Management Report

for

Independent School District No. 194
Lakeville, Minnesota
June 30, 2011

MMKR
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, Lakeville, Minnesota's (the District) financial statements for the year ended June 30, 2011. 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 of the District, 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 26, 2011

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AUDIT SUMMARY

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

OUR RESPONSIBILITY UNDER AUDITING STANDARDS GENERALLY ACCEPTED IN THE UNITED STATES OF AMERICA, *GOVERNMENT AUDITING STANDARDS*, AND THE U.S. OFFICE OF MANAGEMENT AND BUDGET 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, 2011. Professional standards require that we provide you with information about our responsibilities under auditing standards generally accepted in the United States of America, *Government Auditing Standards*, and the U.S. Office of Management and Budget Circular A-133, as well as certain information related to the planned scope and timing of our audit. We have communicated such information to you verbally and in our audit engagement letter. Professional standards also require that we communicate to you the following information related to our audit.

PLANNED SCOPE AND TIMING OF THE AUDIT

We performed the audit according to the planned scope and timing previously discussed and coordinated 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, 2011:

- 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 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 compliance requirements that could have a direct and material effect on each major federal program.
- We reported no deficiencies in the internal controls over compliance and its operation that we consider to be material weaknesses in our testing of major federal programs.
- We reported one finding based on our testing of the District's compliance with Minnesota laws and regulations. The District did not comply with Minnesota Statute § 123B.78, Subd. 4 related to borrowing funds from the Debt Service Fund.

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, 2011.

We also issued a report on compliance with the Minnesota Department of Education's (MDE) *Manual for Activity Fund Accounting*, in which we reported two findings for having inactive accounts and for having receipts not deposited on a timely basis.

FOLLOW-UP ON PRIOR YEAR FINDINGS AND RECOMMENDATIONS

As a part of our audit of the District's financial statements for the year ended June 30, 2011, we performed procedures to follow-up on the findings and recommendations that resulted from our prior year audit. The following is a summary of these findings and recommendations along with the results of our follow-up:

Federal ARRA Reporting

As a part of our audit of the District's financial statements for the year ended June 30, 2010, We noted that the District did not submit one of the four quarterly surveys for the ARRA – Special Education – Grants to States, the ARRA – Special Education – Preschool Grants program, and ARRA – State Fiscal Stabilization Funds – Education State Grants program and one of the quarterly surveys was not submitted timely. We are pleased to report that this was not a finding in the fiscal 2011 audit.

Cash Receipts

As a part of our audit of the District's financial statements for the year ended June 30, 2010, at the various district school sites, one individual was responsible for: the collection of cash receipts, preparing the deposits, and creating the initial records used to record the receipts. There was also no verification of cash collections by someone independent of the cash deposit process. We recommended that an individual not involved in the initial receipt and deposit of the cash perform procedures to verify that all cash collected at the various district school sites were being deposited, such as having the District's business office staff obtain and review original documentation for cash received at the school. We are pleased to report that additional internal controls were added by the District in fiscal year 2011 which eliminated our concerns in this area.

Payroll

As a part of our audit of the District's financial statements for the year ended June 30, 2010, the payroll clerks had the ability to both update pay rates and hours, and subsequently process payroll. We recommended that the duties within the payroll system be further segregated by limiting the access to the pay rates to only individuals in the human resources department. We are pleased to report that additional internal controls were added by the District in fiscal year 2011 which eliminated our concerns in this area.

Journal Entries

As a part of our audit of the District's financial statements for the year ended June 30, 2010, the accounting supervisor currently had the ability to both create and post a journal entry to the general ledger. Also, not all journal entries posted to the general ledger were being reviewed and approved. We recommended that the District further segregate duties over journal entries by having someone independent of the journal entry process review and approve all journal entries posted to the general ledger. We are pleased to report that additional internal controls were added by the District in fiscal year 2011 which eliminated our concerns in this area.

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. For the year ended June 30, 2011, the District has implemented Governmental Accounting Standards Board (GASB) Statement No. 54, "Fund Balance Reporting and Governmental Fund Type Definitions." This statement established new 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.

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 2011 is not finalized until well into fiscal year 2012. 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 2011 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 severance benefits payable for which it is probable employees will be compensated. The "vesting method" used by the District to calculate this liability is based on assumptions involving the probability of employees becoming eligible to receive the benefits (vesting), the potential use of accumulated sick leave prior to termination, and the age at which such employees are likely to retire.
>
> The District has recorded expenditures and liabilities for pension benefits and other post-employment benefits (OPEB). These obligations are calculated using actuarial methodologies described in GASB Statements No. 27 and 45, as applicable. These actuarial calculations include significant assumptions, including projected changes, healthcare insurance costs, investment returns, retirement ages, and employee turnover.
>
> The District's self-insured activities require recording a liability for claims incurred but not yet reported, which are based on estimates.
>
> The depreciation of capital assets involves estimates pertaining to useful lives.

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 each opinion unit's financial statements taken as a whole.

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 26, 2011.

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.

Fiscal Year Ended June 30,	Formula Allowance Amount	Formula Allowance Percent Increase
2002	$ 4,068	2.6 %
2003	$ 4,601	2.6 % (1)
2004	$ 4,601	– %
2005	$ 4,601	– %
2006	$ 4,783	4.0 %
2007	$ 4,974	4.0 %
2008	$ 5,074	2.0 %
2009	$ 5,124	1.0 %
2010	$ 5,124	– %
2011	$ 5,124	– %
2012	$ 5,174	1.0 %
2013	$ 5,224	1.0 %

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

As noted in the table above, after having been frozen at the same level for the last three years, the Legislature has added $50 to the basic formula allowance for both fiscal 2012 and 2013. In recent years, the modest increases in the formula allowance have forced many districts to continually cut expenditure budgets or seek increased referendum revenue in order to maintain programs.

