Management Report

for

Independent School District No. 194
Lakeville, Minnesota
June 30, 2009

CERTIFIED PUBLIC ACCOUNTANTS

PRINCIPALS
Kenneth W. Malloy, CPA
Thomas M. Montague, CPA
Thomas A. Karnowski, CPA
Paul A. Radosevich, CPA
William J. Lauer, CPA
James H. Eichten, CPA
Aaron J. Nielsen, CPA
Victoria L. Holinka, CPA

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, Lakeville, Minnesota's (the District) financial statements for the year ended June 30, 2009. 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 Auditing 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 those charged with governance, the School Board, management, and those who have responsibility for oversight of the financial reporting process and is not intended to be, and should not be, used by anyone other than these specified parties.

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

October 14, 2009

Malloy, Montague, Karnowski, Radosevich & Co., P.A.
5353 Wayzata Boulevard • Suite 410 • Minneapolis, MN 55416 • Telephone: 952-545-0424 • Telefax: 952-545-0569 • www.mmkr.com

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 those charged with governance of the District.

OUR RESPONSIBILITY UNDER AUDITING STANDARDS GENERALLY ACCEPTED IN THE UNITED STATES OF AMERICA, *GOVERNMENT AUDITING STANDARDS*, AND OMB CIRCULAR A-133

We have audited the financial statements of the governmental activities, each major fund, and the aggregate remaining fund information of the District as of and for the year ended June 30, 2009. Professional standards require that we provide you with information about our responsibilities under auditing standards generally accepted in the United States of America, *Government Auditing Standards*, and OMB Circular A-133, as well as certain information related to the planned scope and timing of our audit. We have communicated such information to you verbally and in our letter to you dated June 19, 2009. 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, 2009:

- 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.
- 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 recorded cash transactions of these accounts for the year ended June 30, 2009.

We also issued a report on compliance with the Minnesota Department of Education's (MDE) *Manual for Activity Fund Accounting*, in which we reported four findings related to these accounts having improper activity, inactive accounts, accounts with deficit balances, and cash receipt and disbursement transactions that lacked appropriate documentation, or were for administrative activities not allowed to be paid by student funds.

FOLLOW-UP ON PRIOR YEAR FINDINGS AND RECOMMENDATIONS

As a result of our audit of the District's financial statements for the year ended June 30, 2008, we reported the following findings that were corrected by the District in the current year:

- Management has provided us with descriptions of the internal control policies and procedures in place at the District. Through our audit testing, we were able to review and observe many of these controls to assure they are implemented and functioning as designed. In the prior year, we had noted that most of these policies and procedures were not documented in writing, including governance-level controls such as policies for fraud-risk assessment and monitoring of controls by management and the School Board. The District created the proper internal control documentation in the current year to correct this deficiency.
- During our audit testing in the prior year, we noted that some supervisors did not believe the District had an adequate system in place to identify when and if employees are not adequately recording time. In the prior year we noted one instance where a supervisor was approving timesheets even though the individual felt adequate controls where not in place for the verification of employee time at his site. During our testing in the current year, we noted that this condition has been corrected.
- Minnesota Statute § 118A.03 requires that if a district's deposits exceed federal insurance coverage, excess deposits must be covered by corporate surety bonds or collateral that has a market value of at least 110 percent of such excess. This requirement was not met for the District's deposit account at June 30, 2008. The District maintained the required collateral coverage throughout the current fiscal year.
- The District did not have proper segregation of duties with regard to bank reconciliations. The bank reconciliations were prepared by the bookkeeper who has access to and is an integral part of the controls over cash receipts of the District. During our testing, we noted this condition has been corrected.

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.

The District implemented Governmental Accounting Standards Board (GASB) Statement No. 45, "Accounting and Financial Reporting by Employers for Post-Employment Benefits Other Than Pensions," during the year ended June 30, 2009. This statement provides new guidance on accounting and financial reporting for "other post-employment benefits" (OPEB) accounted for in the financial statements of plan sponsors or employers. This change required the District to report a change in accounting principle adjustment to beginning equity on the government-wide statements as described in Note 1 of the notes to basic financial statements.

The application of remaining policies was not changed during the year. We noted no transactions entered into by the District during the year for which there is a lack of authoritative guidance or consensus. All significant transactions have been recognized in the financial statements in the proper period.

ACCOUNTING ESTIMATES AND MANAGEMENT JUDGMENTS

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

> General education revenue and certain other revenues are computed by applying an allowance per student to the number of students served by the District. Student attendance is accumulated in a state-wide database—MARSS. Because of the complexity of student accounting and because of certain enrollment options, student information is input by other school districts and the MARSS data for fiscal year 2009 is not finalized until well into fiscal year 2010. 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 fiscal 2009 is not finalized until after the District has closed its financial records for the fiscal period. 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 Assets for separation 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 expenditures for OPEB and pension benefits. These obligations are calculated using actuarial methodologies described in GASB Statement Nos. 27 and 45. These actuarial calculations include significant assumptions, including projected changes, healthcare insurance costs, investment returns, retirement ages, and employee turnover.
>
> The depreciation of capital assets involves estimates pertaining to useful lives.

