Management Report

for

Independent School District No. 194
Lakeville, Minnesota
June 30, 2007

CERTIFIED PUBLIC ACCOUNTANTS

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To the School Board of
Independent School District No. 194
Lakeville, Minnesota

We have prepared this management report in conjunction with our audit of Independent School District No. 194's (the District) financial records for the year ended June 30, 2007. 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
- Accounting and Reporting Updates
- Legislative Summary

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.

This report is intended solely for the information and use of management and those who have responsibility for oversight of the financial reporting process.

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

October 4, 2007

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AUDIT SUMMARY

We hereby provide you with the following 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 audit committee of the District.

Our Responsibility Under Auditing Standards Generally Accepted in the United States of America and OMB Circular A-133

Our responsibility, as described by professional standards, is to plan and perform our audit to obtain reasonable, but not absolute, assurance about whether the financial statements are free of material misstatement and are fairly presented in accordance with accounting principles generally accepted in the United States of America. Because an audit is designed to provide reasonable, but not absolute, assurance and because we did not perform a detailed examination of all transactions, there is a risk that material misstatements may exist and not be detected by us.

In planning and performing our audit, we considered the District's internal control over financial reporting in order to determine our auditing procedures for the purpose of expressing our opinions on the financial statements and not to provide assurance on the internal control over financial reporting. We also considered internal control over compliance with requirements that could have a direct and material effect on a major federal program in order to determine our auditing procedures for the purpose of expressing our opinion on compliance and to test and report on internal control over compliance.

As part of obtaining reasonable assurance about whether the District's financial statements are free of material misstatement, we performed tests of its compliance with certain provisions of laws, regulations, contracts, and grants, noncompliance with which could have a direct and material effect on the determination of financial statement amounts. However, providing an opinion on compliance with those provisions was not an objective of our audit. We also examined, on a test basis, evidence about the District's compliance with compliance requirements applicable to each of its major federal programs for the purpose of expressing an opinion on the District's compliance with those requirements. While our audit provides a reasonable basis for our opinion, it does not provide a legal determination on the District's compliance with those requirements.

Audit Opinion and Findings

Based on our audit of the District's financial statements for the year ended June 30, 2007:

- We have issued an unqualified opinion on the District's annual financial statements.
- We noted no matters involving the District's internal control over financial reporting that we consider to be significant deficiencies or material weaknesses.
- The results of our testing disclosed no instances of noncompliance that are required to be reported under *Government Auditing Standards*.
- We noted that the Schedule of Expenditures of Federal Awards is fairly stated, in all material respects, in relation to the basic financial statements.
- The results of our tests indicate that the District has complied, in all material respects, with the requirements applicable to each major federal program.
- We noted no matters involving the internal control over compliance and its operation that we consider to be material weaknesses in our testing of major federal programs.
- There was one Minnesota Legal Compliance Finding in the current year. Minnesota Statute § 471.425, Subd. 4a, states that district contracts must require the prime contractor to pay any subcontractor within 10 days of the prime contractor's receipt of payment from the District. The requirement was not included in all contracts entered into during the year.

Significant Accounting Policies

Management is responsible for the selection and use of appropriate accounting policies. We advise management about the appropriateness of accounting policies and their application. The District's accounting policies follow accounting principles generally accepted in the United States of America, as explained in detail in Note 1 of the notes to basic financial statements. There were no significant changes in the District's accounting policies during the year ended June 30, 2007. We noted no transactions entered into by the District during the year that were both significant and unusual, and of which, under professional standards, we are required to inform you, or transactions for which there is a lack of authoritative guidance or consensus.

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 fiscal year 2007 is not finalized until well into fiscal year 2008. 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.

Accounts payable and accounts receivable amounts related to tuition billings to other school districts are computed using formulas derived by the Minnesota Department of Education (MDE). Because of the timing of the calculations, the billings for fiscal 2007 are not finalized until after the District has closed its financial records for the fiscal period. The revenues and expenditures related to the billings are calculated using preliminary information available to the District on non-resident students attending the District and resident students attending other districts.

The District has recorded a liability in the Statement of Net Assets for severance and health 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 uses estimates of useful lives for the depreciation of capital assets.

Management expects any differences between estimates and actual amounts of these estimates to be insignificant. We reviewed and tested management's procedures and underlying supporting documentation in the area discussed above. We concluded that the accounting estimates and management judgments appeared to consider all significant factors and resulted in appropriate accounting recognition.

Audit Adjustments

For purposes of this letter, professional standards define an audit adjustment as a proposed correction of the financial statements that, in our judgment, may not have been detected except through our auditing procedures. An audit adjustment may or may not indicate matters that could have a significant effect on the District's financial reporting process (that is, cause future financial statements to be materially misstated). In our judgment, none of the adjustments we proposed, whether recorded or unrecorded by the District, either individually or in the aggregate, indicate matters that could have a significant effect on the District's financial reporting process.

During the fiscal 2007 audit, we identified known uncorrected financial statement misstatements (passed adjustments). These passed adjustments included approximately $28,000 of unrecorded accounts payable and about $46,000 of unrecorded arbitrage liabilities.

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 recorded cash transactions of these accounts for the year ended June 30, 2007.

We also issued a report on compliance with the MDE's *Manual for Activity Fund Accounting*, in which we reported the following findings:

- Certain accounts of the District's extracurricular student activities do not meet the definition of an extracurricular student activity as defined in the *Manual for Activity Fund Accounting*.
- Certain accounts of the District's extracurricular student activities are inactive and should be closed.
- Cash receipts accounted for by the District as student activity revenue were not deposited to the bank on a timely basis.
- Certain cash receipts and cash disbursements within the student activity accounts were not properly approved by the appropriate building official or designee and/or lacked original vendor invoices and/or backup documentation.

