

# Management Letter

## Kato Public Charter School

Mankato, Minnesota

For the Year Ended

June 30, 2016

Management and Members of the School Board  
Kato Public Charter School  
Mankato, Minnesota

We have audited the financial statements of the governmental activities, each major fund and the remaining fund information of the Kato Public Charter School, Mankato, Minnesota (the School) for the year ended June 30, 2016, and have issued our report thereon dated September 29, 2016. Professional standards require that we provide you with information about our responsibilities under generally accepted auditing standards as well as certain information related to the planned scope and timing of our audit. We have communicated such information in our letter to you dated June 16, 2016. Professional standards also require that we communicate to you the following information related to our audit.

**Our Responsibility under Auditing Standards Generally Accepted in the United States of America and *Government Auditing Standards***

As stated in our engagement letter, our responsibility, as described by professional standards, is to express opinions about whether the financial statements prepared by management with your oversight are fairly presented, in all material respects, in conformity with accounting principles generally accepted in the United States of America. Our audit of the financial statements does not relieve you or management of your responsibilities.

Also, our responsibility is to plan and perform the audit to obtain reasonable, but not absolute, assurance that the financial statements are free of material misstatement. We are responsible for communicating significant matters related to audit that are, in our professional judgment, relevant to your responsibilities in overseeing the financial reporting process. However, we are not required to design procedures specifically to identify such matters.

**Significant Audit Findings**

In planning and performing our audit, we considered the School's internal control over financial reporting as a basis for designing our auditing procedures for the purpose of expressing our opinion on the financial statements, but not for the purpose of expressing an opinion on the effectiveness of the School's internal control over financial reporting. Accordingly, we do not express an opinion on the effectiveness of the School's internal control over financial reporting.

*A deficiency in internal control* exists when the design or operation of a control does not allow management or employees, in the normal course of performing their assigned functions, to prevent, or detect and correct, misstatements on a timely basis. A *material weakness* is a deficiency, or a combination of deficiencies, in internal control, such that there is a reasonable possibility that a material misstatement of the entity's financial statements will not be prevented, or detected and corrected on a timely basis. A *significant deficiency* is a deficiency, or a combination of deficiencies, in internal control that is less severe than a material weakness, yet important enough to merit attention by those charged with governance.

Our consideration of internal control was for the limited purpose described in the first paragraph of this section and was not designed to identify all deficiencies in internal control that might be material weaknesses or significant deficiencies. Given these limitations, during our audit we did not identify any deficiencies in internal control that we consider to be material weaknesses. However, material weaknesses may exist that have not been identified.

## **Compliance and Other Matters**

As part of obtaining reasonable assurance about whether the School's financial statements are free of material misstatement, we performed tests of its compliance with certain provisions of laws, regulations, contracts, and grant agreements, noncompliance with which could have a direct and material effect on the determination of financial statement amounts. However, providing an opinion on compliance with those provisions was not an objective of our audit, and accordingly, we do not express such an opinion. The results of our tests disclosed no instances of noncompliance or other matters that are required to be reported under *Government Auditing Standards* or Minnesota statutes.

## **Planned Scope and Timing of the Audit**

We performed the audit according to the planned scope and timing previously communicated to you through various means.

## **Qualitative Aspects of Accounting Practices**

Management is responsible for the selection and use of appropriate accounting policies. The significant accounting policies used by the School are described in Note 1 to the financial statements. We noted no transactions entered into by the governmental unit 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 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 School's financial statements are estimated historical cost of the capital assets, depreciation on capital assets and amounts receivable from the Minnesota Department of Education (MDE).

- Management's estimate of capital asset basis is based on estimated historical cost of the capital assets and depreciation is based on the estimated useful lives of capital assets.
- Management's estimate of amounts due from the Minnesota Department of Education is based on pupil unit and other information provided by the MDE.

We evaluated the key factors and assumptions used to develop these accounting estimates in determining that it is reasonable in relation to the financial statements taken as a whole.