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). It also does not reflect the one-time replacement of a portion of a district's general education aid with federal fiscal stabilization funds in fiscal 2010.

STATE OUTLOOK

The 2011 legislative session began with the Governor and Legislature facing a projected budget deficit of $6.2 billion (later revised down to $5.0 billion in the February 2011 Economic Forecast) for the 2012–2013 biennium. In addition, the 2010 election had dramatically changed the state's political landscape. A Democratic Governor was in power for the first time since 1991, while the Republicans had majority control of both the House and the Senate for the first time since 1971. Predictably, as the session progressed it became clear that the Governor and Legislature were having difficulty agreeing on a state budget for the next biennium. Shortly after the 2011 regular session ended, the Governor vetoed eight major state appropriation bills and the omnibus tax bill passed by the Legislature, which left the majority of state agencies without a budget for the next fiscal year. This resulted in a shutdown of "nonessential" state agencies that began July 1, 2011 and effectively ended with the passing of appropriation bills in a special session on July 19th and 20th.

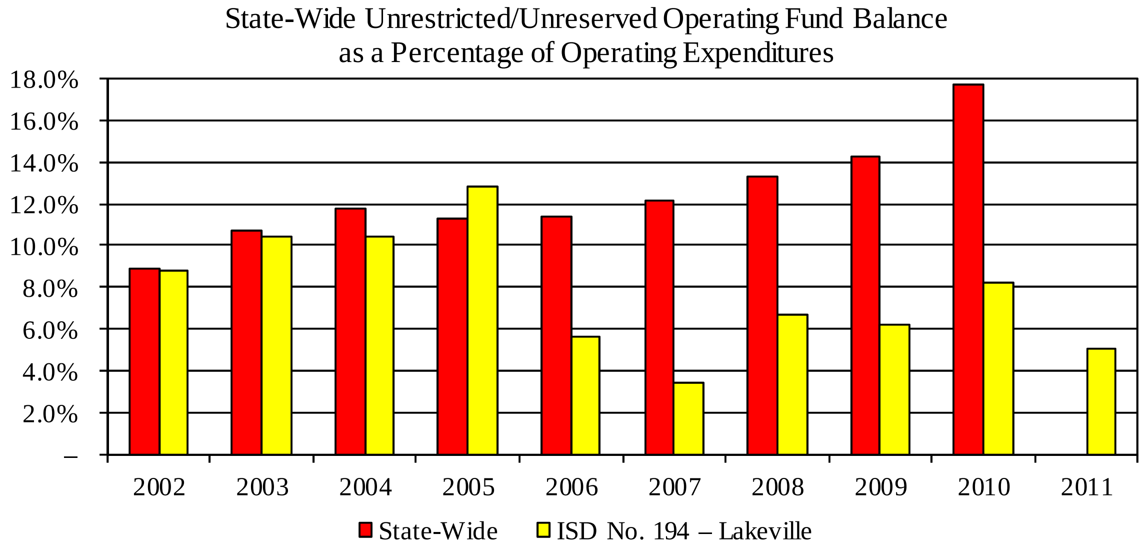
The large projected budget deficit facing the 2011 Legislature was typical of the financial challenges the state has experienced in recent years. Unfavorable economic conditions have caused a steady deterioration of the state's financial condition, which has resulted in series of cuts and holdbacks in state aids to local governments and other entities. As was the case in the last biennium, the adopted state budget for 2012–2013 utilized several large "accounting shifts" in an attempt to minimize the need for tax increases or state aid cuts to balance the budget. The accounting shifts, further explained in the Legislative Summary section of this report, included delaying an even higher percentage of estimated state aid payments to school districts and charter schools, and a small expansion of the "tax shift," which accelerates the recognition of district tax levy revenue with an off-setting reduction in state aid. Both of these types of shifts significantly reduce the amount of operating cash available to Minnesota school districts and charter schools, but are intended to be revenue neutral. While these shifts have spared districts from deeper aid cuts in the short-term, some argue that their use does not address the state's budget woes, but only delays them. If the economy remains sluggish, further state budget shortfalls are likely.

EFFECT ON INTERNAL CONTROLS

These circumstances have resulted in a sustained cycle of budget reductions for many Minnesota school districts and charter schools, forcing many to make significant staffing cuts or reassignments. In some cases, such measures have weakened internal controls by reducing the segregation of accounting duties or delaying the performance of key control procedures. Unfortunately, the economic downturn has also placed additional financial strain on many individuals, elevating the risk of fraud and theft. Recent communications from the Minnesota Office of the State Auditor have reported a substantial increase in incidents of fraud and theft involving local governments. A comprehensive and functioning system of internal controls is critical to safeguarding public assets and producing the accurate and timely financial information necessary to effectively manage a school district. When faced with difficult budgetary decisions, we encourage our clients to be mindful of these factors and to continue to make sound financial controls a priority.

STATE-WIDE SCHOOL DISTRICT FINANCIAL HEALTH

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



Note: State-wide information is not available for fiscal 2011.

The calculation above reflects only the unrestricted/unreserved fund balance of the General Fund, and the corresponding expenditures, which is the same method the state uses for the calculation of statutory operating debt (SOD). We have also included the comparable percentages for your district.

Even with limited funding increases, school district unrestricted/unreserved fund balance has been increasing as a percentage of operating expenditures on a state-wide basis in recent years. This trend is the result of many factors, including districts reducing operating expenditures, adapting to funding restrictions, efforts to maintain fund balance for cash flow purposes, and in some cases community support in the form of operating referendums.

As of June 30, 2010, this ratio was 8.2 percent for the District, as compared to a state-wide average of 17.7 percent. The District's unrestricted operating fund balance as a percentage of operating expenditures was 5.1 percent at the end of the current year.

