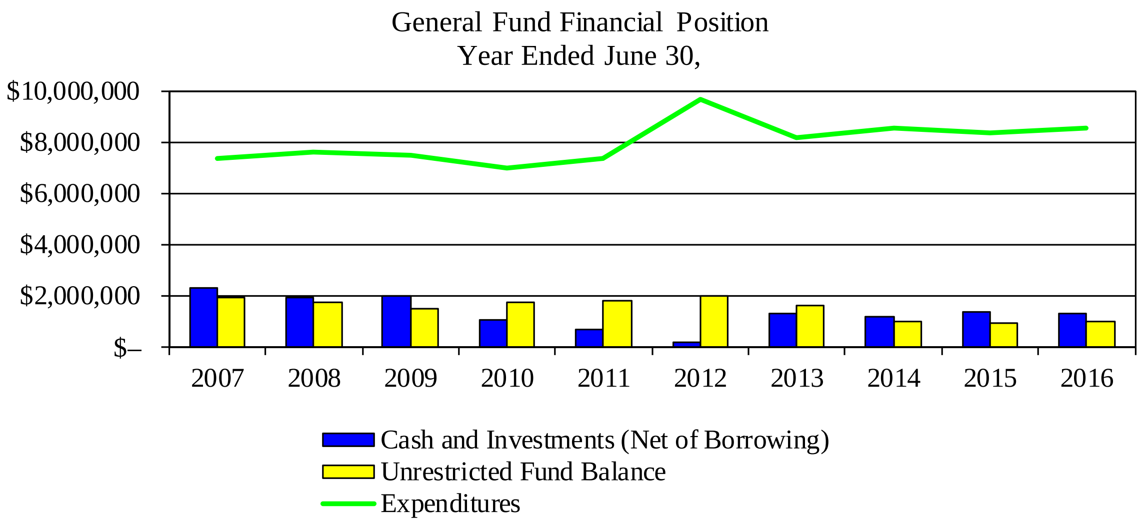
SUMMARY

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

FINANCIAL TRENDS OF YOUR DISTRICT

GENERAL FUND FINANCIAL POSITION

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



The District ended fiscal year 2016 with a General Fund cash balance of $1,284,757 and an unrestricted fund balance of $977,154, excluding restricted fund balance deficits. The spike in 2012 expenditures reflects the $1,930,000 capital outlay for the SCRED facility in that year.

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

GENERAL FUND COMPONENTS OF FUND BALANCE

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

	Fiscal Year				
	2012	2013	2014	2015	2016
Nonspendable fund balances	$ 22,386	$ 99,759	$ –	$ –	$ –
Restricted fund balances (1)	106,569	3,584	(86,505)	(107,641)	(31,920)
Unrestricted fund balances					
Assigned	619,574	673,568	10,500	61,781	4,500
Unassigned	1,375,219	946,715	1,001,970	873,946	972,654
Total fund balances	$ 2,123,748	$ 1,723,626	$ 925,965	$ 828,086	$ 945,234
Unrestricted fund balances as a percentage of total expenditures	20.6%	19.7%	11.9%	11.2%	11.4%
Unassigned fund balances as a percentage of total expenditures	14.2%	11.5%	11.7%	10.4%	11.4%

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

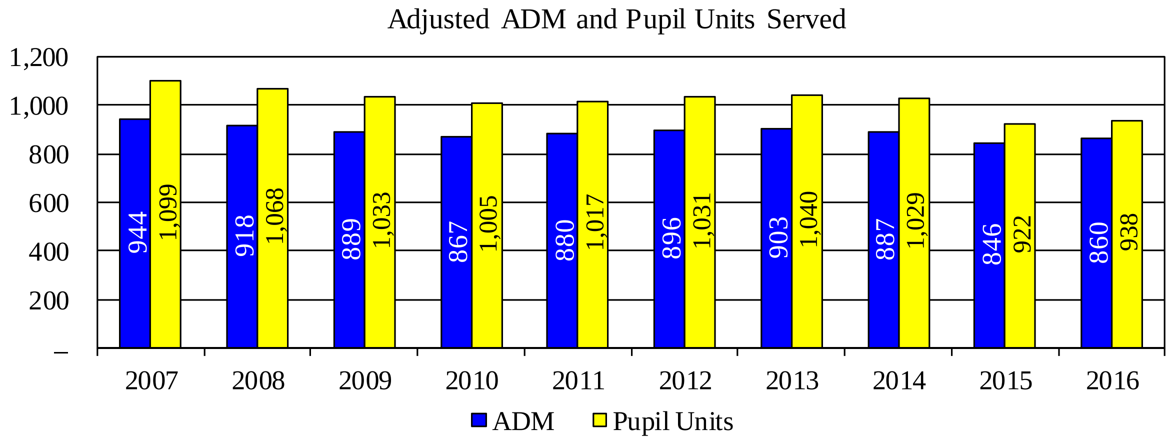
The table above reflects the total General Fund unrestricted fund balance and percentages, which differs from those used in the previous discussion of state-wide fund balances, which are based on a state formula.