The disclosures in the financial statements are neutral, consistent, and clear. Certain financial statement disclosures are particularly sensitive because of their significance to financial statement users.

## **Difficulties Encountered in Performing the Audit**

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

## **Corrected and Uncorrected Misstatements**

Professional standards require us to accumulate all known and likely misstatements identified during the audit, other than those that are clearly trivial, and communicate them to the appropriate level of management. We did not propose any journal entries that we consider to be audit entries or corrections of management decisions.

## **Management Representations**

We have requested certain representations from management that are included in the management representation letter dated September 29, 2016.

## 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 School’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 School’s auditors. However, these discussions occurred in the normal course of our professional relationship and our responses were not a condition to our retention.

## Other Matters

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

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

We were not engaged to report on the introductory, which accompany the financial statements but are not RSI. We did not audit or perform other procedures on this other information and we do not express an opinion or provide any assurance on it.

## Financial Position and Results of Operations

Our principal observations and recommendations are summarized on the following pages. These recommendations resulted from our observations made in connection with our audit of the School’s financial statements for the year ended June 30, 2016.

### General Fund

A summary of current year budgeted and actual revenue and expenditures is as follows:

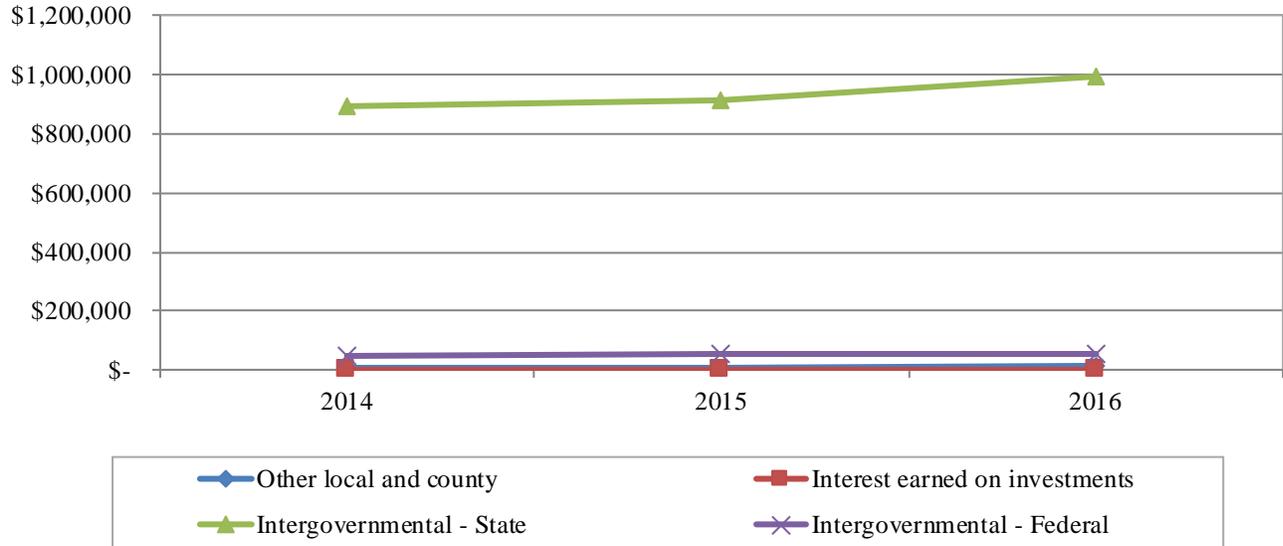
|                             | Final<br>Budget   | Actual<br>Amounts | Variance with<br>Final Budget |
|-----------------------------|-------------------|-------------------|-------------------------------|
| Revenues                    | \$ 1,067,092      | \$ 1,047,943      | \$ (19,149)                   |
| Expenditures                | 1,039,971         | 1,014,806         | 25,165                        |
| Net change in fund balances | 27,121            | 33,137            | 6,016                         |
| Fund balances, July 1       | 522,073           | 522,073           | -                             |
| Fund balances, June 30      | <u>\$ 549,194</u> | <u>\$ 555,210</u> | <u>\$ 6,016</u>               |

- Revenues were under budget for fiscal year 2016. This negative variance was mainly attributable to Federal revenue coming in under budget by \$28,762.
- Expenditures were under budget for fiscal year 2016. This positive variance primarily relates to regular instruction which were favorable to budgeted amounts by \$19,923.