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

Governmental Funds Revenue per Student (ADM) Served

	State-Wide		Seven-County Metro Area		ISD No. 194 – Lakeville		
	2009	2010	2009	2010	2009	2010	2011
General Fund							
Property taxes	$ 1,371	$ 1,473	$ 1,833	$ 1,968	$ 1,354	$ 1,448	$ 1,949
Other local sources	458	435	381	372	198	225	232
State	7,859	7,119	7,920	7,143	7,123	6,498	6,619
Federal	452	1,233	489	1,274	164	858	334
Total General Fund	10,140	10,260	10,623	10,757	8,839	9,029	9,134
Special revenue funds							
Food Service	454	469	453	465	465	457	476
Community Service	507	503	613	604	504	499	511
Debt Service Fund	1,034	1,040	1,131	1,137	1,442	1,527	1,613
Total revenue	$ 12,135	$ 12,272	$ 12,820	$ 12,963	$ 11,250	$ 11,512	$ 11,734
ADM served per MDE School District Profiles Report (current year estimated)					11,299	11,242	11,123

Note: Excludes Capital Projects – Building Construction Fund, 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 District's governmental fund revenue for 2011 was $222 per student higher than the prior year. General Fund property tax revenue increased by $501 per student from the prior year, mainly due to a $5.9 million increase in the tax shift. General Fund revenue from federal grants declined by $524 per student, primarily due to a one-time $6.2 million replacement of general education aid with federal fiscal stabilization funds in fiscal 2010. General Fund state aid revenues were $121 per student more than last year due to the combination of the effects of the tax shift and federal stabilization funding changes in fiscal 2011. Revenue from other local sources, including gifts, rent, and investment income, increased by $7 per student in the General Fund.

It is important to note that the District's Debt Service Fund revenue per student information includes revenue from crossover refunding bond escrow activity.

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

Governmental Fund Expenditures per Student (ADM) Served

	State-Wide		Seven-County Metro Area		ISD No. 194 – Lakeville		
	2009	2010	2009	2010	2009	2010	2011
Administration and district support services	$ 854	$ 807	$ 876	$ 781	$ 720	$ 751	$ 827
Elementary and secondary regular instruction	5,112	4,885	5,411	5,069	4,122	4,110	4,301
Vocational education instruction	153	149	152	150	63	77	89
Special education instruction	1,817	1,832	2,002	1,992	1,633	1,693	1,800
Instructional support services	502	461	598	550	360	355	374
Pupil support services	874	861	968	937	901	900	951
Sites, buildings, and other	850	794	824	755	818	864	889
Total General Fund operating expenditures	10,162	9,789	10,831	10,234	8,617	8,750	9,231
General Fund capital expenditures	466	440	443	414	265	177	247
Special revenue funds							
Food Service	454	458	453	456	431	448	474
Community Service	522	513	634	618	485	495	508
Debt Service Fund	1,244	1,129	1,334	1,184	1,494	1,606	1,645
Total expenditures	$ 12,848	$ 12,329	$ 13,695	$ 12,906	$ 11,292	$ 11,476	$ 12,105
ADM served per MDE School District Profiles Report (current year estimated)					11,299	11,242	11,123

Note: Excludes Capital Projects – Building Construction Fund, 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. Factors affecting the comparison include the growth cycle or maturity of the District, average employee experience, availability of funding, population density, and even methods of allocating costs.

The differences from program to program reflect the District's particular character, such as its community service programs, as well as the fluctuations from year to year for such things as capital expenditures.

The District experienced an increase in total expenditures per student in fiscal 2011 of $629, or 5.5 percent due mostly to a 4.4 percent increase in expenditures combined with a 1.1 percent decrease in ADM. 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.

It is important to note that the District's Debt Service Fund revenue per student information includes revenue from crossover refunding bond escrow activity.

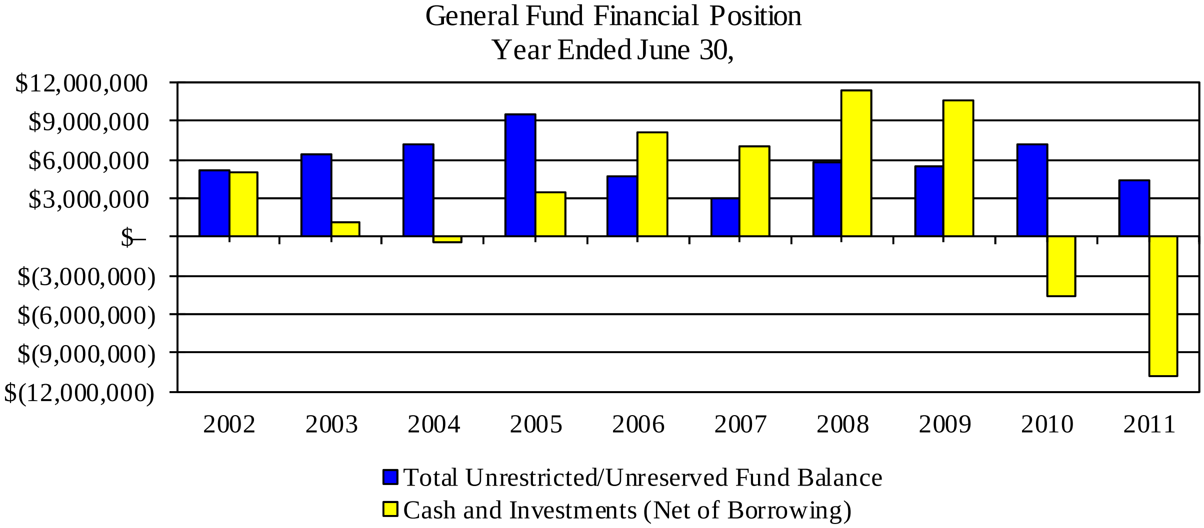
SUMMARY

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

FINANCIAL TRENDS OF YOUR DISTRICT

GENERAL FUND FINANCIAL POSITION

The following graph displays the District's General Fund trends of financial position. Unrestricted (formerly unreserved) fund balance and cash balance are typically used as indicators of financial health.