Management expects any differences between estimates and actual amounts of these estimates to be insignificant. We evaluated the key factors and assumptions used by management in the areas discussed above in determining that they are reasonable in relation to the financial statements taken as a whole.

CORRECTED AND UNCORRECTED MISSTATEMENTS

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

During our audit we did not propose any audit adjustments.

DIFFICULTIES ENCOUNTERED IN PERFORMING THE AUDIT

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

DISAGREEMENTS WITH MANAGEMENT

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

MANAGEMENT CONSULTATIONS WITH OTHER INDEPENDENT ACCOUNTANTS

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

OTHER AUDIT FINDINGS OR ISSUES

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

MANAGEMENT REPRESENTATIONS

We have requested certain representations from management that are included in the management representation letter dated October 14, 2009.

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. 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 decade and as approved for the next two fiscal 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.

	Formula Allowance		
School Year	Amount	Percent Increase	
1999–2000	$ 3,740	4.7 %	(1)
2000–2001	$ 3,964	4.2 %	(1)
2001–2002	$ 4,068	2.6 %	
2002–2003	$ 4,601	2.6 %	(1)
2003–2004	$ 4,601	– %	
2004–2005	$ 4,601	– %	
2005–2006	$ 4,783	4.0 %	
2006–2007	$ 4,974	4.0 %	
2007–2008	$ 5,074	2.0 %	
2008–2009	$ 5,124	1.0 %	
2009–2010	$ 5,124	– %	
2010–2011	$ 5,124	– %	

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

As noted in the table above, current legislation has frozen the basic formula allowance at the 2008–2009 fiscal year level for the next two fiscal years. In general, the moderate increases in the formula allowance have forced districts to continually cut expenditure budgets or increase referendum revenue in order to maintain programs.

The table above does not reflect temporary funding changes such as the $51 per pupil unit one-time additional general education aid school districts and charter schools received in 2008–2009, or the technology and operating capital aid received by school districts and charter schools in 2007–2008 ($40 per pupil unit) and 2008–2009 ($55 per pupil unit).

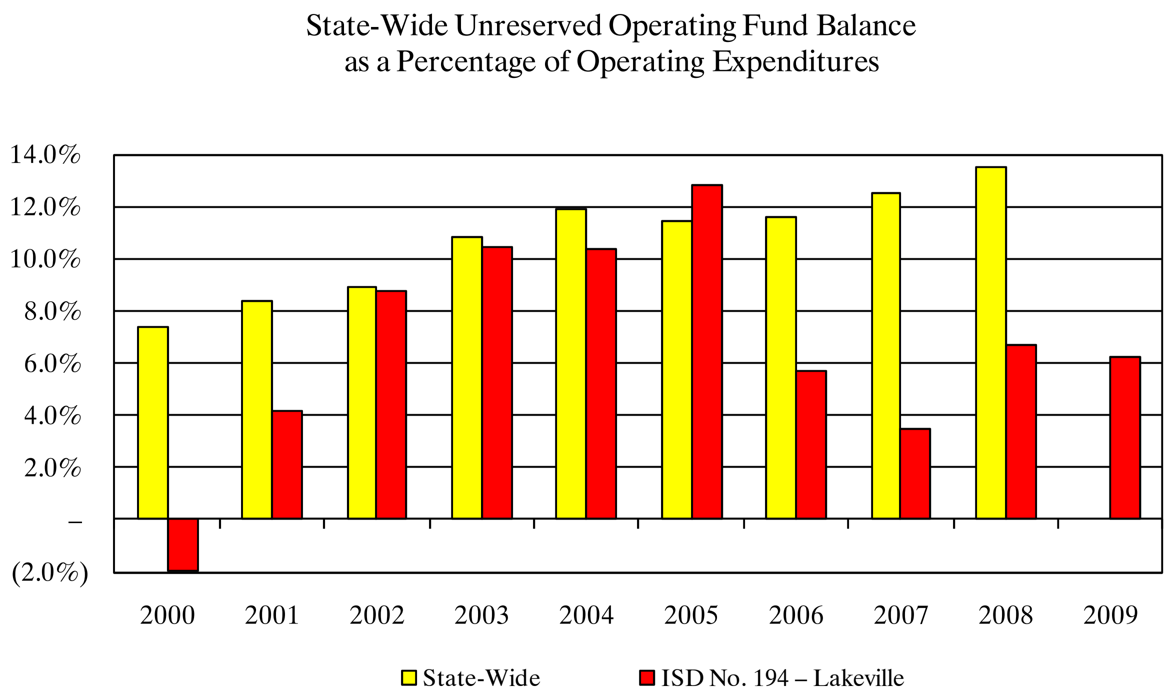
The table also does not reflect a one-time reduction to general education aid in 2009–2010 that will be offset by federal fiscal stabilization funds. The reduction, which will be allocated to school districts and charter schools based on their 2007–2008 general education revenue, amounts to approximately 7.82 percent of this revenue. The reduction will be offset dollar-for-dollar by federal stimulus funds used by the state for fiscal stabilization.