A further breakdown of revenue by source for the past three years in the General and special revenue fund is as follows:

|                                | <u>2014</u>           | <u>2015</u>           | <u>2016</u>             | <u>Per ADM</u>       |
|--------------------------------|-----------------------|-----------------------|-------------------------|----------------------|
| Other local and county         | \$ 10,101             | \$ 6,826              | \$ 11,677               | \$ 150               |
| Interest earned on investments | 498                   | 43                    | 100                     | 1                    |
| Intergovernmental - State      | 891,938               | 913,133               | 991,063                 | 12,706               |
| Intergovernmental - Federal    | <u>50,132</u>         | <u>56,981</u>         | <u>54,381</u>           | <u>697</u>           |
| <br>Total revenues             | <br><u>\$ 952,669</u> | <br><u>\$ 976,983</u> | <br><u>\$ 1,057,221</u> | <br><u>\$ 13,554</u> |

### Revenue by Source

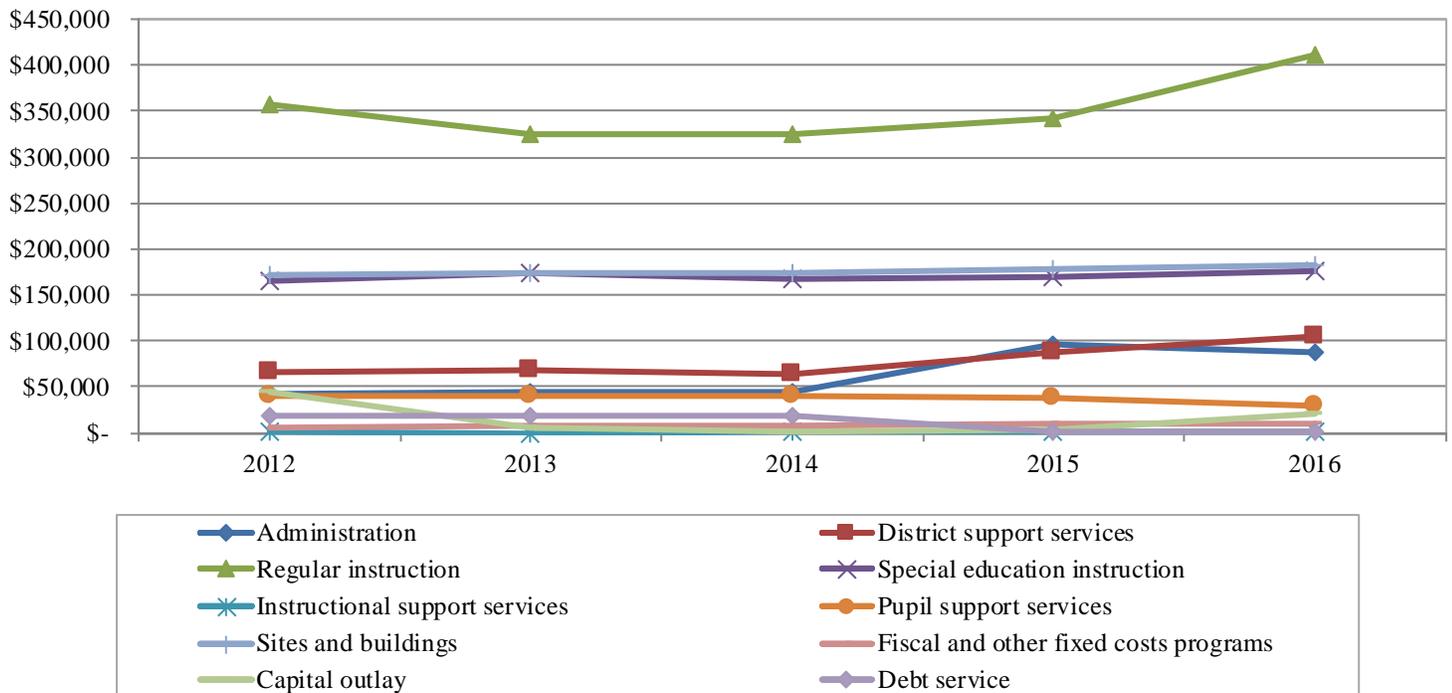


A further breakdown of expenditures by program for the past five years in the General fund and Food Service fund is as follows:

|                                       | 2012              | 2013              | 2014              | 2015              | 2016               | Per ADM          | Peer Group<br>Per ADM |
|---------------------------------------|-------------------|-------------------|-------------------|-------------------|--------------------|------------------|-----------------------|
| Administration                        | \$ 42,257         | \$ 43,781         | \$ 45,084         | \$ 96,443         | \$ 87,181          | \$ 1,118         | \$ 2,434              |
| District support services             | 65,388            | 68,701            | 64,746            | 88,208            | 105,468            | 1,352            | 503                   |
| Regular instruction                   | 356,787           | 325,205           | 324,922           | 342,707           | 411,209            | 5,272            | 4,775                 |
| Vocational education instruction      | -                 | -                 | -                 | -                 | -                  | -                | 1                     |
| Special education instruction         | 165,428           | 173,860           | 168,494           | 170,246           | 176,972            | 2,269            | 2,519                 |
| Instructional support services        | 788               | -                 | 664               | 1,724             | 1,193              | 15               | 308                   |
| Pupil support services                | 39,472            | 40,829            | 39,365            | 37,654            | 28,941             | 371              | 1,125                 |
