

# STATE OF MINNESOTA

## Office of the State Auditor



**Rebecca Otto**  
**State Auditor**

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PETITION ENGAGEMENT

**INDEPENDENT SCHOOL DISTRICT #23**

FOR THE YEARS ENDED JUNE 30, 2007 AND 2008

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The mission of the Office of the State Auditor is to oversee local government finances for Minnesota taxpayers by helping to ensure financial integrity and accountability in local governmental financial activities.

Through financial, compliance, and special audits, the State Auditor oversees and ensures that local government funds are used for the purposes intended by law and that local governments hold themselves to the highest standards of financial accountability.

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**INDEPENDENT SCHOOL DISTRICT #23**  
**For the Years Ended June 30, 2007 and 2008**



**Petition Engagement**

**Audit Practice Division**  
**Office of the State Auditor**  
**State of Minnesota**

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## INDEPENDENT PETITION ENGAGEMENT

Petitioners  
Superintendent and School Board  
Independent School District #23

### INTRODUCTION

Eligible voters of Independent School District #23 (District) petitioned the Office of the State Auditor (OSA) to examine the books, accounts, and affairs of the District in accordance with Minn. Stat. § 6.54 for the years ended June 30, 2007 and 2008. The statute allows the OSA, in the public interest, to confine the scope of the audit to less than that requested by the petition. Through discussion and agreement with petitioner representatives, the scope of our review was limited to addressing the issues discussed below.

### **INFORMATION PRESENTED PRIOR TO THE 2007 OPERATING REFERENDUM**

The petitioners raised concerns about information presented to the public, by the District, prior to the 2007 election approving an operating referendum. The petitioners stated that the District told the public that, without the approval of the operating referendum, the District would likely fall into a Statutory Operating Debt (SOD). The District provided information that the General Fund's fund balance was a negative \$10,000. After the referendum passed, it was announced that the unreserved/undesignated fund balance as of June 30, 2007, was approximately \$885,000.

The District has been experiencing declining enrollment, declining revenues, and has had to make numerous cuts in expenditures in the past few years. In 2007, the District approved placing an operating referendum on the ballot that would increase revenue by approximately \$1,000,000 per year for five years. The referendum would provide an additional \$1,000/per pupil unit. In November 2007, the operating referendum passed by majority vote.

Prior to the referendum election, the District distributed a flyer titled “Your School - Your Communities - Your Decision” to the public providing information on the 2007 operating referendum. In addition, the District held 12 public meetings to discuss the pros and cons of the referendum and get input from the citizens of the community. A PowerPoint presentation was used at those meetings to provide information on the 2007 operating referendum. Superintendent Stender provided the OSA with a copy of the flyer, the PowerPoint presentation, and the outline used for narrating the PowerPoint presentation. The information presented to the public by the District provides that, without the referendum: extra and co-curricular activities would be lost, class sizes would be increased, enrollment would erode, and the District would likely enter into SOD, which would result in the Minnesota Department of Education assuming local control. The information presented also provided some other options for the District if the referendum did not pass, what would happen if the operating referendum passed, and the cost to the taxpayers.

Articles published by the Frazee-Vergas Forum on September 26, 2007, and October 10, 2007, reference statements made by Superintendent Deron Stender and Board member Richard Ziegler during the public meetings, indicating the General Fund’s fund balance would be a negative \$10,000. Inquiry with Superintendent Stender revealed that he had prepared some estimates of the General Fund’s fund balance to show the estimated differences up through fiscal year 2010 if the referendum was passed or if the referendum was not passed. His estimates show that, for fiscal year ending June 30, 2007, he anticipated the General Fund’s fund balance to be \$105,829. For fiscal year ending June 30, 2008, his estimates show the District’s General Fund would have a negative fund balance of \$10,614. For fiscal years ending June 30, 2009 and 2010, the General Fund’s fund balance was estimated to continue a downward pattern if the operating referendum was not passed or move back into a positive balance if the operating referendum was passed.