The resources represented by this fund balance are critical to a district's ability to maintain adequate cash flow throughout the year, to retain its programs, and to cushion against the impact of unexpected costs or funding shortfalls.

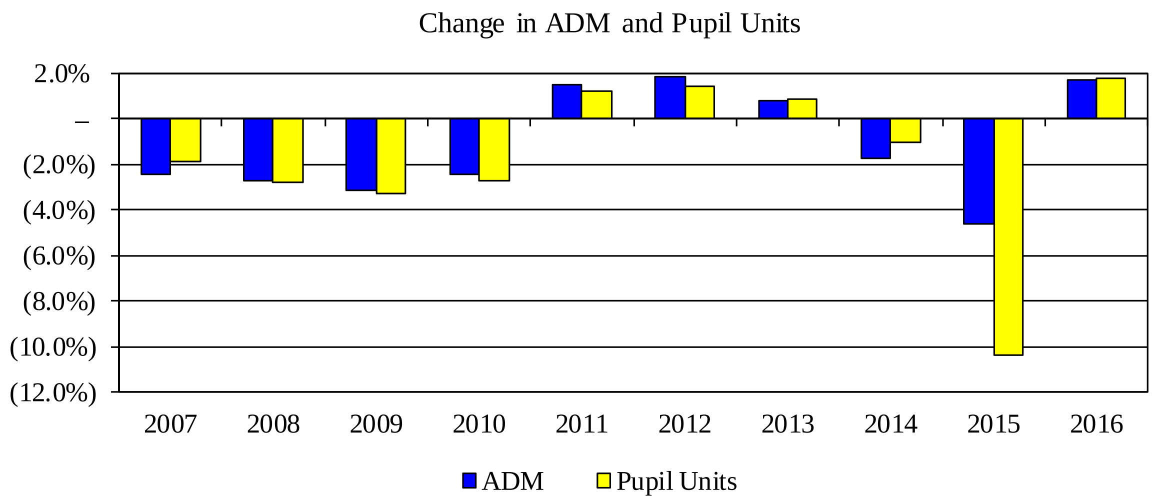
The School Board has formally adopted a fund balance policy regarding the minimum fund balance. The policy establishes that the District will strive to maintain a minimum unassigned general operating funds balance of 15 percent of the general operating expenditures for each fiscal year. If the balance will decrease below 15 percent, the administration shall apprise the School Board of this prior to budget adoption. If the balance will decrease below 10 percent, the School Board will initiate certain measures to ensure that the balance does not fall below this level. As of June 30, 2016, the District has calculated a fund balance percentage of 10.8 percent, as intended in the fund balance policy as interpreted by the District.