Segregation of Duties

We want to take this opportunity to remind management and the School Board of the importance of internal controls and segregating accounting duties and responsibilities. In recent years, school districts have experienced growing pressures in managing public funds. These pressures have come by the way of higher levels of public awareness, transparency of governmental finances, and new auditing standards, including the fraud standard and the SAS Suite. As part of our audit we consider the adequacy of numerous components of the District's internal controls over financial reporting. It should be understood that internal controls are never perfected, and those controls which protect the District's funds from such things as fraud and accounting errors need to be continually reviewed by your management and modified as necessary.

Internal Controls

The School Board sets the tone, educates employees about the importance of internal controls, and provides funding to implement the controls. Even the best designed internal controls cannot be effective without the active involvement of management. The governing body must ensure that internal controls remain a top management priority. Management can develop a favorable control environment by setting a positive tone, communicating to all employees the importance of internal controls, and taking appropriate action against staff who are not complying with approved internal control policies and procedures. Management should also encourage staff to communicate situations not addressed by the policies and procedures, so that policies and procedures may be adopted as necessary.

Management is responsible for evaluating the effectiveness of internal controls on an ongoing basis. Proper documentation of control procedures is essential. Written policies and procedures outline the specific authority and responsibility of individual employees, providing for accountability. Written polices serve as a reference and training tool for new employees and ensure that procedures remain in place despite employee turnover. To be effective, an accounting policies and procedures manual must be complete, up-to-date, and readily available to all employees who need it.

Other Matters

Auditing standards also require us to consider the following topics as potential areas that might need to be communicated to the appropriate officials or committee:

- Other information in documents containing audited financial statements
- Disagreements with management
- Consultations with other accountants
- Major issues discussed with management prior to retention as auditors
- Difficulties encountered in performing the audit

During our audit, we did not encounter any circumstances and we are unaware of any items in any of these areas which require discussion with those who have responsibility for oversight of the financial reporting process.

Condition of Financial Records

We found, as in the past, the District's financial records to be in good condition. The District has completed its financial records quickly after year-end and, as a result, is one of the first audits we issue each year for our school district clients.

FUNDING PUBLIC EDUCATION IN MINNESOTA

Improvements in the economy and financial condition of the state have resulted in some additional funding to schools in recent years. Changes in the "tax shift" and aid metering system in recent years have eased districts' cash flow, and fewer districts are reliant on short-term borrowing. Coupled with increasing interest rates, this improvement in cash flow has also provided districts an opportunity for enhanced investment revenue. While these improvements were welcome, it will continue to be a challenge to meet the educational needs of our children, while weighing the costs to the public.

Due to its complexity, it would be impossible to fully explain the funding of public education in Minnesota within this report. The last section of this report, which contains a summary of legislative changes affecting school districts, gives an indication of how complicated the funding system is. The following 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 few years. We have adjusted the percentage change from year to year for non-comparable changes such as referendum reduction and aids that were previously separately funded and subsequently "rolled-in" or "rolled-out" to general education revenue. We have also included state-wide General Fund revenue per un-weighted ADM as calculated by the MDE.

	Formula Allowance		State Calculated Revenue per ADM (2)	
School Year	Amount	Percent Increase	Amount	Percent Increase
2000–2001	$ 3,964	4.1 % (1)	$ 7,057	6.1 %
2001–2002	$ 4,068	2.6 %	$ 7,247	2.7 %
2002–2003	$ 4,601	2.3 % (1)	$ 7,712	6.4 %
2003–2004	$ 4,601	– %	$ 7,898	2.4 %
2004–2005	$ 4,601	– %	$ 7,996	1.2 %
2005–2006	$ 4,783	4.0 %	$ 8,319	4.0 %
2006–2007	$ 4,974	4.0 %	$ 8,794	5.7 %
2007–2008	$ 5,074	2.0 %	$ 9,384 (3)	6.7 % (3)
2008–2009	$ 5,124	1.0 %	$ 9,650 (3)	2.8 % (3)

(1) Percentage adjusted to eliminate changes caused by referendum reduction; rolled-in (out) aids which do not affect total district revenue

(2) Includes General Fund state aids, tax credits, tax levies, and referendums

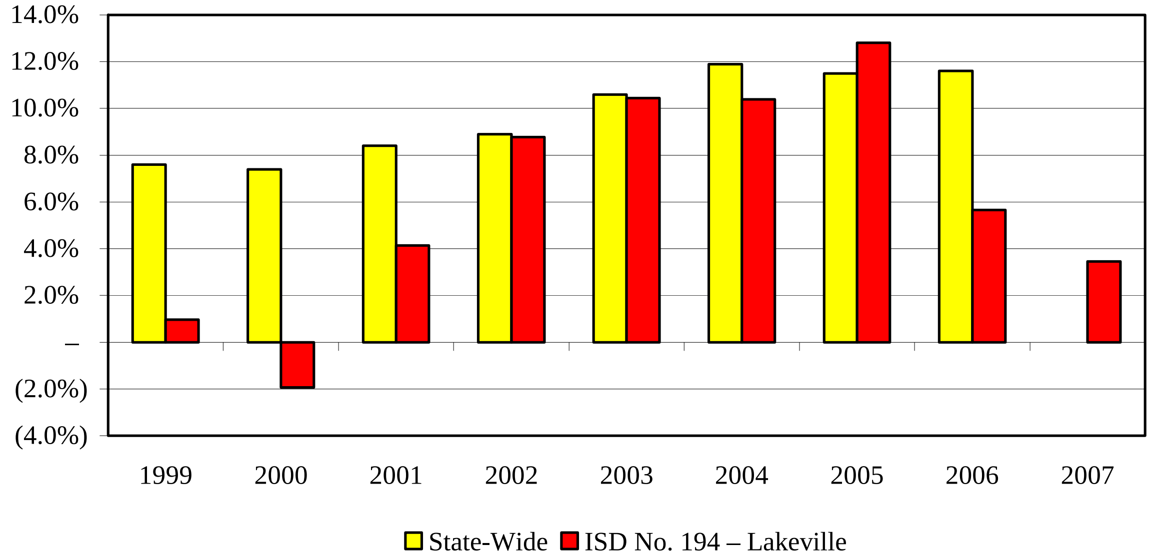
(3) Estimated

The major difference between the formula increases and the state calculated increases are operating referendums, including a projection of those that might pass in the fall of 2007.