The information below shows the differences between the General Fund’s estimated unreserved/undesignated fund balance and activity affecting the unreserved/undesignated fund balance compared with the actual amounts for the years ending June 30, 2007 and 2008.

2006 - 2007 Year	Estimated <sup>1</sup>	Actual <sup>2</sup>	Difference
Beginning Unreserved/Undesignated Fund Balance	\$ 798,249	\$ 798,249	\$ -
Revenues	8,541,060	8,995,066	454,006
Expenditures	9,233,480	8,954,051	279,429
Other Sources (Uses)	-	28,340	28,340
Effect Due to Changes in Reserves	-	17,301	17,301
Ending Unreserved/Undesignated Fund Balance	<u>\$ 105,829</u>	<u>\$ 884,905</u>	<u>\$ 779,076</u>

<sup>1</sup>Source: Summary worksheets prepared by Superintendent Stender titled “Estimated Fund Balance With \$1,000 Referendum” used to estimate the fund balances for fiscal years ending June 30, 2006 through 2010, if referendum is passed and if referendum is not passed.

<sup>2</sup>Source: Annual audited financial statements.

2007 - 2008 Year	Estimated <sup>3</sup>	Actual <sup>4</sup>	Difference
Beginning Unreserved/Undesignated Fund Balance	\$ 105,829	884,905	\$ 779,076
Revenues	9,763,387	8,594,846	(1,168,541)
Expenditures	9,879,830	8,323,496	1,556,334
Other Sources (Uses)	-	141	141
Effect Due to Changes in Reserves	-	(294,959)	(294,959)
Ending Unreserved/Undesignated Fund Balance	\$ (10,614)	\$ 861,437	\$ 872,051

Superintendent Stender noted his estimates were based on trends from the previous years. He stated that, the enrollment numbers provided to the state were conservative due to the history of declining enrollment and a desire to avoid over-estimating, which could result in the District having to pay back excess General Education Aid. A second reason given for the difference between the estimated numbers and actual was that actual cuts in expenditures were greater than he had anticipated when his estimates were prepared.

One major funding source for the District is General Education Aid. This funding is an allocation from the state based on the number of enrolled students in the District. The table below illustrates the effects that declining enrollment has had on the District.

Year	Number of Students <sup>5</sup>	General Education Aid <sup>6</sup>	Aid Per Student
2002 - 2003	1,204	\$ 7,568,157	\$ 6,286
2003 - 2004	1,165	7,288,842	6,257
2004 - 2005	1,112	7,044,837	6,335
2005 - 2006	1,093	7,113,668	6,508
2006 - 2007	1,013	6,925,285	6,836
2007 - 2008	922	6,460,590	7,007

Year	Number of Students <sup>5</sup>	Total Revenue <sup>7</sup>	Revenue Per Student
2002 - 2003	1,204	\$ 9,596,671	\$ 7,971
2003 - 2004	1,165	9,074,407	7,789
2004 - 2005	1,112	8,934,333	8,034
2005 - 2006	1,093	9,130,830	8,354
2006 - 2007	1,013	8,995,067	8,880
2007 - 2008	922	8,594,846	9,322

<sup>3</sup>Source: Summary worksheets prepared by Superintendent Stender titled "Estimated Fund Balance With \$1,000 Referendum" used to estimate the fund balances for fiscal years ending June 30, 2006 through 2010, if referendum is passed and if referendum is not passed.

<sup>4</sup>Source: Annual audited financial statements.

<sup>5</sup>Source: District's enrollment numbers, which were verified to the Minnesota Department of Education District/School ADM report.

<sup>6</sup>Source: Minnesota Department of Education two year comparison reports and the District's general ledger.

<sup>7</sup>Source: Revenues and expenditures were obtained from the Minnesota Department of Education UFARS compliance reports.