AVERAGE DAILY MEMBERSHIP (ADM) AND PUPIL UNITS

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



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



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

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

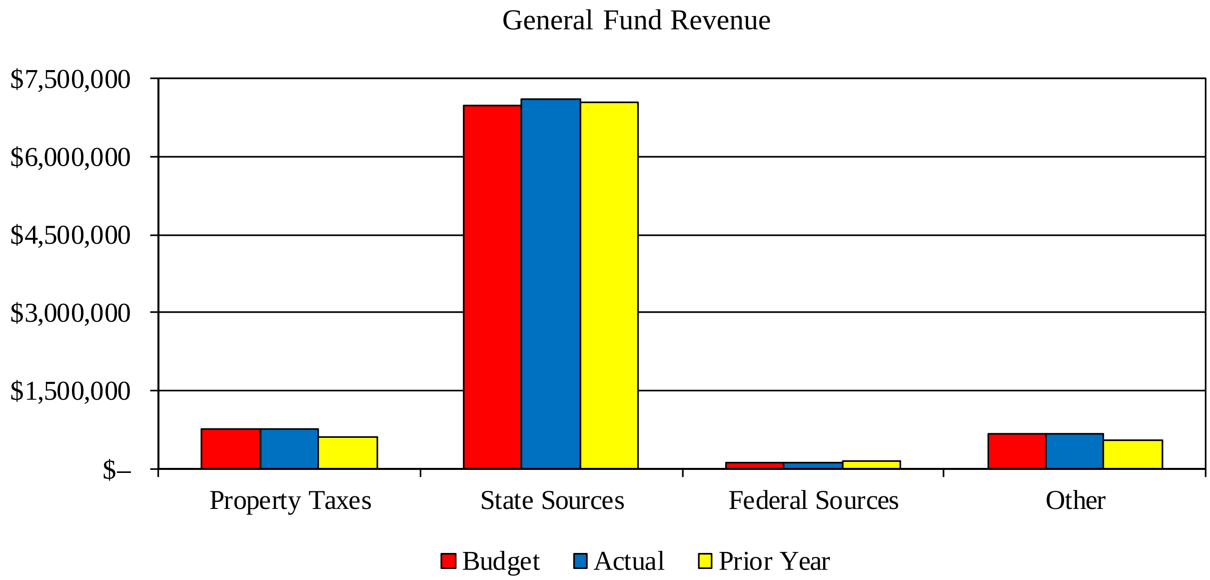
The District served an estimated ADM of 860 in 2016, an increase of 14 (1.7 percent) over last year.

ADM is weighted as follows in computing pupil units:

Fiscal	Pre-Kindergarten	Handicapped Kindergarten	Half-Day Kindergarten	Full-Day Kindergarten	Elementary 1–3	Elementary 4–6	Secondary
2007	1.250	1.000	0.557	0.557	1.115	1.060	1.300
2008 through 2014	1.250	1.000	0.612	0.612	1.115	1.060	1.300
2015 through 2016	1.000	1.000	0.550	1.000	1.000	1.000	1.200

GENERAL FUND REVENUES

The following graph presents the District's General Fund revenues for 2016:



Current year revenues totaling $8,684,310 were over budget by $146,004, or 1.7 percent, and were $350,315, or 4.2 percent, higher than the prior year.

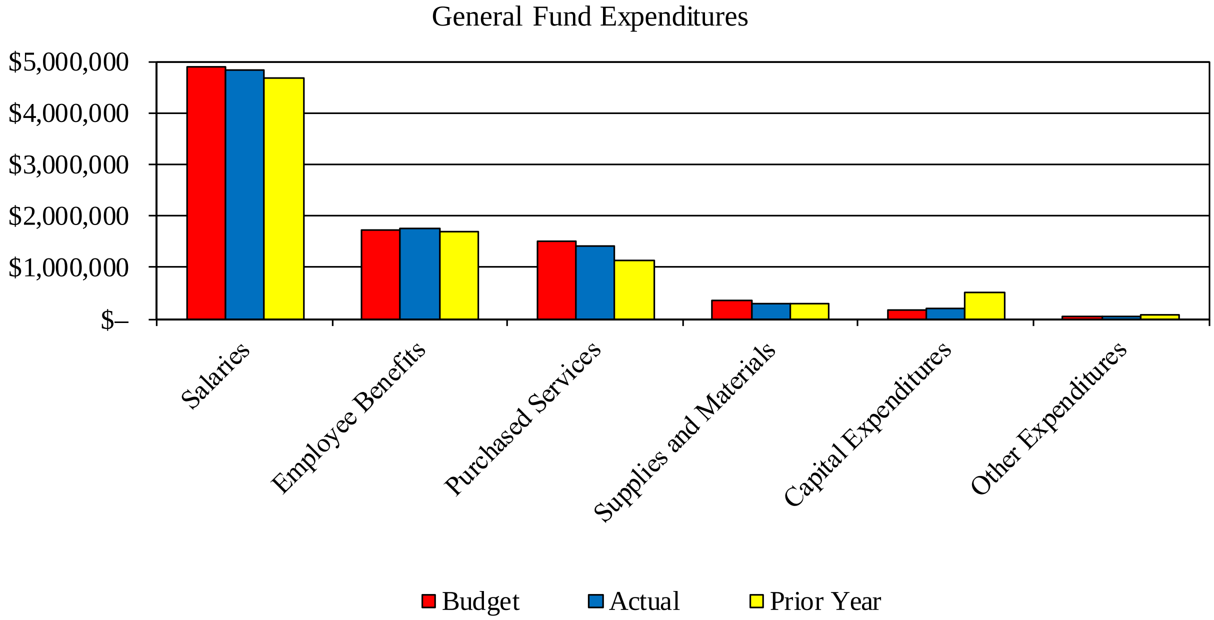
The variance to budget was mainly in state sources, which were $143,644 over budget. The District served more students than anticipated in the budget, contributing to the favorable variance in state sources. State sources totaling $82,499, financing pension benefits, passed through the District also caused actual revenues to exceed budget.