METERING OF STATE AID PAYMENTS

In order to help reduce the state budget deficit, the 2009 Legislature changed the metering of state aid payments to Minnesota school districts and charter schools beginning in 2009–2010. In recent years, districts have been paid 90 percent of their estimated state aid entitlements by June 30 each year, with the remaining 10 percent paid out in the following fiscal year. In 2009–2010, the state will pay only 73 percent of estimated state aid entitlements by year-end, with the remaining 27 percent being paid out in the following fiscal year. This change will not affect the accrual based revenue recorded by districts for the year, but will have a significant impact on their cash flow.

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.



Note: State-wide information is not available for fiscal 2009.

The calculation above reflects 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.

Even with limited funding increases, school districts have maintained a relatively stable unreserved fund balance on a state-wide basis in recent years. This stability may be the result of districts adapting to funding restrictions, effective cost containment measures, in some cases community support in the way of operating referendums, and other factors.

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; proceeds from sales of real property and equipment; insurance recoveries; and sales of bonds, loans, and interfund transfers.

Revenue per Student (ADM) Served

	State-Wide		Seven-County Metro Area		ISD No. 194 – Lakeville		
	2007	2008	2007	2008	2007	2008	2009
General Fund							
Property taxes	$ 1,020	$ 1,160	$ 1,365	$ 1,527	$ 1,112	$ 1,252	$ 1,365
Other local sources	504	487	414	417	177	189	200
State	7,490	7,833	7,613	8,029	6,965	7,179	7,182
Federal	444	456	464	492	206	200	166
Special revenue funds							
Food service	415	433	418	434	423	432	469
Community service	445	474	538	570	463	508	508
Debt Service Fund	938	993	1,032	1,114	1,066	1,152	1,087
Total revenue	$ 11,256	$ 11,836	$ 11,844	$ 12,583	$ 10,412	$ 10,912	$ 10,977
ADM served and tuition paid					11,088	11,192	11,206

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 increase in 2009 of $65 per student is mostly related to increases in property taxes. This increase in the General Fund reflects the growth in the per pupil formula allowance, along with additional state entitlements for the one-time general education increase and others as discussed earlier.

The table below reflects comparative data available from the MDE for all expenditures, excluding the Capital Projects – Building Construction Fund:

Expenditures per Student (ADM) Served

	State-Wide		Seven-County Metro Area		ISD No. 194 – Lakeville		
	2007	2008	2007	2008	2007	2008	2009
Administration	$ 395	$ 412	$ 380	$ 405	$ 538	$ 522	$ 465
District support services	385	399	392	412	222	252	261
Elementary and secondary regular instruction	4,362	4,528	4,523	4,730	3,922	3,908	4,156
Vocational education instruction	131	142	127	141	58	57	64
Special education instruction	1,649	1,703	1,815	1,904	1,665	1,676	1,646
Instructional support services	425	461	481	536	354	329	363
Pupil support services	784	835	857	914	925	809	909
Sites, buildings, and other	782	811	737	778	766	823	824
Total General Fund operating expenditures	8,913	9,291	9,312	9,820	8,450	8,376	8,688
General Fund capital expenditures	451	505	435	494	168	230	267
Food service	415	437	416	432	422	449	435
Community service	446	470	539	564	457	485	489
Debt service	1,077	1,064	1,253	1,015	1,399	1,153	1,110
Total expenditures	$ 11,302	$ 11,767	$ 11,955	$ 12,325	$ 10,896	$ 10,693	$ 10,989
ADM served and tuition paid					11,088	11,192	11,206

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.

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.

As the table reflects, the District has traditionally expended less per ADM on general operating costs and total costs than either the state-wide or the seven-county metro area averages.

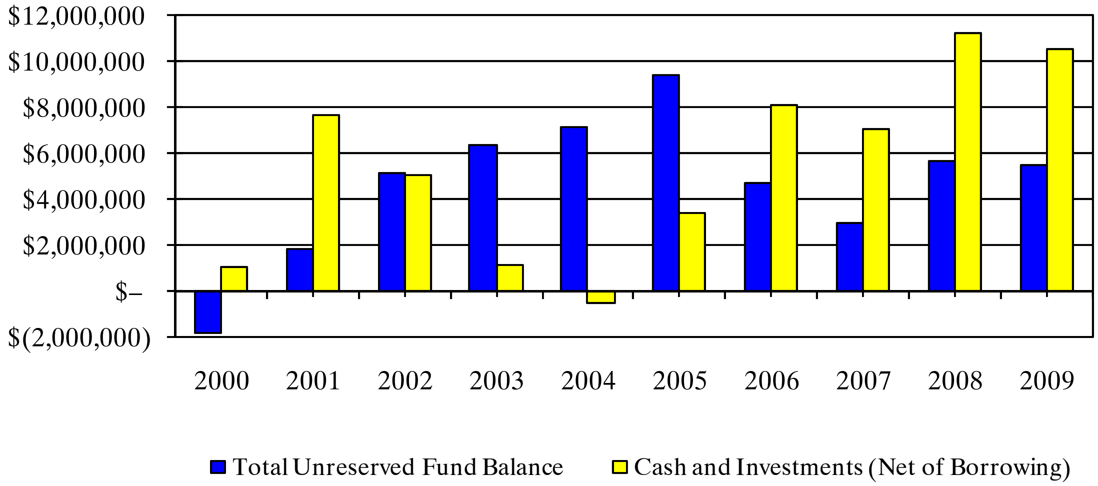
SUMMARY

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 2009 with unreserved fund balance of $5,473,850, a decrease of $241,552 from the prior year. The cash and investment balance, net of borrowing at year-end was $10,562,913, down $720,203 from the prior year.