| Sites and buildings                   | 172,435           | 173,911           | 173,203           | 177,335           | 182,705            | 2,342            | 2,514                 |
| Fiscal and other fixed costs programs | 6,587             | 7,213             | 8,284             | 9,123             | 8,980              | 115              | -                     |
| Capital outlay                        | 45,561            | 5,380             | 2,285             | 3,425             | 20,971             | 269              | 377                   |
| Debt service                          | 17,544            | 17,543            | 17,545            | 2,395             | 2,396              | 31               | -                     |
| <b>Total expenditures</b>             | <b>\$ 912,247</b> | <b>\$ 856,423</b> | <b>\$ 844,592</b> | <b>\$ 929,260</b> | <b>\$1,026,016</b> | <b>\$ 13,154</b> | <b>\$ 14,556</b>      |

The above chart compares the amount the School spends per ADM in comparison to a peer group. We have compiled the peer group average expenditure information from other charter schools with comparable ADM. The peer group average is derived from information available on the website of the Minnesota Department of Education.

### Expenditures by Program



**Food Service Special Revenue Fund**

A summary of activity is shown below:

|                             | <u>Final<br/>Budget</u> | <u>Actual<br/>Amounts</u> | <u>Variance with<br/>Final Budget</u> |
|-----------------------------|-------------------------|---------------------------|---------------------------------------|
| Revenues                    | \$ 10,607               | \$ 9,278                  | \$ (1,329)                            |
| Expenditures                | <u>11,305</u>           | <u>11,210</u>             | <u>95</u>                             |
| Net change in fund balances | (698)                   | (1,932)                   | (1,234)                               |
| Fund balances, July 1       | <u>2,812</u>            | <u>2,812</u>              | <u>-</u>                              |
| Fund balances, June 30      | <u><u>\$ 2,114</u></u>  | <u><u>\$ 880</u></u>      | <u><u>\$ (1,234)</u></u>              |

The fund experienced a decrease of fund balance during the year due to expenditures being greater than revenues. The School should have a minimum of one-month reserve in fund balance for this fund. This level would indicate fund balance should be around \$933. Also, a school food authority must limit its net cash resources to an amount that does not exceed three months' average expenditures for the nonprofit school food service, unless a higher amount has been approved by the Minnesota Department of Education Accountability and Improvement. At the end of the 2016 fiscal year, the School was in compliance with this requirement.