The increase from the prior year was spread across nearly all of the above sources, with federal sources decreasing slightly from last year. Property tax sources increased over the prior year as approved through the levy certification process. The increase in state sources included the pass-through of state aid for pension benefits, as previously discussed. Other local sources were up from the prior year with more donations, fees, reimbursements, and miscellaneous sales as anticipated in the budget.

The graph above reflects the concentration of state sources (82.0 percent) followed by property taxes (8.9 percent) received to finance General Fund operations.

GENERAL FUND EXPENDITURES

The following graph presents the District's General Fund expenditures for 2016:



Current year expenditures of $8,567,402 were under budget by $126,712 (1.5 percent), and were $182,043 (2.2 percent) more than the prior year.

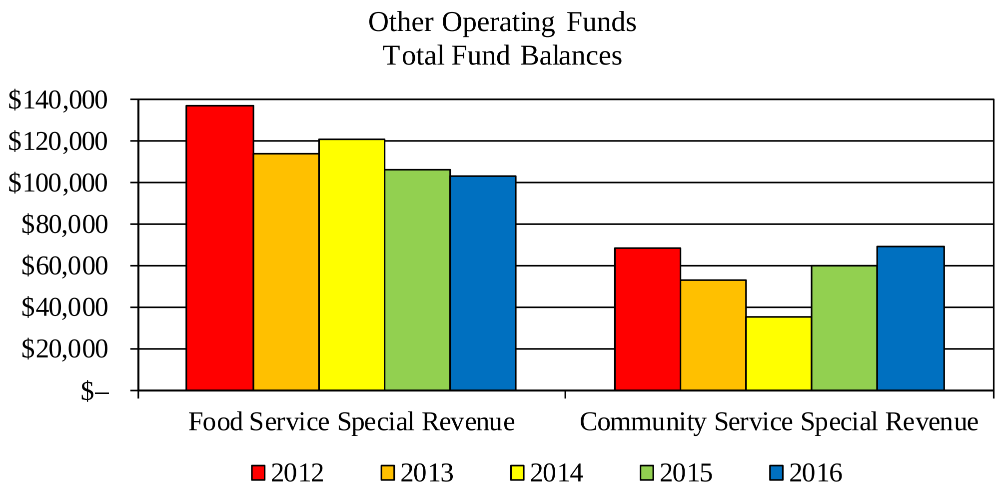
As presented in the graph above, expenditures were less than projected in most categories and spread across all programs. Employee benefits had actual expenditures exceeding budget, which was due to the $82,499 of pension pass-through as discussed with revenues. Without the revenue and expenditure neutral pass-through, employee benefit spending would also have been within appropriated amounts. The largest under spending was in purchased services (primarily within sites and buildings) partially due to fuel costs remaining below anticipated amounts.

Expenditure increases were primarily due to planned program enhancements and contractual salary and benefit increases. Within sites and buildings, the District had an increase in purchased services, which was offset by a decrease in capital spending as planned in the budget.

Salaries and employee benefits, which account for 77.0 percent of General Fund spending, were $217,338 (3.4 percent) over the prior year and $9,764 (0.1 percent) under budget.

OTHER FUNDS OF THE DISTRICT

The following graph shows what is referred to as the other operating funds. The remaining nonoperating funds are only included in narrative form below, since their level of fund balance can fluctuate significantly due to such things as issuing and spending the proceeds of refunding or building bonds and, therefore, the trend of fund balance levels 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 recognized a decrease in fund balance of $3,377 in 2016, compared to a budgeted decrease of $6,705. Revenues were more than anticipated in the budget by $3,219, while expenditures were under budget by $109. Total fund balance of $103,113 equals 25.3 percent of its annual expenditures totaling $406,796.

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

Community Service Special Revenue Fund

The District's Community Service Special Revenue Fund recognized a fund balance increase of $9,280, compared to a budgeted increase of $6,134. Revenues were over budget by $3,833, while expenditures were below appropriations by $10,960. The District's General Fund transferred $24,616 to this operation, which was $11,647 less than planned in the budget. Total fund balance of $69,052 represents 16.9 percent of the fund's expenditures totaling $409,121.

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.