Year	Number of Students <sup>8</sup>	Total Expenditures <sup>9</sup>	Expenditures Per Student
2002 - 2003	1,204	\$ 9,259,409	\$ 7,691
2003 - 2004	1,165	9,195,154	7,893
2004 - 2005	1,112	9,056,504	8,144
2005 - 2006	1,093	9,037,671	8,269
2006 - 2007	1,013	8,954,051	8,839
2007 - 2008	922	8,323,496	9,028

Over the six-year period, the number of students has declined by 282 students (23 percent). This has resulted in a decline in General Education Aid and total revenue each year, except for the fiscal year ended June 30, 2006. General Education Aid and revenue increased that year due to an increase in allocation per student. For the six-year period, the District has also made substantial cuts in expenditures to compensate for much of the lost revenues. The result of these cuts has been that the District maintained a positive unreserved/undesignated fund balance through fiscal year ended June 30, 2008.

Minnesota Statutes § 123B.81 distinguishes between operating debt and SOD. A district is allowed to have a negative balance in the unreserved General Fund balance; however, when the deficit exceeds negative 2.5 percent of the operating expenditures in that fund, a district is declared to be in SOD. If a district goes into SOD, it must reduce its expenditures, as well as submit to the Commissioner of Education for approval a special operating plan on how it plans to reduce the district's expenditures.

Every year, the state calculates a SOD percent based on unreserved/undesignated fund balance and expenditures. The average SOD calculation for schools in Minnesota is around 13 percent according to a representative from the Minnesota Department of Education. The District's SOD calculation has been below the average for several years, but is still well above the requirement for entering into SOD. The District's calculations are shown below.

Year	Unreserved/ Undesignated Fund Balance	Expenditures for SOD Calculation	SOD Calculation <sup>10</sup>
2002 - 2003	\$ 1,036,133	\$ 7,700,038	13.46%
2003 - 2004	856,372	7,754,812	11.04%
2004 - 2005	760,214	7,672,704	9.91%
2005 - 2006	798,249	7,370,211	10.83%
2006 - 2007	884,905	7,535,746	11.74%
2007 - 2008	861,437	7,298,162	11.80%

<sup>8</sup>Source: District's enrollment numbers, which were verified to the Minnesota Department of Education District/School ADM report.

<sup>9</sup>Source: Revenues and expenditures were obtained from the Minnesota Department of Education UFARS compliance reports.

<sup>10</sup>Source: Minnesota Department of Education UFARS compliance reports.



The Superintendent prepared the fund projections and estimates used prior to the levy referendum. He told us that he used historical trends to project the estimates of student enrollment and the effects on revenues and expenditures. At the time of our audit, only “Summary” worksheets were available regarding these estimates. When we asked for a copy of the detailed calculations and assumptions supporting the estimates used, the Superintendent was unable to provide them. He stated that he had erased them when the actual amounts became available. As previously described the Superintendent had general explanations for the differences between the pre-referendum estimates and the actual amounts; however, we were unable to examine the details supporting the estimates used by the Superintendent to determine their reasonableness in light of the circumstances.

Minnesota Statutes § 15.17 states that all school districts and public officers in this state “shall make and preserve all records necessary to a full and accurate knowledge of their official activities.” Further this statute states: “The chief administrative officer of each public agency shall be responsible for the preservation and care of the agency’s government records, which shall include written or printed books, papers, letters, contracts, documents, maps, plans, computer-based data, and other records made or received pursuant to law or in connection with the transaction of public business.”

The District undertook to present these fund balance estimates to citizens in order to affect the levy vote. The assumptions, estimates, and calculations used to create this information are necessary to a full and accurate knowledge of the District’s activities in this regard, and they were made in connection with the transaction of public business. These records should have been preserved. It was the Superintendent’s statutory duty to make sure they were not destroyed.

We recommend that the District preserve all public records as required by state law.