## Fund Balance - Operating Funds

The fund balances of the operating funds as of June 30 for the past three years were as follows:

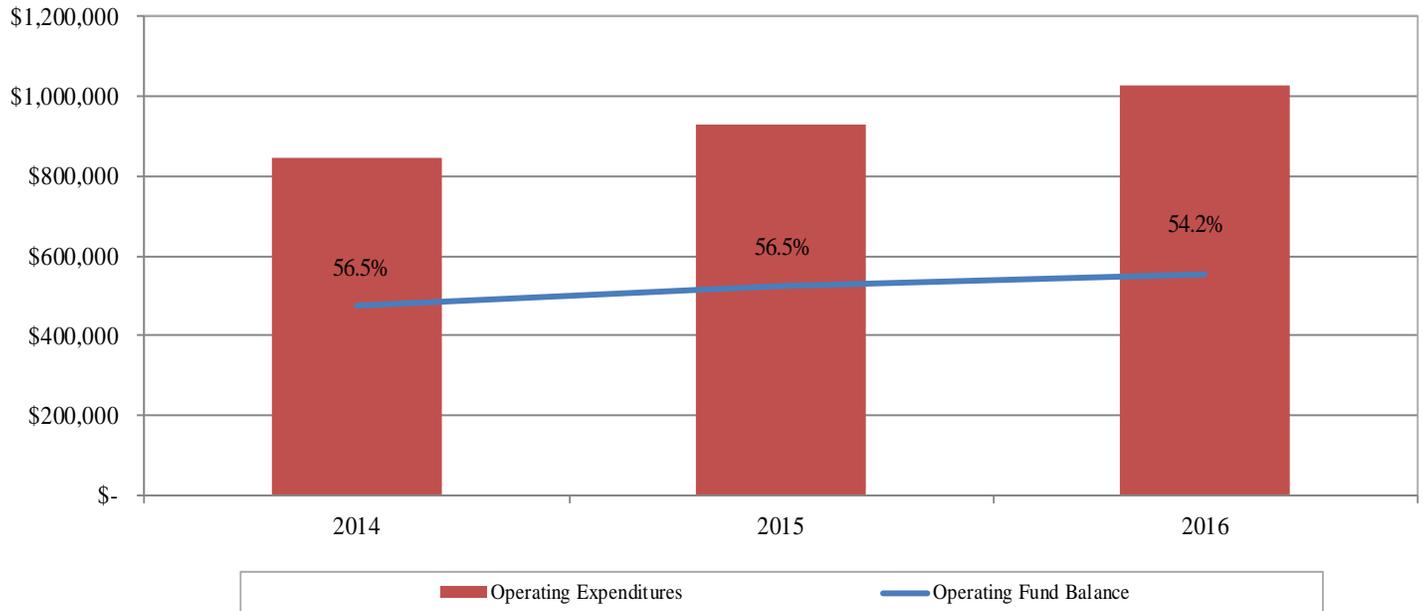
| Fund                | 2014       | 2015       | 2016       |
|---------------------|------------|------------|------------|
| General             | \$ 474,781 | \$ 522,073 | \$ 555,210 |
| Food Service        | 2,381      | 2,812      | 880        |
| Total fund balances | \$ 477,162 | \$ 524,885 | \$ 556,090 |

The operating fund expenditures for the past three years were as follows:

| Fund               | 2014       | 2015       | 2016         |
|--------------------|------------|------------|--------------|
| General            | \$ 834,380 | \$ 917,184 | \$ 1,014,806 |
| Food Service       | 10,212     | 12,076     | 11,210       |
| Total expenditures | \$ 844,592 | \$ 929,260 | \$ 1,026,016 |

|   |           |           |           |
|---|-----------|-----------|-----------|
| Net operating fund balances as a percent of operating fund expenditures | 56.5 %    | 56.5 %    | 54.2 %    |
| Average daily membership  | 66        | 81        | 78        |
| Expenditures per pupil unit   | \$ 12,797 | \$ 11,472 | \$ 13,154 |