The decrease in fund balance and cash balance in the General Fund was the result of a planned decrease as the District's General Fund budget planned for a decrease in total fund balance of $1,993,790.

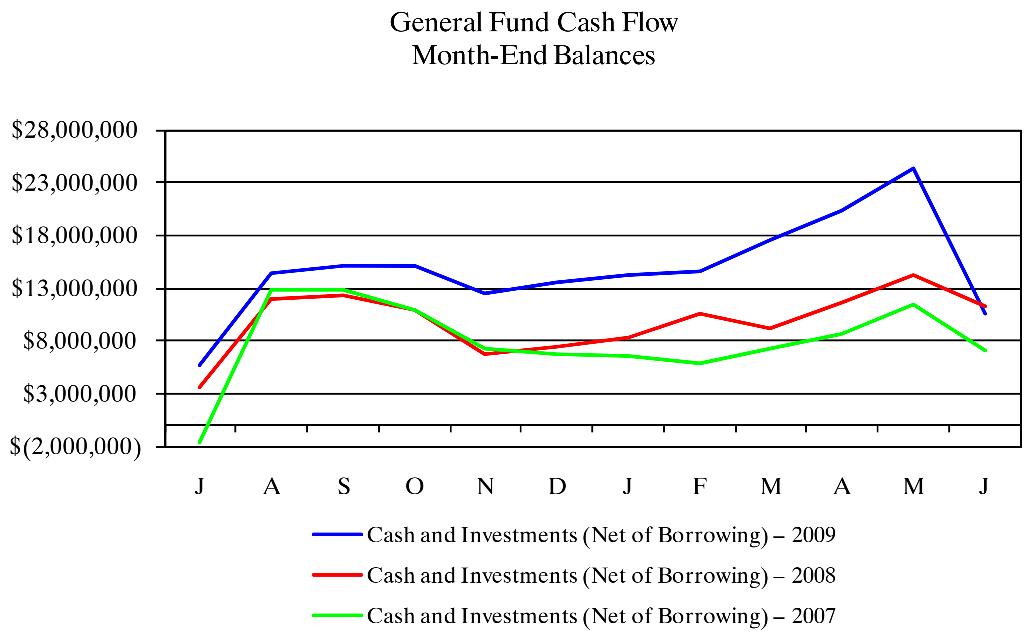
The following table presents the components of the General Fund's balance for the past five years:

	Year Ended June 30,				
	2005	2006	2007	2008	2009
Reserved fund balance	$ 737,885	$ 1,771,460	$ 1,433,597	$ 1,635,954	$ 1,397,031
Unreserved – designated fund balance	1,913,382	1,849,025	1,804,227	1,893,181	1,658,669
Unreserved – undesignated fund balance	7,511,025	2,890,659	1,172,565	3,822,191	3,815,181
Total fund balance	$ 10,162,292	$ 6,511,144	$ 4,410,389	$ 7,351,326	$ 6,870,881
Unreserved – undesignated fund balance as a percentage of expenditures	8.9%	3.1%	1.2%	4.0%	3.8%
Total unreserved fund balance as a percentage of expenditures	11.2%	5.1%	3.1%	6.0%	5.5%

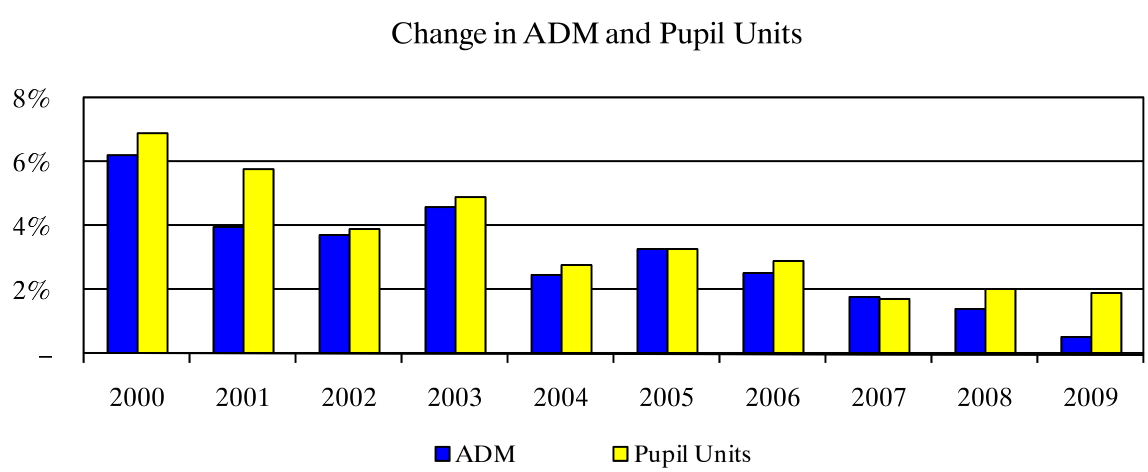
The table above reflects the total General Fund unreserved fund balance and percentages, which may be different from those used in the previous discussion of state-wide fund balances, which are based on a state formula. The resources represented by this fund balance are critical to a district's ability to maintain adequate cash flow throughout the year, to retain its programs, and to cushion against the impact of unexpected costs or funding shortfalls.