### **STUDENT ACTIVITY ACCOUNTS AND EVENT ADMISSIONS**

The petitioners were concerned that collections for the student activity accounts and interest from those deposits have been transferred to the General Fund. If this is true, is this legal? The Future Farmers of America (FFA) accounts generally have a larger balance due to tree plantings and the annual fruit sale. Can that money be controlled by the FFA Alumni Association? The petitioners question if all cash collected from sporting events, concerts, and other student activities are accounted for?

The District does not currently have a Board-adopted policy relating to student activity accounts, but it is in the process of getting one approved by the School Board. The District follows the guidelines laid out in the Manual for Activity Fund Accounting (MAFA), Chapter 14 of the Uniform Financial Accounting and Reporting Standards (UFARS) Manual, issued by the Minnesota Department of Education, pursuant to Minn. Stat. § 123B.49. The MAFA states that its purpose is to provide uniform procedures for the financial management of student activity funds in Minnesota Public Schools. The manual is the basis from which local school boards develop policies and procedures to control and account for these funds. The MAFA also states

that it contains legal authority and fiscally sound practices to guide the development and maintenance of an accounting system for student activity accounts. It provides guidance and processes for setting up, monitoring, and reporting student activity accounts. The FFA Alumni Association has no authority to account for or control student activity accounts.

The MAFA states that student activity accounts are used to account for dollars raised by the students for the students. For this reason, the District maintains one bank account that is specifically designated for student activity accounts. Collections for the student activity accounts are handled as follows: Student activity receipts are counted and recorded by the organizations in their individual Pay Order/Receipt books. Receipts are turned in to the business office by the student representative or advisor and recounted by the business office to verify the amount. Each activity has a separate ledger sheet where the deposit is recorded, and the money is deposited in the student activity bank account. Disbursements for the student activity accounts are handled as follows: Student activity disbursements are requested by the activity advisor and student representative. The Pay Order/Receipt books must be completed and signed by both the advisor and the student representative. The request must be accompanied by proper documentation to support the disbursement. The request is turned in to the business office where it is reviewed to determine if it is a proper expense and, if so, a check is written by the business office personnel and signed by one other District-authorized person. A copy of the Pay Order/Receipt and supporting documentation is kept by the business office. The disbursement is recorded on each activity's individual ledger sheet, which keeps a running balance of the account. Any transfers between activity accounts must be approved by both the transferee and the transferor organization.

The MAFA states that interest earnings from student activity dollars may be deposited in the School District's General Fund to offset specific overhead that resulted from the maintenance of the activity fund. However, it also states that earnings in excess of cost must be maintained in the activity fund. Earnings may also be either maintained in separate activity accounts to be spent for a specific purpose, or they may be commingled and periodically apportioned among all accounts that are part of the commingled cash management system based on the average deposit as determined by the balance at the beginning or end of a period of time.

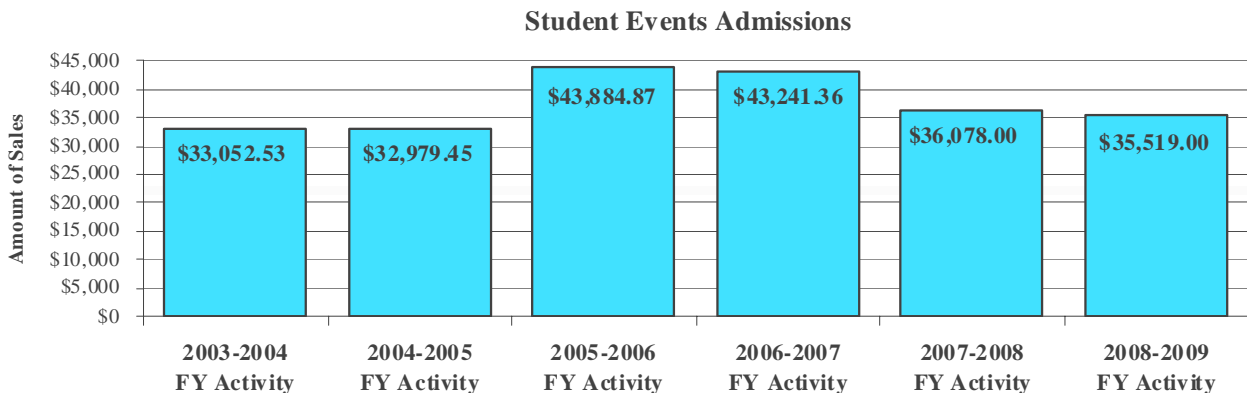
The District has a separate student activity account set up for the interest earned on the bank account. None of the interest has been allocated to any of the accounts due to the fact that a reasonable basis for the allocation has not been determined. The balances in certain accounts fluctuate greatly from day to day or from the beginning of the year to the end of the year. For example, some accounts may have a high balance for a majority of the year and hardly anything at the end of the year.