STATE-WIDE SCHOOL DISTRICT FINANCIAL HEALTH

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

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



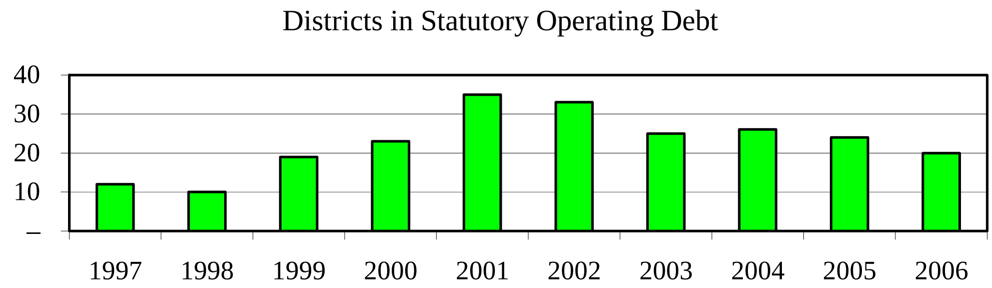
Note: State-wide information is not available for fiscal 2007.

For years prior to 2001, the percentage calculation includes all of the unreserved operating funds and certain particular reserved fund balances. The more recent years reflect only the unreserved fund balance of the General Fund and the corresponding expenditures, which is the same method which the state now uses for the calculation of statutory operating debt (SOD). We have also included the comparable percentages for your district starting with 1999.

Even with limited funding increases, school districts have improved their unreserved fund balances on a state-wide basis from 2000 to 2004. This may be the result of districts adapting to the funding restrictions, in some cases community support in the way of operating referendums, and other factors. Another element may be the unreserved fund balances in charter schools which are included in the state-wide numbers. State-wide unreserved fund balances turned towards a downward trend in 2005 and a slight improvement in 2006.

As the graph shows, the District has been experiencing a steady decline in this calculation in recent years.

Once a school district reaches a certain level of financial concern, as determined by state guidelines, it is considered in "Statutory Operating Debt" (SOD). This requires the District to establish and follow a plan of financial recovery, overseen by the MDE. The following chart shows the number of Minnesota school districts in SOD over the past 10 years:



The table below shows a comparison of total 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, refunding bond debt service fund activity, Internal Service Fund, and fiduciary funds. Also, proceeds from sales of real property and equipment; insurance recoveries; and sales of bonds, loans, and interfund transfers are not included.

Revenue per Student (ADM) Served

	State-Wide		Seven-County Metro Area		ISD No. 194 – Lakeville		
	2005	2006	2005	2006	2005	2006	2007
General Fund							
Property taxes	$ 776	$ 545	$ 1,086	$ 747	$ 984	$ 744	$ 1,112
Other local sources	442	520	374	439	151	181	177
State	6,996	7,545	7,087	7,741	6,509	6,965	6,965
Federal	446	464	456	476	199	213	206
Special revenue funds							
Food service	382	398	386	401	394	405	423
Community service	399	421	491	511	427	448	463
Debt Service Fund	807	879	872	946	966	957	1,066
Total revenue	$10,248	$10,772	$10,752	$11,261	$ 9,630	$ 9,913	$10,412
ADM served and tuition paid					10,678	10,930	11,088

Note: Excludes Capital Projects – Building Construction Fund, refunding bond debt service activity, Internal Service Fund, and fiduciary funds

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

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 receives less funding from state sources as compared to the average district. Consequently, the District relies more on property taxes and other funding sources to finance its schools than the average Minnesota school district. The District also receives a considerable amount less in total revenue per student than the average district.

The table below reflects comparative data available from the MDE for all expenditures, excluding building construction, refunding bond debt service fund activity, Internal Service Fund, and fiduciary funds:

Expenditures per Student (ADM) Served

	State-Wide		Seven-County Metro Area		ISD No. 194 – Lakeville		
	2005	2006	2005	2006	2005	2006	2007
Administration	$ 362	$ 376	$ 353	$ 366	$ 496	$ 546	$ 538
District support services	364	369	379	378	209	213	222
Elementary and secondary regular instruction	4,054	4,191	4,163	4,313	3,464	3,785	3,922
Vocational education instruction	130	133	122	127	36	53	58
Special education instruction	1,533	1,632	1,670	1,771	1,462	1,623	1,665
Instructional support services	382	405	441	458	324	340	354
Pupil support services	710	741	760	800	810	871	925
Sites, buildings, and other	716	769	673	727	678	781	766
Total General Fund operating expenditures	8,251	8,616	8,561	8,940	7,479	8,212	8,450
General Fund capital expenditures	431	453	401	438	414	189	168
Food service	387	396	389	395	360	428	422
Community service	407	427	498	517	412	459	457
Debt service	833	1,057	894	1,125	907	1,204	1,399
Total expenditures	$10,309	$10,949	$10,743	$11,415	$ 9,572	$10,492	$10,896
ADM served and tuition paid					10,678	10,930	11,088

Note: Excludes Capital Projects – Building Construction Fund, refunding bond debt service activity, Internal Service Fund, and fiduciary 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. For example, one district may pay tuition to a cooperative that provides vocational or special education services for its students, while another may serve those students within the district, or even act as a host for other districts and receive tuition. Other 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.