The District's General Fund ended fiscal year 2011 with unrestricted fund balance of $4,435,964, a decrease of $2,781,306 from the prior year. The cash and investments balance, net of borrowing at year-end was a deficit balance of ($10,862,718), down $6,296,728 from the prior year due to the change in metering of state aid payments and an increase in the tax shift in the current year.

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

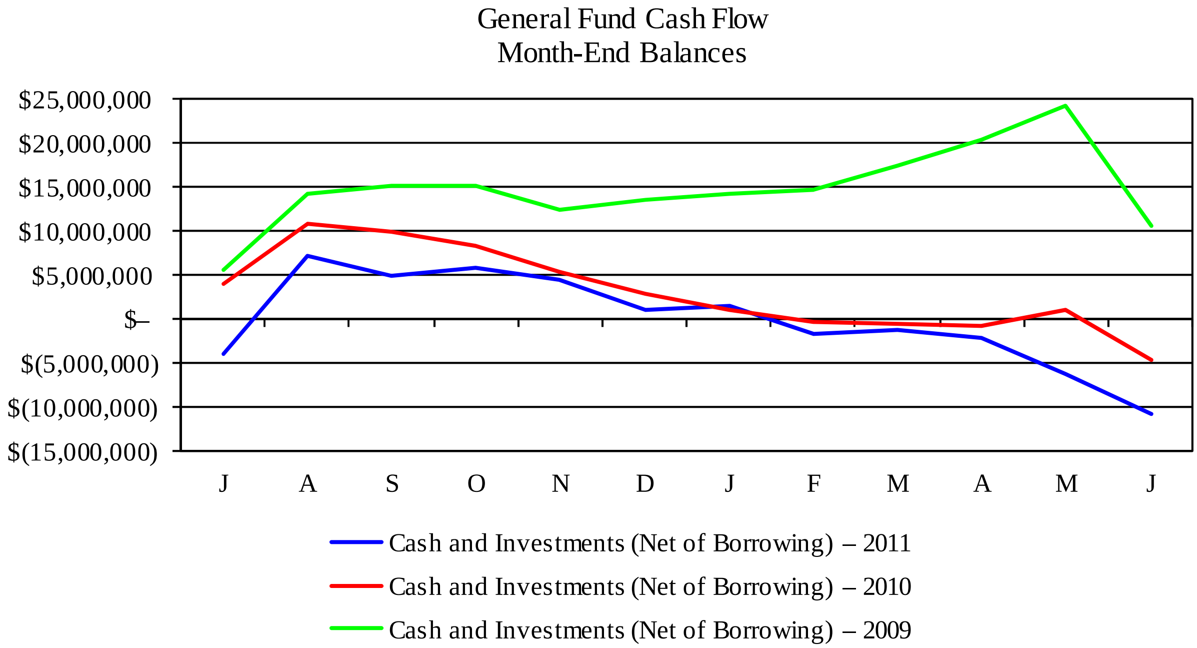
	Year Ended June 30,				
	2007	2008	2009	2010	2011
Nonspendable fund balances	$ –	$ –	$ –	$ –	$ 22,600
Restricted (formerly reserved) fund balances	1,433,597	1,635,954	1,397,031	805,822	732,508
Unrestricted (formerly unreserved) fund balances					
Assigned (formerly designated)	1,804,227	1,893,181	1,658,669	1,658,669	–
Unassigned (formerly undesignated)	1,172,565	3,822,191	3,815,181	5,558,601	4,435,964
Total fund balance	$ 4,410,389	$ 7,351,326	$ 6,870,881	$ 8,023,092	$ 5,191,072
Unrestricted (formerly unreserved) fund balances as a percentage of expenditures	1.2%	4.0%	3.8%	5.5%	4.2%
Unassigned (formerly undesignated) fund balances as a percentage of expenditures	3.1%	6.0%	5.5%	7.2%	4.2%

The School Board has formally adopted a fund balance policy regarding the minimum unassigned fund balance for the General Fund. The policy states that the District will endeavor to maintain a General Fund unassigned fund balance of 4 to 8 percent of General Fund expenditures (excluding categorical funding). At June 30, 2011, the unassigned fund balance of the General Fund was 4.4 percent of the General Fund expenditures (excluding categorical funding).

The table above reflects the total General Fund unrestricted 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

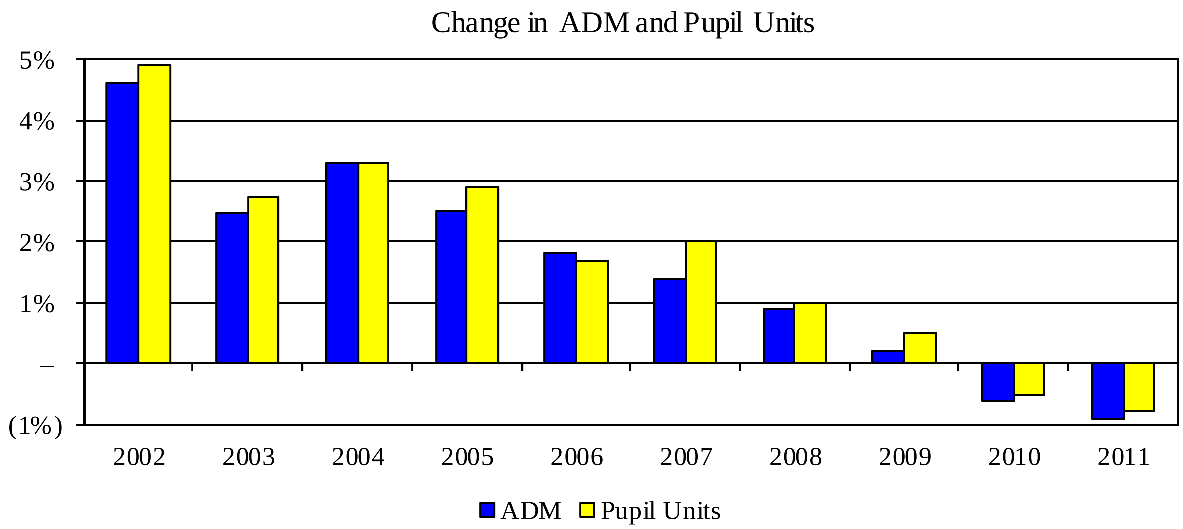
The level of cash and investments varies considerably during the year due to the timing of various revenues and expenditures. The following graph summarizes the level of cash and investments (net of borrowing) over the past three years:



The graph above shows the peaks and valleys of the General Fund cash and investments balance (net of borrowing) on a monthly basis. During the fiscal year ended June 30, 2011, the available cash balance in the District's General Fund fluctuated by approximately $16.8 million. Changes in funding structure and state aid payment schedules significantly affect the cash flow of Minnesota school districts. As further described in the Legislative Summary section of this report, state aids normally paid on a 90–10 schedule were changed to a 73–27 schedule for fiscal 2010 and 70–30 for fiscal 2011. Beginning in fiscal 2011, a delay in aid payments also occurred with the change in the recognition of property tax revenue from the tax shift.

AVERAGE DAILY MEMBERSHIP AND PUPIL UNITS

The following graph shows the rate of ADM change from year to year, and the relationship of the resulting pupil units:

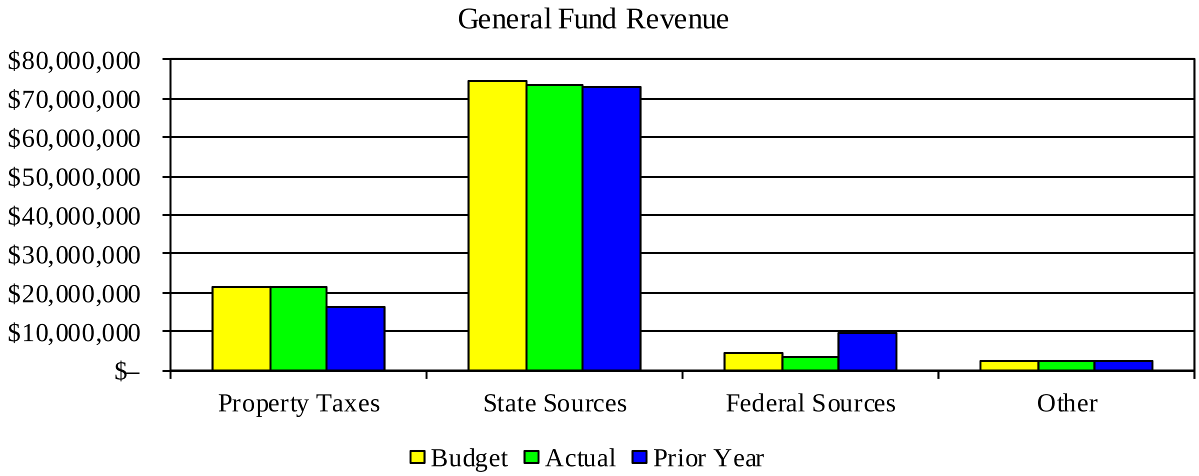


ADM is a measure of students enrolled in the District, which is then converted to pupil units (the base for determining revenue) using a statutory formula. Not only is the original budget based on ADM estimates, the final audited financial statements are based on updated, but still estimated, ADM since 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 11,037 in 2011, a decrease of 105 ADM from the prior year.

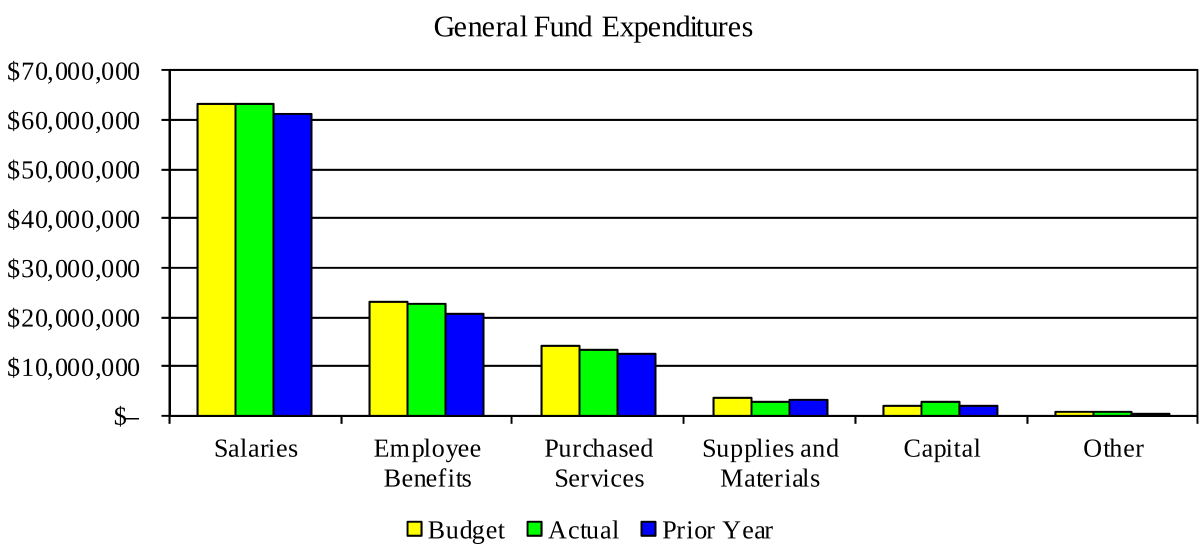
GENERAL FUND REVENUE AND EXPENDITURES

The following graphs summarize the District's General Fund revenue and expenditures for 2011:



Total General Fund revenues for 2011 were $101,599,916, an increase of $95,145 from the prior year, and $1,345,550 under budget. As discussed earlier, an increase in the tax shift resulted in a shift of about $5.3 million from state aids to taxes in fiscal 2011, and in fiscal 2010 about $6.2 million of state general education aid was replaced with one-time federal stimulus funding. Neither of these factors changed the total revenue received in the District's General Fund, but they caused significant fluctuations between the various revenue sources, obscuring the true changes in revenue from year-to-year.