During our audit, we reviewed the manual ledger sheets prepared for each student activity account to look for any unusual transactions. We verified that transfers between accounts were approved and recorded on each student activity ledger involved. All student activity accounts that had total receipts over \$10,000 for the 2006 - 2007 fiscal year were reviewed in detail. This was accomplished by tracing all the recorded transactions to the original receipts, purchase

orders, and other supporting documentation for those transactions. The testing revealed that the student activity accounts are being recorded properly and that no money has been transferred to the District's General Fund. The FFA account does make payments to the District for reimbursement of payments made to individuals for planting trees.

The District records all revenue earned from sporting events and other student events such as concerts in the General Fund. The revenue is recorded and coded with the correct account number based on the guidelines set forth in the UFARS Manual. This manual provides specific codes to record revenue from the collections of admissions and other fees. The money collected at events is totally separate from the money that students earn for their individual student activity accounts. The District has established internal control procedures over collections of admissions from sporting events and concerts. Before the event, the business office provides a cash bag with a set amount of cash for making change to the Athletic Director or other responsible staff in charge. As patrons enter the gate, the fee is collected and their hand is stamped to indicate they have paid. Cash boxes are used at each gate. When the gates are closed, the Athletic Director or other responsible staff collects the cash boxes, counts the cash, and places the cash in the bank bag provided by the business office. For evening events, the bag is stored in the high school vault until the next morning when it is delivered to the business office. A business office person counts the cash, removing the start-up cash, and prepares a receipt for the collection amount. Bank deposits are made by a different business office person. Controls over event collections could be improved by establishing a system that tracks the attendance numbers so attendance can be compared to collections to ensure all gate collections are being turned over to the business office.

We randomly chose two months of admissions from events and traced them to the deposit made with the bank and the District's general ledger. The results of the tests showed nothing unusual concerning the collection and recording of event admissions. A trend analysis (shown below) was also completed comparing the revenues collected over the past six fiscal years. Event revenue may vary from year to year due to how good the team was in a given year, how many home games occurred in a given year, distance of the team the District was playing, and the number of concerts performed.



## **BUILDING IMPROVEMENTS**

The petitioners questioned whether the operating referendum money can be used for building repairs and maintenance and whether building improvements, such as a new heating system, air conditioning, and fire protection, can be paid for from the Health and Safety Fund and levied for without public approval. Petitioners also wanted to know why debt was issued.

Minnesota Statutes § 126C.17 authorizes school districts to increase General Fund revenues through voter approval of an operating referendum. Per the Minnesota Department of Education, in 1995 school districts merged their Capital Fund into their General Fund. Since then, school districts are allowed to use general and referendum revenues for any purpose authorized for the use of capital revenues under Minn. Stat. § 126C.10, subd. 14. This statute lists many purposes for which the revenue may be used and includes building repairs and improvements, among other things.