As the table reflects, the District has traditionally expended less per ADM on general operating costs and total costs than the state-wide averages. In 2007, the expenditures per ADM increased $404. Most of this increase was for elementary and secondary regular instruction and debt service on the new high school bond issues.

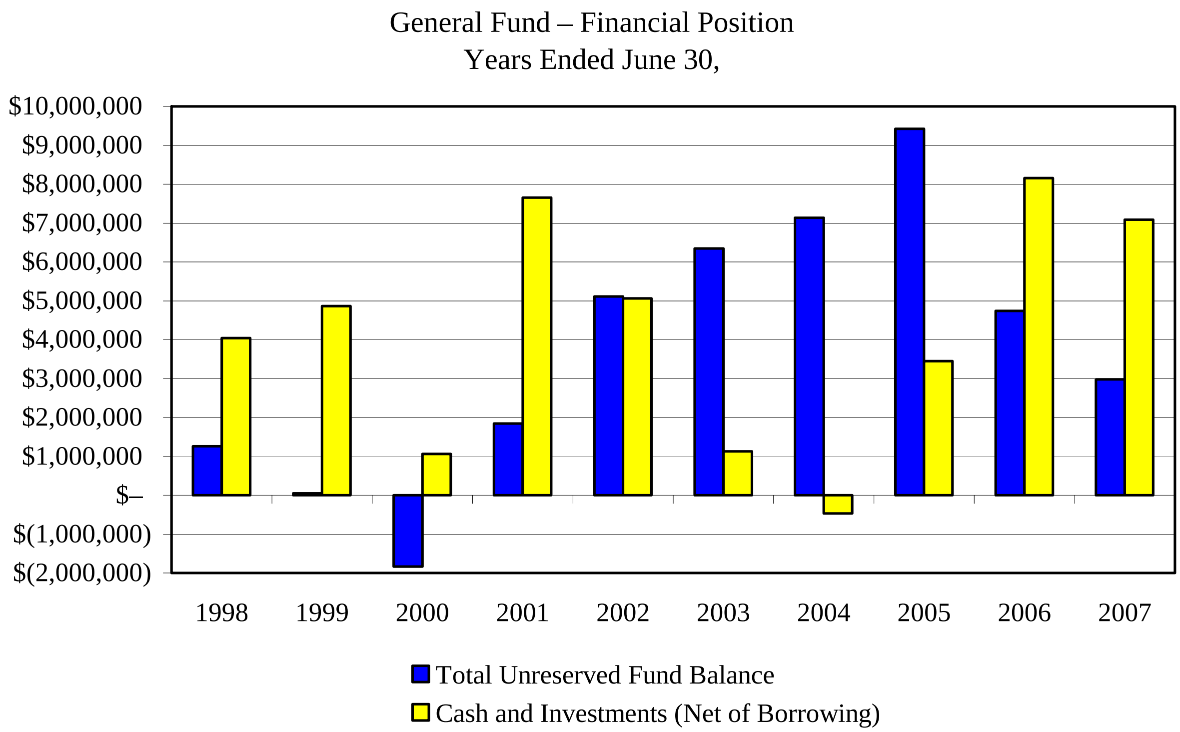
SUMMARY

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 has created a challenge for 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. Unreserved fund balance and cash balance are typically used as indicators of financial health or equity.



The District's General Fund ended fiscal year 2007 with unreserved fund balance of $2,976,792, a decrease of $1,762,892 from the prior year. The cash and investment balance, net of borrowing at year-end, was $7,088,878, down $1,068,629 from the prior year

The decline in fund balance and cash balance in the General Fund was the result of a planned decline as the District's General Fund budget planned for a decline in total fund balance of about $4,500,000.

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

	Year Ended June 30,				
	2003	2004	2005	2006	2007
Reserved fund balance	$ 1,372,814	$ 1,054,281	$ 737,885	$ 1,771,460	$ 1,433,597
Unreserved – designated fund balance	1,658,669	1,866,046	1,913,382	1,849,025	1,804,227
Unreserved – undesignated fund balance	4,890,956	5,272,139	7,511,025	2,890,659	1,172,565
Total fund balance	$ 7,922,439	$ 8,192,466	$ 10,162,292	$ 6,511,144	$ 4,410,389
Unreserved – undesignated fund balance as a percentage of expenditures	6.9%	6.9%	8.9%	3.1%	1.2%
Total unreserved fund balance as a percentage of expenditures	9.3%	9.4%	11.2%	5.1%	3.1%

Unreserved fund balance as a percentage of expenditures is one key measure of a school district's financial health. The resources represented by this fund balance are critical to a district's ability to maintain adequate cash flow throughout the year, to retain its programs, and to cushion against the impact of unexpected costs or funding shortfalls. At June 30, 2007, the unreserved fund balance in the General Fund represented 3.1 percent of annual expenditures, or less than two weeks of operations, assuming level spending throughout the year.