Debt Service Fund

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

Total fund balance in the Debt Service Fund decreased by $6,620 in the current year, which was $1,861 more than the decrease anticipated in the budget. As of June 30, 2016, fund balance in the Debt Service Fund totaling $300,647 is available to meet future debt service requirements.

The District issued refunding bonds in 2016, used to call the 2006A General Obligation School Building Refunding Bonds, that will reduce future debt payments by $1,483,737 with a present value savings of $1,352,510.

Permanent Fund

During fiscal 2016, the Permanent Fund recognized a slight fund balance decrease of $728, ending the year with $512,372 in total fund balance. Of this total fund balance, $511,000 is considered permanently restricted.

GOVERNMENT-WIDE FINANCIAL STATEMENTS

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

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

	June 30, 2016	June 30, 2015	Increase (Decrease)
Net position – governmental activities			
Total fund balances – governmental funds	$ 1,930,418	$ 1,814,715	$ 115,703
Total capital assets, net of depreciation	17,188,581	18,000,711	(812,130)
Total long-term debt	(18,698,162)	(18,975,062)	276,900
Other adjustments	1,971,037	1,150,229	820,808
Total net position – governmental activities	$ 2,391,874	$ 1,990,593	$ 401,281
Net position			
Net investment in capital assets	$ 5,250,185	$ 5,280,035	$ (29,850)
Restricted	1,066,261	1,038,644	27,617
Unrestricted	(3,924,572)	(4,328,086)	403,514
Total net position	$ 2,391,874	$ 1,990,593	$ 401,281

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

Total net position increased by $401,281 during fiscal 2016. The District's net investment in capital assets decreased $29,850 this year. The change in this category of net position typically depends on the relationship between the rate at which the District's capital assets are being depreciated, and how that compares to the rate at which the District is repaying the debt issued to purchase or construct those assets.

The restricted portion of the District's net position increased $27,617, primarily in amounts restricted for capital asset acquisition and OPEB benefits and other purposes. Unrestricted net position increased $403,514 with the improved financial position of the General Fund as previously discussed.

LEGISLATIVE SUMMARY

The 2016 legislative session was relatively short and focused on contentious issues such as taxes, bonding and transportation. Education advocates were interested in support for early learning, increasing student support services and teacher diversity and retention. In the end very few new chapters of law were enacted. The supplemental budget bill provided an increase of $25 million plus a reallocation of $53.3 million in savings from a maximum effort loan early repayment program in new money to support education.

The following is a brief summary of recent legislative changes and issues affecting the future funding of Minnesota school districts:

2016 Session – Brief summary of significant funding changes:

Early Repayment of Maximum Effort Loans – Allows a district with an outstanding capital loan balance that received a loan before January 1, 2007 to close the loan by repaying the full outstanding original principal on the loan by November 30, 2016 without paying the interest on the loan.

Voluntary Pre-Kindergarten – Aid available through a formula driven model to a state-wide cap of $25 million to provide comprehensive programming to children who are four years old on September 1 of the school year in which they enroll. Funding prioritized on the basis of the concentration of prior year kindergarten students eligible for free and reduced-price lunch and the proximity of three and four star Parent Aware programs to the district or charter school. The application deadline for fiscal year (FY) 2017 by July 1, 2016 with the Minnesota Department of Education (MDE) to approve by August 1, 2016.

Equity Revenue – For FY 2017–2019 makes non-metropolitan area school districts eligible for a 16 percent increase in the sliding scale portion of equity revenue. Districts within the seven-county metropolitan area will continue to receive the 25 percent increase over the initial calculation of this revenue source.

Support Our Students Grant Program – $12.133 million grant program to hire new support staff (counselors, school psychologists, social workers, school nurses, and chemical dependency counselors). Grant program eligibility includes school districts, charter schools, intermediates, and cooperatives.

Intermediates and Cooperatives/Staff Development Grants – $4.5 million grant program to intermediates and cooperatives that provide instruction in federal settings four or higher. Revenue to be used for activities related to enhancing services to students who may have challenging behaviors or mental health issues or who are suffering from trauma.

2015 Session – Brief summary of significant funding changes:

Basic General Education Revenue – The 2015 Legislature approved 2 percent increases for each of the two subsequent fiscal years, raising the per pupil allowance to $5,948 for FY 2016 and $6,067 for FY 2017.

A number of other changes were made to the general education formula, including:

- The extended time allowance increased from $5,017 to $5,117 beginning in FY 2016.
- Charter schools with extended time programs will receive 25 percent of the state average per adjusted pupil unit (APU) (about $19 per APU) beginning in FY 2016.
- Funding eligibility for English learner revenue is extended from six to seven years in FY 2017.
- School districts not in a compensatory pilot project are allowed to allocate up to 50 percent of compensatory revenue among building sites based on a local plan beginning in FY 2016.