GENERAL FUND CASH FLOW

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



The graph above shows the peaks and valleys of the General Fund cash and investments balance (net of borrowing) on a monthly basis. The swing between its high and low month-end cash balances is about $18.6 million. Changes in funding structure and state aid payment schedules significantly affects the cash flow of Minnesota school districts.

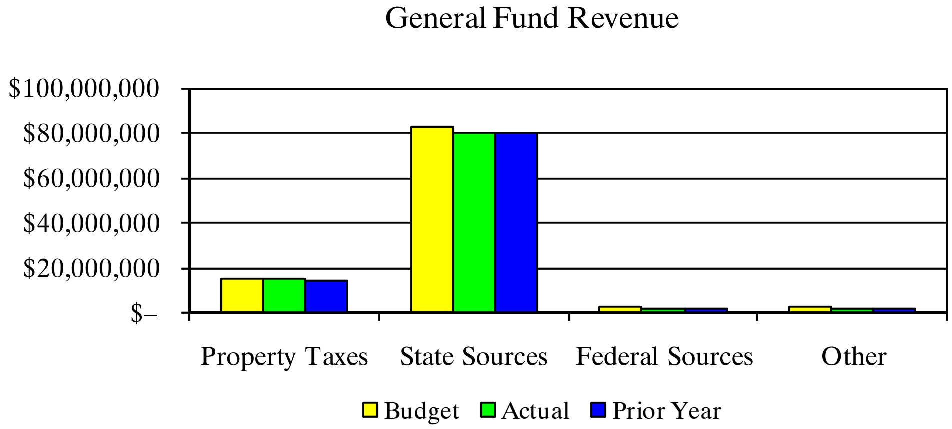


ADM is a measure of students attending class, which is then converted to pupil units (the base for determining revenue) using a statutory formula. Not only is the original budget based on ADM estimates, the final audited financial statements are based on updated, but still estimated, ADM since the counts 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 11,206 in 2009, an increase of 13 ADM from the prior year.

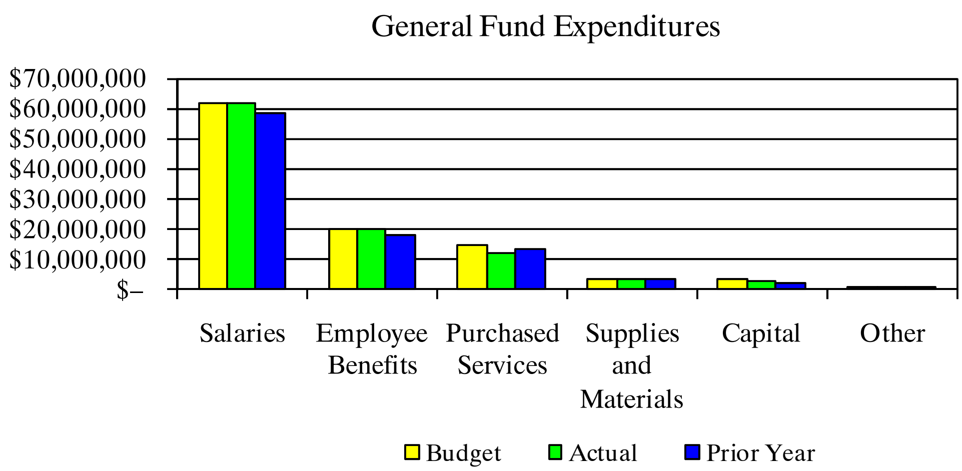
GENERAL FUND REVENUE AND EXPENDITURES

The following graphs summarize the District's General Fund revenue and expenditures for 2009:



Total General Fund revenues for 2009 were $99,876,299, an increase of $1,157,752 from the prior year, and $2,763,181 under budget. Revenue increases were mostly related to increases in student population, increases in the basic formula allowance, and the one-time general education increase of $51 per pupil unit.

Revenues were under budgeted amounts mainly due to special education aid (net of tuition billing costs) being less than budget by nearly $2,000,000. Most of this relates to a change in the processing of special education bills with Intermediate District No. 917. These bills are now being processed by the MDE, which nets any costs the District has against any revenue received. Federal revenue was also below budgeted amounts by almost $430,000, mostly due to less than expected spending of federal special education grant funding.