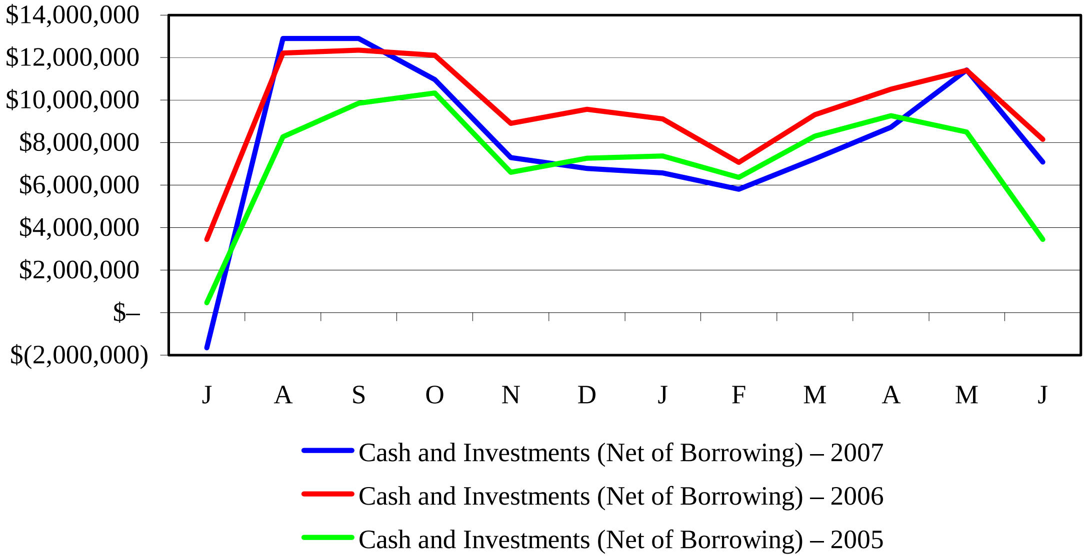
The preceding table and graph illustrate the declining financial position of the General Fund in recent years, specifically the unreserved portion of fund balance. The District will need to continue to closely monitor its financial condition as continuation of this declining fund balance will quickly result in deficit fund balances in the District.

Through legislative changes in funding, public school districts have become extremely dependent on state revenues to finance operations. Considering the demands placed on the state's resources, we believe it is particularly important to maintain an adequate level of fund balance. We want to stress the importance of maintaining an adequate fund balance and suggest that the District implement measures to maintain or improve its fund balance. We understand it is difficult to justify building any kind of fund balance surplus when faced with minimal funding increases and significant budget reductions year after year, which inevitably means increased reductions or increased fees charged to participants.

GENERAL FUND CASH FLOW

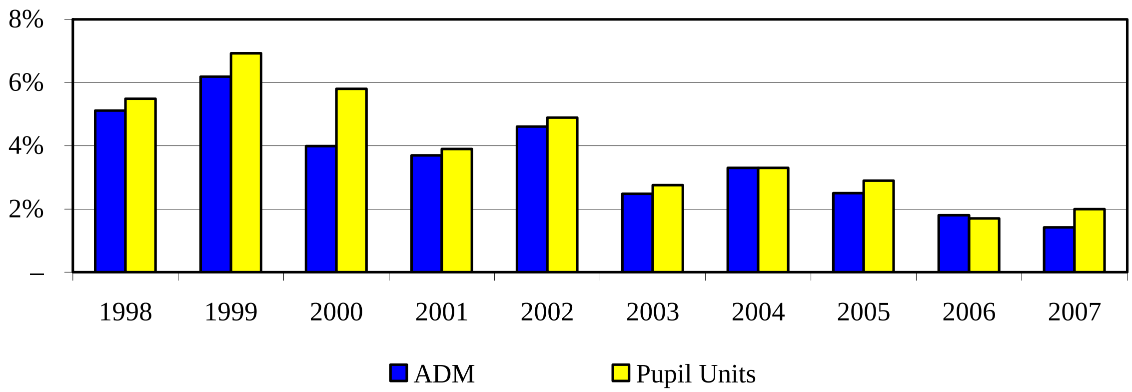
The level of cash and investments varies considerably during the year due to the timing of various revenues and expenditures. The following graph summarizes the level of cash and investments (net of borrowing) over the past three years:

General Fund Cash Flow
Month-End Balances



The graph above shows the peaks and valleys of the General Fund cash and investments balance (net of borrowing) on a monthly basis. The District's cash flow balances during fiscal 2007 were lower than the prior year which was caused by the District having a lower General Fund balance.

Change in ADM and Pupil Units

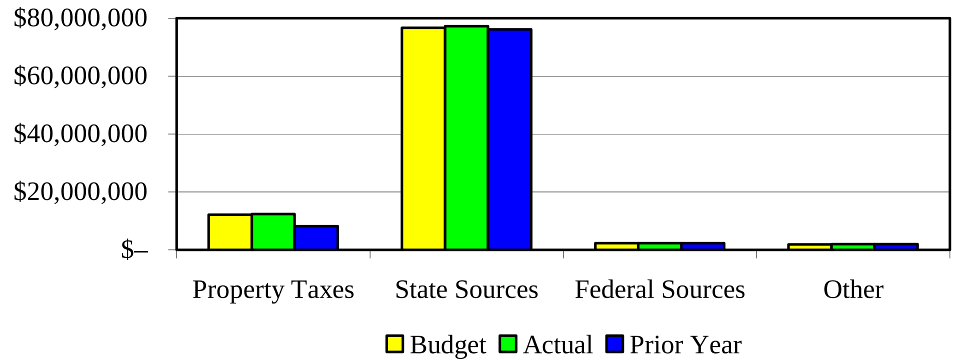


ADM is a measure of students attending class, which is then converted to pupil units (the base for determining revenue) using a statutory formula. Not only is the original budget based on ADM estimates, the final audited financial statements are based on updated, but still estimated, ADM since the counts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

GENERAL FUND REVENUE AND EXPENDITURES

The following graphs summarize the District's General Fund revenue and expenditures for 2007:

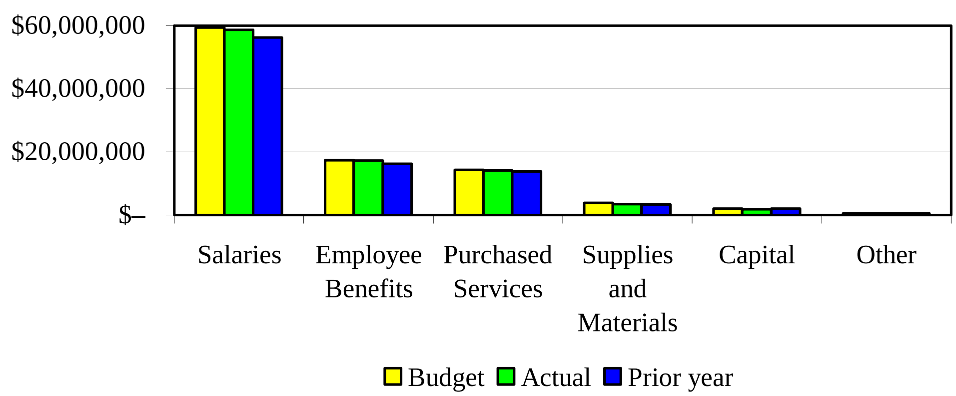
General Fund Revenue



Total General Fund revenues for 2007 were $93,807,153, an increase of $5,239,657 from the prior year, and $772,524 over budget. A large percentage of the increase ($3,780,000) in revenues compared to fiscal 2006 is related to an increase in the basic formula allowance in fiscal 2007 and the increase in the number of students served. The District also received more special education aid in fiscal 2007 of about $800,000. During 2007, the District also qualified for additional equity aid which provided $590,000 in additional revenue.

Revenues were over budgeted amounts mainly due to general education aid being slightly higher than anticipated and interest earnings being more than budgeted.

General Fund Expenditures



Total General Fund expenditures for 2007 were $95,908,758, an increase of $3,684,439 or 4.0 percent from the prior year, and $1,612,338 under budget.

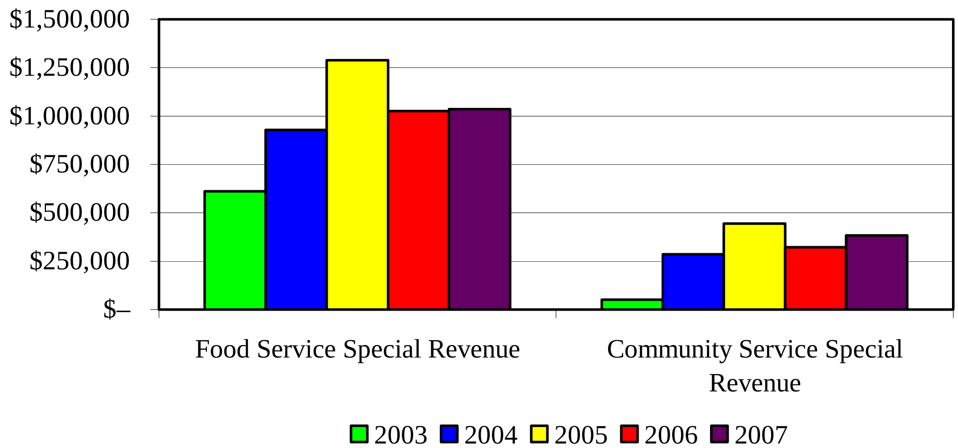
Expenditures were higher in 2007 mainly in salaries and benefits. Salary costs increased in regular instruction as the District served additional students and provided inflationary salary increases. Employee benefit costs continued to increase with matching programs and with health insurance having the highest increase. Special education salaries and benefits also experienced a significant increase in 2007. The District's transportation costs also increased in 2007 as total costs increased about 12.5 percent.

Expenditures were under budgeted amounts in most program areas of the District. A few of the largest budget savings were in the sites and buildings program area where custodial salary costs and fuel costs were lower than anticipated.

OTHER GOVERNMENTAL FUNDS

The following graph shows what is referred to as the other operating funds. The remaining non-operating 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.

Other Governmental Funds
Fund Balances – Last Five Fiscal Years



FOOD SERVICE SPECIAL REVENUE FUND

The District's Food Service Special Revenue Fund's financial condition has been stable for the past several years. In 2007, the $8,951 increase in fund balance was $90,299 better than the planned decrease in fund balance.

Over the years we have emphasized to our school district clients that food service operations should be self-sustaining, and should not become an additional burden on general education funds. This would include the accumulation of fund balance for future capital improvements to food service facilities and to provide a cushion in the event of a negative trend in operations.

COMMUNITY SERVICE SPECIAL REVENUE FUND

The District's Community Service Special Revenue Fund experienced an increase in fund balance of $61,349 for the year ended June 30, 2007, which was $129,643 more than the $68,294 planned decrease in fund balance.

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

CAPITAL PROJECTS – BUILDING CONSTRUCTION FUND

The District utilized $2,793,727 of capital funds during fiscal 2007, leaving $1,570,500 of alternative facility funds and $2,634,507 of building bond proceeds as of June 30, 2007.

DEBT SERVICE FUND

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

DISTRICT-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 Accounting Standards Board (GASB) Statement No. 34 reporting model also requires the inclusion of two district-wide financial statements designed to present a clear picture of the District as a single, unified entity. These district-wide statements provide information on the total cost of delivering educational services, including capital assets and long-term liabilities.