The following changes were made to elements of the general education tax levy:

- The student achievement levy, reestablished to allow districts to levy up to $20 million state-wide for FY 2016 (taxes payable 2015), is being phased out. There will be no change to the $20 million limit for FY 2017 (taxes payable 2016). The levy is reduced to $10 million state-wide for FY 2018 (taxes payable 2017), and eliminated for FY 2019.
- The equalization factor for operating capital was increased from $14,500 for FY 2016 to $14,740 for FY 2017, $17,473 for FY 2018, and $20,510 for FY 2019 and later years.

Language was also added requiring districts to use the 2 percent general education staff development set-aside for: teacher development and evaluation, principal development and evaluation, professional development, in-service education, and staff development plans. Staff development plans are required to be aligned and integrated with teacher development and evaluation agreements.

Quality Compensation Program (Q Comp) – The 2015 Legislature made the following changes to the Q Comp alternative compensation for teachers program:

- The cap on basic Q Comp aid increases 16.5 percent to $75,636,000 beginning in FY 2017.
- Cooperatives other than intermediate districts are eligible to participate in Q Comp beginning in FY 2017. The year prior to participating, 70 percent of the teachers employed by the cooperative must agree to adopt a Q Comp system.
- Beginning in FY 2017, the Q Comp aid formula for intermediates and other cooperatives changes to $3,000 per licensed teacher employed on October 1 of the previous year.
- Alternative teacher pay systems are now allowed to include incentives for teachers to pursue training, advanced certifications, or masters degrees; and for teachers identified as effective or highly effective to work in hard-to-fill positions or hard-to-staff schools.

Special Education Funding – State funding for special education is being transitioned to new funding formulas beginning in FY 2016.

For FY 2016, state regular special education aid was 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 2016, special education aid is paid directly to cooperatives and intermediate districts, rather than flowing through the resident districts. Tuition bills are reduced by the aid paid directly to these entities.

The formula for special education excess cost aid for FY 2016 was the greater of: 56.0 percent of the difference between the district's unreimbursed nonfederal special education costs and 7.0 percent of the district's general education revenue; or 62.0 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.

Long-Term Facilities Maintenance Revenue – Beginning in FY 2017, the current deferred maintenance, health and safety, and alternative facilities programs will be rolled into a new long-term facilities maintenance revenue program.

The new revenue for FY 2017 will be $193 per APU, multiplied by the lessor of one, or the ratio of the district's average building age to 35 years. Funding will increase to $292 per APU for FY 2018 and $380 per APU for FY 2019, multiplied by the same building age factor. Additional funding will be available for approved indoor air quality, fire alarm and suppression, and asbestos abatement projects with a cost per site of $100,000 or more. Districts may issue bonds for this program, levy on a pay-as-you-go basis, or a combination of the two. The 25 largest districts currently eligible for alternative facilities revenue will continue to be eligible for reimbursement of approved project costs without a per-pupil limit.

Revenue for long-term facilities maintenance will be equalized up to a limit of one times the annual allowance per APU. The aid/levy mix for the equalized portion of the revenue will be calculated using an equalizing factor of 123 percent of the state average adjusted net tax capacity (ANTC) per pupil unit, calculated with an exclusion of 50 percent of the value of class 2a Agricultural Land from ANTC. Levy equalization will be the same regardless of whether the district chooses to issue bonds or make annual pay-as-you-go levies. Debt service levies under the program will be excluded from regular debt service equalization.

All districts are guaranteed to receive at least as much revenue and at least as much state aid as they would have received under the existing law.

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 2017. 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.

ACCOUNTING AND AUDITING UPDATES

GASB STATEMENT NO. 73, *ACCOUNTING AND FINANCIAL REPORTING FOR PENSIONS AND RELATED ASSETS THAT ARE NOT WITHIN THE SCOPE OF GASB STATEMENT NO. 68, AND AMENDMENTS TO CERTAIN PROVISIONS OF GASB STATEMENT NOS. 67 AND 68*

The objective of this statement is to improve the usefulness of information about pensions included in financial statements of state and local governments for making decisions and assessing accountability. This statement also clarifies the application of certain provisions of GASB Statement Nos. 67 and 68 regarding 10-year schedules of required supplementary information (RSI) and other recognition issues pertaining to employers and nonemployer contributing entities. These changes will improve financial reporting by establishing a single framework for the presentation of information about pensions, enhancing comparability for similar information reported by employers and nonemployer contributing entities.