Total General Fund expenditures for 2009 were $100,357,044, an increase of $4,579,434 or 4.8 percent from the prior year, and $4,276,226 or 4.1 percent under budget. Salaries and employee benefits increased about $5.2 million or 6.2 percent. Salaries increased about $3.3 million due to contracted settlement increases and annual step increases. Benefits increased about $1.9 million due to increased salaries and significant increases in medical insurance costs.

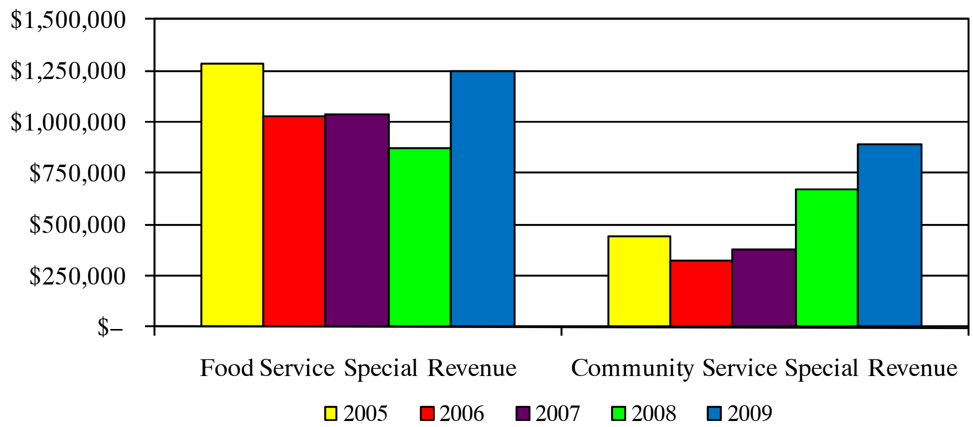
Purchased services for special education were about $1.2 million less than last year related to the change in the tuition billing process discussed earlier.

Total expenditures were under budgeted amounts in most programs but mostly in special education by about $2.3 million. This relates again to the change in the tuition billing process discussed earlier. Other areas that were below budgeted amounts include capital projects for technology of about $800,000 and staff development of about $500,000.

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 2009, the $380,453 increase in fund balance was $271,820 better than the planned increase 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 $215,265 for the year ended June 30, 2009, which was $159,606 more than the $55,659 planned increase 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 $5,005,495 of capital funds during fiscal 2009. At June 30, 2009, this fund had $2,706,133 of alternative facility funds and $750,054 of building bond proceeds available.

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 dedicated to the payment of outstanding debt obligations of the District.

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 Accounting Standards Board (GASB) Statement No. 34 reporting model also requires the inclusion of two government-wide financial statements designed to present a clear picture of the District as a single, unified entity. These government-wide 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 a summarized conversion of the District's governmental fund balances (as discussed earlier) to net assets and the separate components for the last three years:

	June 30,		
	2007	2008	2009
Total fund balances – governmental funds	$ 143,688,596	$ 120,455,651	$ 117,501,349
Net assets – governmental activities			
Capital assets, less accumulated depreciation	145,867,804	140,910,179	140,486,773
Long-term liabilities	(363,017,361)	(335,749,955)	(320,620,127)
Accrued interest payable	(5,333,704)	(4,759,308)	(4,328,239)
Unamortized debt issue discounts	37,081,411	34,985,819	34,348,413
Net pension obligations	–	–	(1,549,038)
Other	271,676	399,652	597,330
Total net assets – governmental activities	$ (41,441,578)	$ (43,757,962)	$ (33,563,539)
Net assets			
Invested in capital assets, net of related debt	$ (32,273,825)	$ (35,641,865)	$ (31,644,356)
Restricted	2,740,162	3,031,684	3,703,624
Unrestricted	(11,907,915)	(11,147,781)	(5,622,807)
Total net assets	$ (41,441,578)	$ (43,757,962)	$ (33,563,539)

Some 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 increased by $10,194,423. This was mainly due to the recording of a change in accounting principal of $8,293,626 in conjunction with the implementation of GASB Statement No. 45 as detailed in Note 1 of the District's basic financial statements. This increase can also be attributed to the positive relationship between the rate of depreciation on capital assets and the repayment rate of related debt.

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

This statement provides new guidance on 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, with only a few governments funding these benefits in advance of payment. The guidance in this statement rests on the assumption that OPEB liabilities should be accrued as they are earned by employees providing service to the entity.

Under GASB Statement No. 45, governments offering OPEB will recognize the cost of these benefits 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 the actuarially determined annual required contribution (ARC) for these benefits each year, no asset or liability will be reported on the Statement of Net Assets. However, an employer will need to report a "net pension obligation" on its Statement of Net Assets as an asset or liability if it contributes more or less, respectively, than the ARC each year.

Nothing in the statement is intended to alter the normal application of modified accrual accounting in the governmental funds of the entity. Thus, in governmental funds, OPEB expenditures normally would be recognized when the benefits are due and payable 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.