Theoretically, net assets represent the resources the District has leftover to use for providing services after its debts are settled. However, those resources are not always in expendable form, or there may be restrictions on how some of those resources can be used. Therefore, the statement divides the net assets into three components: net assets invested in capital assets, net of related debt; restricted net assets; and unrestricted net assets. The following table presents components of the District's net assets at year-end, along with a simplified reconciliation of the difference between the governmental fund balances and total net assets for each of the last three fiscal years:

	As of June 30,		
	2005	2006	2007
Total fund balances – governmental funds	$ 81,554,262	$ 73,010,906	$ 143,688,596
Net assets – governmental activities			
Capital assets, less accumulated depreciation	152,185,159	151,565,607	145,867,804
Long-term liabilities	(297,312,668)	(294,965,273)	(363,017,361)
Accrued interest payable	(2,744,421)	(3,650,562)	(5,333,704)
Unamortized debt issue discounts	44,744,517	41,323,597	37,081,411
Other	217,792	168,882	271,676
Total net assets – governmental activities	$ (21,355,359)	$ (32,546,843)	$ (41,441,578)
Net assets			
Invested in capital assets, net of related debt	$ (23,509,348)	$ (29,181,354)	$ (32,273,825)
Restricted	2,415,757	2,982,697	2,740,162
Unrestricted	(261,768)	(6,348,186)	(11,907,915)
Total net assets	$ (21,355,359)	$ (32,546,843)	$ (41,441,578)

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

Total net assets decreased by $8,894,735. The unrestricted portion decreased by $5,559,729, primarily due to the decrease in the General Fund balance, increases in severance and health benefit obligations, and the large amount of deep discount debt the District has outstanding.

ACCOUNTING AND REPORTING UPDATES

GASB STATEMENT NO. 43 – FINANCIAL REPORTING FOR POST-EMPLOYMENT BENEFIT PLANS OTHER THAN PENSION PLANS AND GASB STATEMENT NO. 45 – ACCOUNTING AND FINANCIAL REPORTING BY EMPLOYERS FOR POST-EMPLOYMENT BENEFITS OTHER THAN PENSIONS

These related statements provide new guidance on accounting and financial reporting of post-employment benefits accounted for in trust funds included in the financial statements of plan sponsors or employers, and employer accounting and reporting for post-employment benefits other than pensions by employers when the plan is not accounted for in their financial statements.

Other post-employment benefits (OPEB) refer to non-pension benefits provided after the termination of employment. One example of this type of benefit is healthcare premiums paid by employers on behalf of former employees. Governmental entities have traditionally accounted for OPEB on a pay-as-you-go basis. Only a few governments have funded these benefits in advance of payment. The guidance in these statements rests on the assumption that OPEB should be accrued as an expense as service is provided by employees.

For governments offering OPEB, the cost would be recognized using a three-step approach. The government will be required to project future benefits, discount those benefits to their present value, then use an acceptable actuarial method to allocate costs to individual accounting periods.

Once calculated, the difference between the present value of OPEB benefits earned by employees as the result of past service and resources set aside to pay those benefits will be considered the "unfunded actuarial liability for OPEB." Every employer will be allowed to start fresh at the time of transition to the new standard. There will be no requirement for an employer to recognize an accounting liability for underfunding prior to the implementation of the new standard. Instead, the unfunded actuarial accrued liability for OPEB at transition would be amortized over 30 years. As long as an employer funds the full amount of required contribution, no asset or liability will be reported on the Statement of Net Assets. However, an employer will need to report an asset or liability if the contributions are less or more than the annual required contribution each year.

Nothing in the documents is intended to alter the normal application of modified accrual accounting in the governmental funds of the entity. Thus, OPEB expenditures normally would be recognized when payments are made to the former employees rather than when benefits are earned.

The guidance will require that actuarial valuations for OPEB occur at least every two years for plans with 200 or more members, and every three years for plans with fewer than 200 members. A sole employer plan with fewer than 100 plan members has the option to apply a simplified alternative measurement method rather than obtain actuarial valuations.

These statements will become effective in three phases based on the same criteria as those defined for the implementation of GASB Statement No. 34. GASB Statement Nos. 43 and 45 will be phased in for districts over a three-year period, starting with category one districts in the fiscal years ending June 30, 2007 and 2008, respectively.

GASB STATEMENT NO. 47 – ACCOUNTING FOR TERMINATION BENEFITS

GASB Statement No. 47 provides accounting and reporting guidance for state and local governments that offer benefits such as early retirement incentives or severance to employees that are involuntarily terminated. The statement requires that similar forms of termination benefits be accounted for in the same manner and is intended to enhance both the consistency of reporting for termination benefits and the comparability of financial statements.

GASB Statement No. 47 is effective for financial statements for periods beginning after June 15, 2005, or may be implemented simultaneously with GASB Statement No. 45, depending on your circumstances.

GASB Statement No. 50 – Pension Disclosures – an Amendment of GASB Statement Nos. 25 and 27

This statement expands the disclosure requirements for pension plans, similar to those requirements in GASB Statement Nos. 43 and 45. This will require additional discussion on funding status, use of assumptions, and the determination of contribution rates. This statement will be effective for school districts for the year ended June 30, 2008.

Statements on Auditing Standards

The Auditing Standards Board of the AICPA has issued eight new statements on auditing standards. These statements establish standards and provide guidance concerning the auditor's assessment of the risks of material misstatement (whether caused by error or fraud) in a financial statement audit, and the design and performance of audit procedures whose nature, timing, and extent are responsive to the assessed risks. Additionally, the statements establish standards and provide guidance on planning and supervision, the nature of audit evidence, and evaluating whether the audit evidence obtained affords a reasonable basis for an opinion regarding the financial statements under the audit.

The primary objective of these statements is to enhance the auditors' application of the audit risk model in practice by specifying, among other things:

- More in-depth understanding of the entity and its environment, including its internal control, to identify the risks of material misstatement in the financial statements and what the entity is doing to mitigate them.
- More rigorous assessment of the risks of material misstatement of the financial statements based on that understanding.
- Improved linkage between the assessed risks and the nature, timing, and extent of audit procedures performed in response to those risks.

Essentially, these statements are a continuation of the profession's efforts to reestablish public confidence in the audit process in light of recent major corporate failures. It is anticipated that in most cases, these new standards will add a substantial amount of time to the typical audit, particularly for new engagements or when first implemented on continuing engagements. These statements are effective for school district audits for the fiscal year ending June 30, 2008; however, earlier application is permitted.