General Fund state aid revenues were under budget by $726,292 due mostly to the lower than expected special education state aid in fiscal 2011. Revenues were under budgeted amounts in federal sources by $722,593 due mostly to unspent special education entitlement.



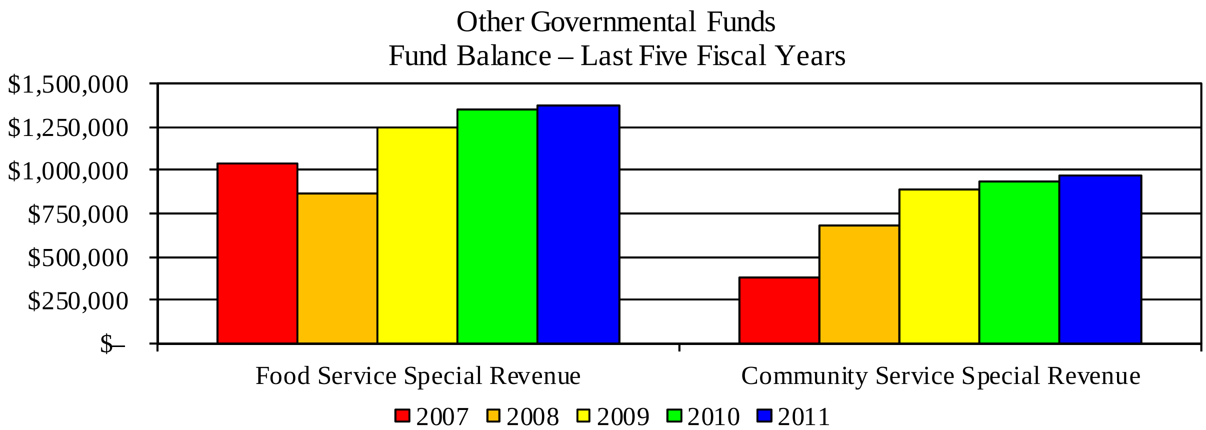
Total General Fund expenditures for 2011 were $105,432,475, an increase of $5,079,915 from the prior year and $1,125,031, or 1.1 percent, under budgeted amounts.

Total expenditures were under budgeted amounts in a number of areas, but mostly in purchased services for special education services by around $700,000 and supplies and materials by $674,000 due to conservative spending relating to funding hold backs and other factors.

Expenditure increases were mostly in instructional areas, including increases in elementary and secondary regular instruction of $2,602,307 and special education of $1,042,095. The increase in the elementary and secondary regular instruction includes a capital lease for technology purchases totaling around $1.0 million.

OTHER FUNDS OF THE DISTRICT

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.



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 2011, the $29,907 increase in fund balance was $18,898 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 $32,709 for the year ended June 30, 2011, which was $48,959 more than the $16,250 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 $4,832,946 of capital project funds during fiscal 2011. At June 30, 2011, this fund still had $4,268,525 of alternative facility funds 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.

Internal Service Fund

The Internal Service Fund is considered a proprietary fund and is used to account for dental insurance offered by the District to its employees as a self-insured plan.

GOVERNMENT-WIDE FINANCIAL STATEMENTS

The District's financial statements include fund-based information that focuses on budgetary compliance, and the sufficiency of the District's current assets to finance its current liabilities. The GASB Statement No. 34 reporting model also requires the inclusion of two government-wide financial statements designed to present a clear picture of the District as a single, unified entity. These government-wide 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,		
	2009	2010	2011
Total fund balances – governmental funds	$ 117,501,349	$ 96,854,269	$ 88,897,614
Net assets – governmental activities			
Capital assets, less accumulated depreciation	140,486,773	138,832,761	136,261,635
Long-term liabilities	(287,820,752)	(263,715,367)	(260,483,116)
Accrued interest payable	(4,328,239)	(4,411,321)	(4,455,192)
Other	597,330	586,016	775,400
Total net assets – governmental activities	$ (33,563,539)	$ (31,853,642)	$ (39,003,659)
Net assets			
Invested in capital assets, net of related debt	$ (31,644,356)	$ (30,411,034)	$ (31,952,618)
Restricted	3,703,624	4,044,717	3,368,202
Unrestricted	(5,622,807)	(5,487,325)	(10,419,243)
Total net assets	$ (33,563,539)	$ (31,853,642)	$ (39,003,659)

Some of the District's fund balances translate into restricted net assets by virtue of external restrictions (statutory restrictions) or by the nature of the fund they are in (e.g. restricted 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 unrestricted fund balances, offset against non-capital long-term obligations such as vacation, severance payable, OPEB, and pension obligations. Consequently, many Minnesota school districts have accumulated deficits in this component of net assets.

Invested in capital assets, net of related debt is the ratio of capitalized capital asset purchases, net of any depreciation to the amount of outstanding debt obligations that were issued to finance these capital purchases.