The requirements of this statement that address accounting and financial reporting by employers and governmental nonemployer contributing entities for pensions not within the scope of GASB Statement No. 68 are effective for financial statements for fiscal years beginning after June 15, 2016, and the requirements of this statement that address financial reporting for assets accumulated for purposes of providing those pensions are effective for fiscal years beginning after June 15, 2015. The requirements of this statement for pension plans that are within the scope of GASB Statement No. 67 or for pensions that are within the scope of GASB Statement No. 68 are effective for fiscal years beginning after June 15, 2015. Earlier application is encouraged.

GASB STATEMENT NO. 74, *FINANCIAL REPORTING FOR POSTEMPLOYMENT BENEFIT PLANS OTHER THAN PENSION PLANS*

The objective of this statement is to improve the usefulness of information about post-employment benefits other than pensions (other post-employment benefits [OPEB]). This statement replaces GASB Statement Nos. 43 and 57. It also includes requirements for defined contribution OPEB plans that replace the requirements for those OPEB plans in GASB Statement Nos. 25, 43, and 50. GASB Statement No. 75, *Accounting and Financial Reporting for Postemployment Benefits Other Than Pensions*, establishes new accounting and financial reporting requirements for governments whose employees are provided with OPEB, as well as for certain nonemployer governments that have a legal obligation to provide financial support for OPEB provided to the employees of other entities.

This statement will improve financial reporting primarily through enhanced note disclosures and schedules of RSI that will be presented by OPEB plans administered through trusts meeting the specified criteria. The new information will enhance the decision-usefulness of the financial reports of those OPEB plans, their value for assessing accountability, and their transparency by providing information about measures of net OPEB liabilities and explanations of how and why those liabilities changed from year to year. The net OPEB liability information, including ratios, will offer an up-to-date indication of the extent to which the total OPEB liability is covered by the fiduciary net position of the OPEB plan. The comparability of the reported information for similar types of OPEB plans will be improved by the changes related to the attribution method used to determine the total OPEB liability. The contribution schedule will provide measures to evaluate decisions related to the assessment of contribution rates in comparison with actuarially determined rates, if such rates are determined. In addition, new information about rates of return on OPEB plan investments will inform financial report users about the effects of market conditions on the OPEB plan’s assets over time and provide information for users to assess the relative success of the OPEB plan’s investment strategy and the relative contribution that investment earnings provide to the OPEB plan’s ability to pay benefits to plan members when they come due.

This statement is effective for financial statements for fiscal years beginning after June 15, 2016. Earlier application is encouraged.

GASB STATEMENT NO. 75, *ACCOUNTING AND FINANCIAL REPORTING FOR POSTEMPLOYMENT BENEFITS OTHER THAN PENSIONS*

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

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

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

GASB STATEMENT NO. 77, *TAX ABATEMENT DISCLOSURES*

This statement requires disclosure of tax abatement information about (1) a reporting government's own tax abatement agreements, and (2) those that are entered into by other governments and that reduce the reporting government's tax revenues. Tax abatements are widely used by state and local governments, particularly to encourage economic development. For financial reporting purposes, this statement defines a tax abatement as resulting from an agreement between a government and an individual or entity in which the government promises to forgo tax revenues and the individual or entity promises to subsequently take a specific action that contributes to economic development or otherwise benefits the government or its citizens.

The requirements of this statement improve financial reporting by giving users of financial statements essential information that is not consistently or comprehensively reported to the public at present. Disclosure of information about the nature and magnitude of tax abatements will make these transactions more transparent to financial statement users. As a result, users will be better equipped to understand (1) how tax abatements affect a government's future ability to raise resources and meet its financial obligations, and (2) the impact those abatements have on a government's financial position and economic condition. The requirements of this statement are effective for financial statements for periods beginning after December 15, 2015. Earlier application is encouraged.

GASB STATEMENT NO. 78, *PENSIONS PROVIDED THROUGH CERTAIN MULTIPLE-EMPLOYER DEFINED BENEFIT PENSION PLANS*

The objective of this statement is to address a practice issue regarding the scope and applicability of GASB Statement No. 68, *Accounting and Financial Reporting for Pensions—an amendment of GASB Statement No. 27.* This issue is associated with pensions provided through certain multiple-employer defined benefit pension plans and to state or local governmental employers whose employees are provided with such pensions. Prior to the issuance of this statement, the requirements of GASB Statement No. 68 applied to the financial statements of all state and local governmental employers whose employees are provided with pensions through pension plans that are administered through trusts that meet the criteria in paragraph 4 of GASB Statement No. 68.