LEGISLATIVE SUMMARY

The following is a brief summary of current legislative changes and issues affecting the funding of Minnesota school districts. More detailed and extensive summaries are available from the MDE.

Basic General Education Revenue – The basic general education formula allowance for fiscal year (FY) 2007 increased by $191 (4 percent) per adjusted marginal cost pupil unit (AMCPU) and will increase $100 (2 percent) in FY 2008 and $50 (1 percent) in FY 2009.

Kindergarten Pupil Unit Weighting – Beginning in FY 2008, the pupil unit weighting for kindergarten increases from 0.557 to 0.612. The additional revenue generated by this increase is unrestricted general education revenue.

Gifted and Talented Revenue – The gifted and talented revenue increased from $4 in FY 2006 to $9 in FY 2007 and will increase to $12 in FY 2008 per AMCPU. Districts now must adopt procedures for the academic acceleration of gifted and talented students.

Alternative Teacher Compensation Revenue (Q Comp) – The alternative teacher compensation revenue remains at $260 per pupil, but in 2010 the state paid portion of this aid decreases by $21 per pupil and the equalized levy portion increases by that same amount.

Equity Revenue – Beginning in FY 2008, districts with referendum revenue per AMCPU above the regional 95th percentile will receive the same equity revenue as other districts, an increase from $23 to $46 per AMCPU.

Alternative Attendance Adjustment – This is a change beginning in FY 2008, in the calculation of the revenue adjustment for serving districts under open enrollment. This will increase the revenue for certain serving districts meeting various criteria, including cases with open enrollment exceeding 20 percent of resident students.

Tax Base Replacement Aid – Beginning in FY 2008, the tax base replacement aid is rolled into general education aid.

Uses of General Education Revenue – Districts may spend general education revenue for kindergarten and pre-kindergarten. A transfer should be made to the community service special revenue fund if spending this revenue on pre-kindergarten programs.

Safe Schools Levy – Beginning for taxes payable 2008 (revenue in FY 2009), the safe school levy is increased from $27 to $30 per AMCPU. Districts that are members of an intermediate district can levy $10 per AMCPU, which is then passed on to the intermediate district. Also, the eligible uses of this levy are expanded.

Career and Technical Levy – The funding for career and technical programs is changed beginning with the tax levy payable in 2008. Districts with approved programs may levy the lesser of $80 per ADM in Grades 10 through 12 or 25 percent of approved expenditures.

Referendum Equalization – For FY 2007, the first tier of referendum equalization was increased from $500 to $600 per resident marginal cost pupil unit (RMCPU) and $700 in FY 2008 and later.

Special Education Tuition Billing – Beginning in FY 2007, the MDE was required to calculate the tuition amounts and adjust state aids, instead of having individual districts and charter schools calculate and collect tuition billings. Intermediate school districts, cooperatives, and certain specific districts are allowed an exemption from this process until FY 2009.

Special Education and Related Aids – Beginning in FY 2008, the special education–regular and transition–disabled aid formulas are based on current year expenditures rather than the second prior year expenditures. The state-wide funding caps for these two programs are now combined and, together with expanded funding for Part C services, the state-wide imputed growth factors are 27.5 percent for FY 2008, 3.8 percent for FY 2009, 1.9 percent for FY 2010, 6.6 percent for FY 2011, and 4.6 percent per year after that. The state-wide proration factor for special education–regular funding is projected to be 89 percent for FY 2008 and 88 percent for FY 2009.

The state total special education excess cost aid increased from $103,600,000 in FY 2006 to $104,700,000 in FY 2007. Beginning in FY 2008, transition–disabled is included in the formula, and the state-wide imputed growth factors in funding are 5.2 percent for FY 2008, zero percent for FY 2009 through FY 2011, and capped at 2 percent per year for subsequent years.

School Technology and Operating Capital Aid – Qualifies all school districts for one-time technology and operating capital aid equal to $40 for FY 2008 and $55 for FY 2009 per AMCPU. The aid must be used only for the purposes authorized for operating capital revenue.

Equity in Telecommunications Access Aid – Provides a one-time increase of $3.9 million in FY 2008 and $5.0 million in FY 2009 over the $3.75 million permanent funding base for the program to fully fund the estimated cost of the current telecommunications access formula for the next two years.

Deferred Maintenance Revenue – Beginning in FY 2008, an equalized deferred maintenance levy is available for smaller districts that do not qualify for the alternative facilities bonding and levy program.

Food Service Reimbursements – School lunch reimbursement increased from 10 cents to 10.5 cents for all students in FY 2007 and to 12 cents in FY 2008.

Early Childhood Family Education (ECFE) – ECFE revenue was increased from $104 to $112 times the greater of 150 or the population of students under 5 years old residing in the district in FY 2007 and later.

Community Education – In FY 2007, the community education revenue allowance was increased from $5.23 to $5.42 times the greater of 1,335 or the population of the district. Also effective for FY 2007, the community education levy rate was reduced from .985 to .9 times the adjusted net tax capacity.

Adult Basic Education (ABE) – Districts can carryover up to 20 percent of their ABE aid until September of the following year. State aid for ABE is increased by 3 percent for FY 2007 and beyond.

Adult Literacy Grants – The state appropriated $1.25 million for FY 2007 and FY 2008 for a grant program to meet the English language needs of unanticipated refugees and immigrants.

Advanced Placement Grants – For FY 2007 only, districts could apply for up to $85 per qualified pupil, in a pre-advanced or advanced placement program.

Character Development Education Revenue Pilot Program – This one-time appropriation for FY 2007 allowed districts to receive $30 per AMCPU for approved character development programs.