The statement will become effective in three phases based on the same criteria as those defined for the implementation of GASB Statement No. 34. GASB Statement No. 45 will be phased in for districts over a three-year period, which started with category one districts in the fiscal year ending June 30, 2008.

The District implemented this standard in the current fiscal year.

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.

The District implemented this standard in the current fiscal year.

GASB Statement No. 51 – Accounting and Financial Reporting for Intangible Assets

Governments possess many different types of assets that may be considered intangible assets, including easements, water rights, timber rights, patents, trademarks, and computer software. This statement requires that all intangible assets not specifically excluded by its scope provisions be classified as capital assets. The requirements in this statement improve financial reporting by reducing inconsistencies that have developed in accounting and financial reporting for intangible assets. These inconsistencies will be reduced through the clarification that intangible assets subject to the provisions of this statement should be classified as capital assets, and through the establishment of new authoritative guidance that addresses issues specific to these intangible assets given their nature. The requirements of this statement are effective for financial statements for periods beginning after June 15, 2009.

GASB Statement No. 53 – Accounting and Financial Reporting for Derivative Instruments

The guidance in this statement improves financial reporting by requiring governments to measure derivative instruments at fair value in their economic resources measurement focus financial statements. These improvements should allow users of those financial statements to more fully understand a government's resources available to provide services. The disclosures provide a summary of the government's derivative instrument activity and the information necessary to assess the government's objectives for derivative instruments, their significant terms, and the risks associated with the derivative instruments. The requirements of this statement are effective for financial statements for periods beginning after June 15, 2009.

GASB Statement No. 54 – Fund Balance Reporting and Governmental Fund Type Definitions

The objective of this statement is to enhance the usefulness of fund balance information by providing clearer fund balance classifications that can be more consistently applied and by clarifying the existing governmental fund type definitions. This statement establishes fund balance classifications that comprise a hierarchy based primarily on the extent to which a government is bound to observe constraints imposed upon the use of the resources reported in governmental funds. The definitions of the General Fund, special revenue, capital projects, debt service, and permanent fund types are clarified by the provisions in this statement. The requirements are also intended to enhance the consistency between information reported in the government-wide statements and information in the governmental fund financial statements and avoid confusion about the relationship between reserved fund balance and restricted net assets. The requirements of this statement are effective for financial statements for periods beginning after June 15, 2010.

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) 2009 increased by $50 (1 percent) per adjusted marginal cost pupil unit (AMCPU) and will remain at this amount for FY 2010 and FY 2011.

One-Time General Education Revenue Increase – FY 2009 Only – Provided additional general education aid for FY 2009 only equal to $51 times the school district or charter school's AMCPU. This is equivalent to a 1 percent increase in the general education formula, except that this one-time increase is not linked to other formulas that use the general education formula allowance.

FY 2010 One-Time General Education Aid Reduction Offset by Federal Fiscal Stabilization Funds – Reduces the FY 2010 general education aid entitlement by $500 million. The reduction is allocated among school districts and charter schools. This one-time reduction is offset on a dollar-for-dollar basis by federal fiscal stabilization funds.

Temporary Suspension of Reserved Revenue for Staff Development – Temporarily suspends the staff development reserve for FY 2010 and FY 2011. The staff development reserve is equal to 2 percent of the district's basic general education revenue.

Federal Recovery Act – The American Recovery and Reinvestment Act (ARRA) of 2009 will provide additional federal funds to districts in the form of stabilization funds and additional grants. The ARRA mandates that there be an unprecedented level of oversight and transparency around the spending of these funds, including added audit and internal control requirements. In addition to increased accountability, districts will also encounter new reporting requirements for ARRA funds.

Compensatory Revenue Payments to Cooperatives – Directs MDE to pay compensatory revenue directly to cooperatives, and to exclude compensatory revenue from the special education tuition adjustment calculations for cooperatives.

Alternative Teacher Compensation Revenue (Q Comp) – Clarification of change made reducing the basic Q Comp aid from 73.1 percent to 65 percent effective for FY 2010 and later. This results in a decrease in the basic aid, with a corresponding increase in the equalized levy revenue.

Operating Capital Reserve Account Transfers – Allows districts to transfer up to $51 per AMCPU from the operating capital reserved fund balance to its unreserved General Fund balance for FY 2009 and FY 2010. This is in addition to the transfer already allowed for FY 2008.

Repeal of the Endowment Fund Reduction – Beginning in FY 2010, districts will no longer receive a reduction in their general education aid by the amount of endowment payments received. This will have the effect of increasing general education aid by $36 per resident ADM for FY 2010.

School Technology and Operating Capital Aid – Qualifies all school districts for technology and operating capital aid equal to $55 per AMCPU for FY 2009. This aid entitlement is no longer available in FY 2010. The aid must be used only for the purposes authorized for operating capital revenue.

State Aid Payment Deferral – For FY 2010 and FY 2011 only, all state aids normally paid on a 90-10 schedule will be changed to a 73–27 schedule.

Final Payment for Districts in SOD – Districts in SOD as of June 30th of the previous year will receive a reduced deferral amount.