This statement amends the scope and applicability of GASB Statement No. 68 to exclude pensions provided to employees of state or local governmental employers through a cost-sharing, multiple-employer defined benefit pension plan that (1) is not a state or local governmental pension plan, (2) is used to provide defined benefit pensions both to employees of state or local governmental employers and to employees of employers that are not state or local governmental employers, and (3) has no predominant state or local governmental employer (either individually or collectively with other state or local governmental employers that provide pensions through the pension plan). This statement establishes requirements for recognition and measurement of pension expense, expenditures, and liabilities; note disclosures; and RSI for pensions that have the characteristics described above. The requirements of this statement are effective for reporting periods beginning after December 15, 2015. Early application is encouraged.

GASB STATEMENT NO. 79, *CERTAIN EXTERNAL INVESTMENT POOLS AND POOL PARTICIPANTS*

This statement establishes criteria for an external investment pool to qualify for making the election to measure all of its investments at amortized cost for financial reporting purposes. An external investment pool qualifies for that reporting if it meets all of the applicable criteria established in this statement. The specific criteria address (1) how the external investment pool transacts with participants; (2) requirements for portfolio maturity, quality, diversification, and liquidity; and (3) calculation and requirements of a shadow price. Significant noncompliance prevents the external investment pool from measuring all of its investments at amortized cost for financial reporting purposes. If an external investment pool meets the criteria in this statement and measures all of its investments at amortized cost, the pool's participants also should measure their investments in that external investment pool at amortized cost for financial reporting purposes. If an external investment pool does not meet the criteria in this statement, the pool's participants should measure their investments in that pool at fair value.

This statement establishes additional note disclosure requirements for qualifying external investment pools that measure all of their investments at amortized cost for financial reporting purposes and for governments that participate in those pools. Those disclosures for both the qualifying external investment pools and their participants include information about any limitations or restrictions on participant withdrawals. The requirements of this statement are effective for reporting periods beginning after June 15, 2015, except for certain provisions on portfolio quality, custodial credit risk, and shadow pricing. Those provisions are effective for reporting periods beginning after December 15, 2015. Earlier application is encouraged.

GASB STATEMENT NO. 80, *BLENDING REQUIREMENTS FOR CERTAIN COMPONENT UNITS—AN AMENDMENT OF GASB STATEMENT NO. 14*

The objective of this statement is to clarify the financial statement presentation requirements for certain component units. This statement amends the blending requirements for the financial statement presentation of component units of all state and local governments. The additional criterion requires blending of a component unit incorporated as a not-for-profit corporation in which the primary government is the sole corporate member. The additional criterion does not apply to component units included in the financial reporting entity pursuant to the provisions of GASB Statement No. 39, *Determining Whether Certain Organizations Are Component Units—an amendment of GASB Statement No. 14.* The requirements of this statement are effective for reporting periods beginning after June 15, 2016. Earlier application is encouraged.

GASB STATEMENT NO. 82, *PENSION ISSUES—AN AMENDMENT OF GASB STATEMENTS NO. 67, NO. 68, AND NO. 73*

The objective of this statement is to address certain issues that have been raised with respect to Statements No. 67, *Financial Reporting for Pension Plans*, No. 68, *Accounting and Financial Reporting for Pensions,* and No. 73, *Accounting and Financial Reporting for Pensions and Related Assets That Are Not Within the Scope of GASB Statement 68, and Amendments to Certain Provisions of GASB Statements 67 and 68*. Specifically, this statement addresses issues regarding (1) the presentation of payroll-related measures in RSI, (2) the selection of assumptions and the treatment of deviations from the guidance in an Actuarial Standard of Practice for financial reporting purposes, and (3) the classification of payments made by employers to satisfy employee (plan member) contribution requirements.

The requirements of this statement are effective for reporting periods beginning after June 15, 2016, except for the requirements of this statement for the selection of assumptions in a circumstance in which an employer's pension liability is measured as of a date other than the employer's most recent fiscal year-end. In that circumstance, the requirements for the selection of assumptions are effective for that employer in the first reporting period in which the measurement date of the pension liability is on or after June 15, 2017. Earlier application is encouraged.

The requirements of this statement will improve financial reporting by enhancing consistency in the application of financial reporting requirements to certain pension issues.

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