Total net assets decreased by $7,150,017. Invested in capital assets, net of related debt, decreased by $1,541,584, mainly due to the relationship between the rate of depreciation on capital assets and the repayment rate of related debt. The unrestricted net assets decreased $4,931,918 due to the decline in the General Fund balance in the current year and the increases in the net OPEB and pension obligations of the District.

GASB STATEMENT NO. 60 – ACCOUNTING AND FINANCIAL REPORTING FOR SERVICE CONCESSION ARRANGEMENTS

This statement provides accounting and financial reporting guidance for governments that participate as either a transferor or an operator in a service concession arrangement (SCA). SCAs are arrangements whereby a government transfers the rights to operate one of its capital assets to a third party operator (either a private party or another government) for consideration, with the operator then being compensated from the fees or charges collected in connection with the operation of the asset. To qualify as an SCA, an arrangement must meet all of the following criteria: 1) the transferor must convey to the operator both the right and the obligation to use one of its capital assets to provide services to the public; 2) the operator must provide significant consideration to the transferor; 3) the operator must be compensated from the fees or charges it collects from third parties; 4) the transferor must have the ability to either determine, modify, or approve what services are to be provided to whom at what price; and 5) the transferor must retain a significant residual interest in the service utility of the asset. This statement provides guidance to governments that are party to an SCA for reporting the assets, obligations, and flow of revenues that result from the arrangement; along with the required financial statement disclosures. The requirements of this statement must be implemented for periods beginning after December 15, 2011, with earlier implementation encouraged.

GASB STATEMENT NO. 61 – THE FINANCIAL REPORTING ENTITY: OMNIBUS

This statement amends the current guidance in GASB Statement No. 14, "The Financial Reporting Entity," for identifying and presenting component units. This statement changes the fiscal dependency criterion for determining component units. Potential component units that meet the fiscal dependency criterion for inclusion in the financial reporting entity under existing guidance will only be included if there is also "financial interdependency" (an ongoing relationship of potential financial benefit or burden) with the primary government. This statement also clarifies the types of relationships that are considered to meet the "misleading to exclude" criterion for inclusion as a component unit; changes the criteria for blending component units; gives direction for the determination and disclosure of major component units; and adds a requirement to report an explicit, measurable equity interest in a discretely presented component unit in a statement of position prepared using the economic resources measurement focus. The requirements of this statement must be implemented for periods beginning after June 15, 2012, with earlier implementation encouraged.

GASB STATEMENT NO. 63 – FINANCIAL REPORTING OF DEFERRED OUTFLOWS OF RESOURCES, DEFERRED INFLOWS OF RESOURCES, AND NET POSITION

This statement provides financial reporting guidance for deferred outflows of resources and deferred inflows of resources; which are defined as the consumption or acquisition of net assets, respectively, applicable to a future reporting period. The statement amends certain reporting requirements in GASB Statement No. 34 and related pronouncements, providing a format for a new Statement of Net Position, which reports deferred outflows of resources and deferred inflows of resources separately from assets and liabilities. It also renames the residual of assets, deferred outflows of resources, liabilities, and deferred inflows of resources as net position, rather than net assets. The requirements of this statement must be implemented for periods beginning after December 15, 2011, with earlier implementation encouraged.

GASB Pension Exposure Drafts

In June, 2011 GASB issued two exposure drafts on accounting and reporting for pensions, one for the reporting of pension benefits within the financial statements of participating employers and the other for pension plan financial reporting. These two exposure drafts are intended to update or replace the current guidance for pension reporting in GASB Statement Nos. 25 and 27.

The exposure drafts propose a variety of changes in financial statement presentation, measurement, and required disclosures relating to pension benefits. Included are proposed major changes in how employers that participate in cost-sharing defined benefit pension plans, such as TRA and PERA, account for pension benefit expenses and liabilities. Currently, employers participating in such plans recognize pension expenses and liabilities only to the extent of their contractually required annual contributions to the plan. The exposure draft proposes that those employers recognize their proportionate share of the collective net pension liability and collective pension expense for all participating employers. If adopted, this guidance could have a significant impact on the financial statements of the participating employers, as participants in plans with a substantial unfunded liability would be required to report their proportionate share of the unfunded liability in their government-wide financial statements.

The proposed effective dates for both exposure drafts are for periods beginning after June 15, 2012, if certain conditions are met, otherwise for periods beginning after June 30, 2013.

Federal Funding Accountability and Transparency Act (Transparency Act)

Effective October 1, 2010, the Transparency Act requires federal award recipients to report specific data, including compensation data in certain circumstances, related to subawards. One of the key requirements of the Transparency Act was the creation of a single, searchable website that provides the public with greater access to information on federal spending. The Transparency Act requires recipients to report first-tier subaward and executive compensation data for new federal grants as of October 1, 2010, if the initial award is equal to or over $25,000. Pass-through entities (primary recipients) must report subaward data through the Federal Funding Accountability and Transparency Subaward Reporting System (FSRS) by the end of the month following the month in which the subaward obligation is made. For a more detailed discussion of the Transparency Act see Part 3, Section L of the 2011 Office of Management and Budget (OMB) A-133 Compliance Supplement available at www.whitehouse.gov/omb. The OMB has issued several documents that provide guidance on the Transparency Act, including *Open Government Directive – Federal Spending Transparency* and *Subaward and Compensation Data Reporting* available at www.whitehouse.gov/omb/open.

LEGISLATIVE SUMMARY

The following is a brief summary of recent 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 per pupil basic general education formula allowance for fiscal year (FY) 2011 was $5,124. The allowance will increase $50 each of the next two years, to $5,174 for FY 2012, and $5,224 for FY 2013.

Small Schools Revenue – Small schools revenue will be added as a new component of general education revenue beginning in FY 2013. School districts with less than 1,000 adjusted marginal cost pupil units (AMCPU) will qualify for an additional revenue allowance per AMCPU of: $522.40 times (1,000 – AMCPU)/1,000. Charter schools are not eligible for this aid.