Property Tax Revenue Recognition Change – Several changes affecting the recognition of property tax revenue were enacted in FY 2009 legislation including the following:

- Beginning in FY 2011, school districts will encounter a change in how tax revenue is recognized for the May, June, and July tax settlements compared to past practice.
- In the absence of new legislation, this change will be permanent, creating a large increase in the amount of property taxes recognized by school districts as revenue during FY 2011. For FY 2012 and later, the impact of this change will be smaller, but still significant.

One-Time Aid Adjustment for Property Tax Revenue Recognition Change – For FY 2011 only, state aid payments during FY 2011 will be reduced by the difference in revenue recognized under the new tax revenue policy compared to the amount under the old policy.

Truth in Taxation Hearing – Removes the requirement that school districts hold a separate truth in taxation hearing. Instead, the district is required to discuss the levy and budget at a regularly scheduled board meeting and allow the public to speak. This section is effective for taxes payable 2010 and later.

Safe Schools Levy – Beginning for taxes payable in 2008 (revenue in FY 2009), the safe schools 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. Districts are required to set aside $3 per AMCPU for specific costs and annual certifications on spending are required beginning in FY 2010.

Safe Schools Levy – Maintenance of Effort (MOE) – Beginning in FY 2010, districts are required to maintain effort at FY 2009 levels for licensed school support staff, including guidance counselors, nurses, social workers, and others from all funding sources other than the safe schools levy. This also modifies existing law requiring MOE to be calculated in terms of total spending. This provision adds a second option allowing districts to meet the MOE requirement in terms of number of full-time equivalent staff instead.

Start of School Year Before Labor Day – Cooperating Districts – The change codifies the existing practice of allowing school districts that have entered pairing and sharing agreements to adjust their calendars to accommodate a school construction project in one of the cooperating districts.

Wind Energy Conversion Systems – Authorizes a school board to become a partner, member, or shareholder in a company that is formed for the sole purpose of constructing, acquiring, owning, or financing a wind energy conversion system. Prohibits a school board from selling, transmitting or distributing electrical energy at retail.

Equalization Factors – Directs the commissioner to adjust the equalizing factors in statute for changes enacted by the legislature to the definition of referendum market value. This would neutralize the effect of a tax base change on school district aid and levy revenues.

Telecommunications/internet Access Equity Aid – Clarifies that intermediate school districts are eligible to receive telecommunications/internet access equity aid. Appropriates $3.75 million for equity in telecommunications access aid for FY 2010 and for FY 2011 (versus $8.7 million in FY 2009).

Review and Comment – Several changes enacted affecting review and comment, including an increase in the cap on school construction projects that are subject to review and comment by the commissioner of education from $500,000 to $1.4 million for all school districts except those with outstanding capital loans.

Notification of Resident District – Removes language in statute holding nonresident districts liable for tuition for not notifying the district of residence that they are serving a nonresident pupil.

Pay Differential of Reserve on Active Duty – Clarifies payment of a pay differential for school district employees who are ordered into active military service.

Charter Schools – Makes numerous revisions with a focus on increased accountability to state charter school laws (Minnesota Statutes, Sections 124D.10 and 124D.11), including those recommended by the Office of the Legislative Auditor in its 2008 report.

Background Check Required – Allows a school hiring authority to pay the costs of conducting a discretionary criminal history background check on school volunteers, independent contractors, and student employees.

Contracting Threshold Limits – Effective August 1, 2008 the requirement to obtain sealed bids on contracts is increased from $50,000 to $100,000. The thresholds for contracts that require a sealed bid or by direct negotiation after receiving two or more quotes is increased from the current law on those estimated between $10,000 and $50,000 to $25,000 and $100,000. The current law for a contract to be made either upon quotation or in the open market is increased for contracts estimated to be of $10,000 or less to $25,000 or less.

Other Post-Employment Benefit (OPEB) Bonding and Levies – New legislation approved in 2009 impacted existing legislation regarding OPEB in the following ways:

- Clarifies that districts may only levy for costs of employees who retired between July 1, 1992, and July 1, 1998, if the district has a sunset clause in their current bargaining agreement.
- Creates a new levy for districts to fund annual costs associated with OPEB expenses conditional on certain requirements, including a sunset clause in effect. Limits the total amount of this new levy to not more the $9.242 million for taxes payable in 2010, $29.863 million for taxes payable in 2011, and an amount equal to the previous year's levy plus $14 million for taxes payable in 2012 and later.
- Amends existing statutes to require voter approval for any bonds to pay OPEB issued after October 1, 2009.

Accounting for Separation and Retirement Benefits – Clarifies accounting requirements for reserved and designated for separation and retirement benefits with the following:

- Designated for separation and retirement benefit account includes compensated absences, termination benefits, pension benefits, and OPEB not accounted for elsewhere.
- Designated account will no longer be limited to 50 percent of the amount necessary to meet obligations for the portion of severance pay that constitutes compensation for accumulated sick leave.
- MDE will eliminate the reserve for severance account beginning with FY 2010 reporting.

Form of Budget Notification – Allows districts to publish a summary of its budget information in the newspaper instead of publishing the full document. The district is required to publish the full document on its website.