Because the District was considering several major repair projects, including a boiler repair or replacement project, roof repairs, lighting in the gymnasiums, window replacement, and a sprinkler system required by the State Fire Marshal, the Board asked McKinstry Co. to provide a presentation during the December 10, 2007, Board meeting. The services provided by McKinstry included a survey of the facilities with recommendations on priorities of projects and funding opportunities.

The projects have been divided into two phases based on the type of funding for the projects. The District has set up a building construction fund to track the expenditures.

Phase I is for boiler replacement and energy conservation projects. In April 2008, the School Board approved entering into a Tax-Exempt Lease Purchase Financing Agreement to help fund the Phase I projects. On May 12, 2008, the Board approved an addendum to add a safety wall and air conditioning for the high school gymnasium to the Phase I projects.

Phase II is for installing a fire protection sprinkling system in the elementary school, due to a mandate from the State Fire Marshal. As long as the sprinkler system was to be installed, in order to save on costs, the District decided it would be beneficial to also upgrade the elementary school's Heating/Ventilation/Air Conditioning (HVAC) system during the same time.

Minnesota Statutes § 123B.57 addresses the Health and Safety Program. The statute lists certain projects eligible for health and safety funding. Among that list are fire and life safety code repair and health, safety, and environmental management, including indoor air quality management, which are the two projects the District is undergoing in Phase II. The statute states that projects with an estimated cost of \$500,000 or more per site, qualifying under the health and safety criteria, are funded under the alternative facilities program addressed in Minn. Stat. § 123B.59. The District can either issue bonds or do a pay-as-you-go levy, and such projects are not eligible for health and safety revenue.

In order to be eligible to participate in the alternative facilities bonding and levy program, a district must meet many requirements detailed in Minn. Stat. § 123B.59, subd. 1(a). When the program first began, it was geared more towards districts with a large number of aging facilities. Currently, 24 districts qualify under Minn. Stat. § 123B.59, subd 1(a), mostly in the metro area. Districts other than the 24 districts above with projects in excess of \$500,000 qualify under Minn. Stat. § 123B.59, subd. 1(b). Under this provision, a district has to meet only two requirements. It must have one or more health and safety projects with an estimated cost over \$500,000, and it must have insufficient funds from capital facilities revenue to fund those projects. The estimated cost of the Phase II projects was over \$500,000, therefore, according to the above statutes, the District was eligible for alternative facilities bonding and levy revenue.

The contractors for Phase II must be paid as they complete the work, and the school does not have the money up front to pay them. For this reason, in October 2008, the Frazee-Vergas School Board approved a resolution authorizing the issuance and sale of General Obligation Alternative Facilities Bonds, Series 2008A, to fund the Health and Safety Phase II projects at the elementary school, which was set to take place during the summer of 2009. The District did not receive voter approval on this issue, but based on Minn. Stat. § 123B.59, subd. 3, it is not required to obtain voter approval. Minn. Stat. § 123B.59, subd. 3, states that as long as the District has met all other requirements for obtaining the Alternative Facilities Bonds, it does not need to follow Minn. Stat. §§ 475.58-.59, which deal with elections, and therefore only needs to obtain approval from the School Board and the Commissioner of Education. Per review of the debt agreement, the principal and interest on the bonds will be funded through an annual ad valorem tax on all taxable property spread upon the tax rolls for collection in 2009 to 2018.

### CONCLUSION

We were not engaged to, and did not perform an audit, the objective of which would be the expression of an opinion on specified elements, accounts, or items. Accordingly, we do not express such an opinion. Had we performed additional procedures, other matters may have come to our attention that we would have reported to you.

This report has been prepared solely for the information and use of the Petitioners, Superintendent, and School Board of Independent School District #23, and is not intended to be, and should not be, used by anyone other than those specified parties.

*/s/Rebecca Otto*

REBECCA OTTO  
STATE AUDITOR

*/s/Greg Hierlinger*

GREG HIERLINGER, CPA  
DEPUTY STATE AUDITOR

August 18, 2009