Compensatory Pilot Project Formula Aid – The 20 largest school districts in the state in terms of adjusted pupil units may be eligible to this one-time aid for FY 2013. To be eligible, the District's compensatory revenue per compensatory pupil unit (free + 1/2 of reduced price lunch count) must be less than $1,400. The aid, which can only be used for basic skills purposes, will equal the amount needed to bring the District's compensatory aid up to $1,400 per compensatory pupil unit.

Training and Experience Revenue – Training and experience revenue will be eliminated as a component of general education revenue effective FY 2012.

State Aid Payment Deferral – State aids normally paid on a 90–10 schedule were changed to a 73–27 schedule for FY 2010 and 70–30 for FY 2011. Beginning in FY 2012, these aids will be paid on a 60–40 payment schedule, which will also apply to charter schools. An exception was allowed for charter schools in which at least 90 percent of the enrollment receives special education services, accelerating regular special education aid payments only to a 90–10 payment schedule.

Early Graduation Programs – Two programs were created that provide students that graduate early with awards between $2,500 and $7,500, depending on how many semesters early they graduate. Students qualifying for the Early Graduation Achievement Scholarship Program receive a scholarship award that may be used at any accredited higher education institution, and students qualifying for the Early Graduation Military Service Award Program receive a cash award equivalent to the scholarship program awards. Beginning in FY 2012, school districts and charter schools will no longer generate pupil units and the associated funding for early graduates participating in these programs.

Temporary Suspension of Reserved Revenue for Staff Development – The temporary suspension of the requirement for school districts and charter schools to reserve 2 percent of their basic general education revenue for staff development, initially suspended for FY 2010 and FY 2011, was extended to include FY 2012 and FY 2013.

Licensed School Support Staff – The requirement for school districts to reserve $3 per pupil of the safe schools levy proceeds for licensed school support staff, as well the maintenance of effort requirement relating to school counselors and other licensed support staff, have been eliminated.

Uses of Operating Capital Revenue – The use of operating capital revenue has been expanded to include costs associated with leasing vehicles, and costs directly associated with closing a school facility, including moving and storage costs.

Endowment/Permanent School Fund Payments – Effective March 1, 2012, the distribution of endowment/permanent school fund revenue will be based on the adjusted average daily membership (ADM) pupils served by each school district rather than resident ADM pupils. Also, charter schools will qualify to receive endowment/permanent school fund payments beginning that same date.

Teacher Contract Deadline – The January 15 deadline for settling teacher contracts and the related penalty have been eliminated.

Literacy Incentive Aid – For FY 2013 and later, a new literacy incentive aid is available to school districts and charter schools. Only school sites that enroll students in Grades 3 and 4, with reading MCA test results from the prior year, generate revenue. There is no requirement for the funds to be spent at the school generating the revenue. The aid may be used for any General Fund purpose.

Literacy incentive aid is the sum of two components, proficiency aid and growth aid. Proficiency aid equals $85 times the school's enrollment from October 1 of the previous year times the school's proficiency index (the percent of third graders meeting or exceeding proficiency on the reading Minnesota Comprehensive Assessments (MCA) test, averaged across the previous three test administrations). Growth aid equals $85 times the school's enrollment on the previous October 1 times the percentage of fourth graders making medium or high growth on the reading MCA, averaged across the previous three test administrations.

Integration Aid – The current integration rule remains in effect with no sunset. However, the current integration aid funding formula remains in place only for FY 2012 and FY 2013. The integration revenue statute is repealed in FY 2014, and the base appropriation for a new program is established for FY 2014 and FY 2015. The Commissioner of Education will convene a 12-member Integration Revenue Replacement Advisory Task Force to develop recommendations for repurposing integration revenue funds to create and sustain opportunities for students to achieve improved educational outcomes.

Property Tax Revenue Recognition Change (Tax Shift) – Beginning in FY 2011, 48.6 percent of property taxes levied for the next school year will be recognized as revenue in the current year, and state aids will be reduced by that same amount. The shift calculation was changed to use gross levies before state tax credits are deducted. Shifted amounts will be repaid (decreased) when the state attains certain specific financial goals, and the aid payment schedule is restored to 90–10.

Homestead Market Value Credit – The homestead market value credit, which reduces the property taxes spread to homestead property based on net tax capacity and replaces it with state aid, is repealed effective for taxes payable in 2012. To help neutralized the impact of the credit repeal on homeowners, a portion of each homestead taxpayer's market value will be excluded in determining the property's net tax capacity for determining net tax capacity-based taxes. The exclusion starts at 40 percent of the value for homes valued up to $76,000, and is gradually reduced as the home value increases, phasing out completely for homes valued over $413,800.

Career and Technical Levy – Beginning with taxes payable in 2012, this levy is increased to the greater of $80 times the District's ADM in Grades 9 through 12, or 35 percent of approved expenditures (instead of the lesser of $80 times the District's ADM in Grades 10 through 12, or 25 percent of approved expenditures).

Fund Transfers – For FY 2012 and FY 2013 only, school districts are authorized to transfer any money from one fund or account to another, excluding transfers from the food service or community service funds, as long as the transfer does not increase state aid obligations or increase local property taxes. School boards may only approve such transfers after they have adopted a resolution stating that the transfer will not diminish instructional opportunities for students.

PERA and TRA Rates – Contribution rates for employers and employees of the PERA Coordinated Plan increase by 0.25 percent effective January 1, 2011. Contribution rates for employers and employees for both the TRA Basic and Coordinated Plans increase by 0.5 percent each year through FY 2015. There is no additional aid to help fund these increases.

Minnesota Department of Education Budget – The MDE budget has been reduced by 5.0 percent annually for FY 2012 and FY 2013.