### Net Operating Fund Balance/Operating Expenditures



## Fund Balance Analysis

The following is a summary of the changes in the School's fund balances for the year ended June 30, 2016:

|   | <u>Balance</u><br><u>June 30, 2015</u> | <u>Revenues</u>     | <u>Expenditures</u> | <u>Balance</u><br><u>June 30, 2016</u> |
|---|--|---------------------|---------------------|--|
| General fund                                      |  |                     |                     |  |
| Nonspendable                                      |  |                     |                     |  |
| Prepaid items                                     | \$ 7,596                               | \$ 10,332           | \$ 7,596            | \$ 10,332                              |
| Restricted for teacher development and evaluation | 2,618                                  | -                   | -                   | 2,618                                  |
| Unassigned  | <u>511,859</u>                         | <u>1,037,611</u>    | <u>1,007,210</u>    | <u>542,260</u>                         |
| Total   | <u>\$ 522,073</u>                      | <u>\$ 1,047,943</u> | <u>\$ 1,014,806</u> | <u>\$ 555,210</u>                      |
| Food Service fund                                 |  |                     |                     |  |
| Restricted for food service                       | <u>\$ 2,812</u>                        | <u>\$ 9,278</u>     | <u>\$ 11,210</u>    | <u>\$ 880</u>                          |

**Future Accounting Standard Changes**

The following Governmental Accounting Standards Board (GASB) Statements have been issued and may have an impact on future School financial statements: <sup>(1)</sup>

**GASB Statement No. 76 - *The Hierarchy of Generally Accepted Accounting Principles for State and Local Governments***

**Summary**

The objective of this Statement is to identify-in the context of the current governmental financial reporting environment-the hierarchy of generally accepted accounting principles (GAAP). The “GAAP hierarchy” consists of the sources of accounting principles used to prepare financial statements of state and local governmental entities in conformity with GAAP and the framework for selecting those principles. This Statement reduces the GAAP hierarchy to two categories of authoritative GAAP and addresses the use of authoritative and nonauthoritative literature in the event that the accounting treatment for a transaction or other event is not specified within a source of authoritative GAAP.

This Statement supersedes Statement No. 55, The Hierarchy of Generally Accepted Accounting Principles for State and Local Governments.

**Effective Date**

The requirements of this Statement are effective for financial statements for periods beginning after June 15, 2015, and should be applied retroactively. Earlier application is permitted.

**Future Accounting Standard Changes - Continued**

**How the Changes in This Statement Will Improve Financial Reporting**

The requirements in this Statement improve financial reporting by (1) raising the category of GASB Implementation Guides in the GAAP hierarchy, thus providing the opportunity for broader public input on implementation guidance; (2) emphasizing the importance of analogies to authoritative literature when the accounting treatment for an event is not specified in authoritative GAAP; and (3) requiring the consideration of consistency with the GASB Concepts Statements when evaluating accounting treatments specified in nonauthoritative literature. As a result, governments will apply financial reporting guidance with less variation, which will improve the usefulness of financial statement information for making decisions and assessing accountability and enhance the comparability of financial statement information among governments.

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This communication is intended solely for the information and use of the members of the School Board, management and others within the administration of the School and the Minnesota Department of Education, and is not intended to be and should not be used by anyone other than these specified parties.

The comments and recommendations in the report are purely constructive in nature, and should be read in this context. Our audit would not necessarily disclose all weaknesses in the system because it was based on selected tests of the accounting records and related data.

If you have any questions or wish to discuss any of the items contained in this letter, please feel free to contact us at your convenience. We wish to thank you for the opportunity to be of service and for the courtesy and cooperation extended to us by your staff.

*Abdo, Eick & Meyers, LLP*

ABDO, EICK & MEYERS, LLP  
Mankato, Minnesota  
September 29, 2016

