



Management Discussion & Analysis

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MANAGEMENT DISCUSSION AND ANALYSIS

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Management Discussion and Analysis
(MD&A)

- Overview
- Minimum Criteria
- MD&A Sample

MD&A OVERVIEW

- Intended to give the reader of the financial statements an easy-to-understand overview of the school district's financial position and results of operations for the year
- Management is required to explain the district's financial position and reasons the position has improved, deteriorated, or is the same compared with the prior year
- Based on currently known facts as of the date of the auditor's report

MD&A
OVERVIEW

- ✦ “What if’s” or information about potential developments or future planned events should not be included
- ✦ Required supplemental information (but precedes basic F/S)
- ✦ CAFR districts-does not replace transmittal letter. Districts presenting a transmittal letter in the CAFR are encouraged by GASB not to duplicate any of the information that is contained in the MD&A

MD&A
Minimum Criteria

- A brief description of the required financial statements for the benefit of users unfamiliar with how they are prepared
- Update wording annually

MD&A
Minimum Criteria

Condensed Government-wide Statements:

Condensed financial information derived from government-wide financial statements

- Statement of Net Assets
- Statement of Activities

Government-wide Analysis:

An analysis of the government’s overall financial position and results of operations, including impact of important economic factors. For example, foundation allowance changes, Headlee rollbacks, pupil enrollment changes or other changes in funding are topics that might impact overall financial position.

MD&A

Minimum Criteria

Fund Level Statements:
An analysis of balances and transactions of individual funds

Budget Information:
An analysis of differences between original and final budgeted amounts and final budgeted amounts and actual amounts (if significant)

Capital Assets & Long-Term Debt:
A description of changes in capital assets and long-term debt during the year and changes therein (*once written, probably won't change much unless there's a new bond issue*)

MD&A

Minimum Criteria

Infrastructure - N/A
A discussion of the condition of infrastructure assets. N/A for schools.

Current Events:
A description of currently known facts, decisions or conditions that have or are expected to have, a material effect on financial position or results of operations (e.g. enrollment, state funding, etc.)

GASB 54 AND THE MD&S

- ✘ Districts should update their discussion on fund balances in the MD&A
- ✘ You will need to explain the new definitions of fund balance that GASB 54 created:
 - + Nonspendable
 - + Restricted
 - + Committed
 - + Assigned

MD&A
SAMPLE

✦ See Public Schools of Petoskey's MD&A attached

Management's Discussion and Analysis

As management of the Public Schools of Petoskey (the "District"), a K-12 school district located in Emmet and Charlevoix Counties, Michigan, we offer readers of the District's financial statements this narrative overview and analysis of the financial activities of the District for the fiscal year ended June 30, 2010. Please read it in conjunction with the District's financial statements, which immediately follows this section.

Overview of the Financial Statements

The District's basic financial statements consist of two parts: Management's Discussion and Analysis (this section) and the basic financial statements. This report also contains other supplementary information.

The basic financial statements include two kinds of statements that present different views of the District:

- The first two statements are the *District-wide financial statements* that provide both short-term and long-term information about the District's overall financial status. These statements present an aggregate view of the District's finances and a longer-term view of those finances.
- The next statements are *fund financial statements* that focus on individual parts of the District. These statements look at the District's operations in more detail than the District-wide financial statements by providing information about the District's most significant funds – the General Fund, the Sinking Fund, and the Debt Service Fund, with all other funds presented in one column as Nonmajor Funds.

The statement of fiduciary assets and liabilities presents financial information about activities for which the District acts solely as an agent for the benefit of students and others.

District-wide financial statements. The *District-wide financial statements* report information about the District as a whole using accounting methods similar to those used by private-sector companies. The statement of net assets and the statement of activities, which appear first in the District's financial statements, include all assets and liabilities and use the accrual basis of accounting. This means that all of the current year's revenues and expenses are taken into account regardless of when cash is received.

The two District-wide financial statements report the District's net assets and how they have changed. Net assets – the difference between the District's assets and liabilities – is one way to measure the District's financial health or position. Over time, increases or decreases in the District's net assets are an indicator of whether its financial position is improving or deteriorating, respectively.

The relationship between revenues and expenses is the District's operating results. However, it should be noted that unlike most private-sector companies where improving shareholder wealth is the goal, the District's goal is to provide services to our students. Therefore, in order to assess the overall health of the District, one must consider many nonfinancial factors such as the quality of education provided, breadth of curriculum offered, condition of school facilities, and the safety of the schools.

The statement of net assets and statement of activities report the governmental activities for the District, which encompass all of the District's services including instruction, supporting services, community services, athletics, and food services. Property taxes, unrestricted State Aid, State grants, and Federal grants finance most of these activities.

Fund financial statements. The District's *fund financial statements* provide detailed information about the most significant funds – not the District as a whole. Some funds are required to be established by State law and by bond covenants, though the District may establish other funds to help control and manage money for particular purposes. It may also establish other funds to show that it is meeting legal responsibilities for using certain taxes, grants, and other money.

The fund level financial statements are reported on a modified accrual basis, which measures only those revenues that are “measurable” and “currently available.” Expenses are recognized to the extent that they are normally expected to be paid with current financial resources.

The fund financial statements are formatted to comply with the legal requirements of the Michigan Department of Education's Bulletin 1022. In the State of Michigan, the District's major instructional and instructional support activities are reported in the General Fund. Additional activities are reported in their relevant funds including:

- Debt Service Fund – consisting of the 2005 refunding bonds, Durant bonds, and two land contracts.
- Special Revenue Funds – consisting of the Food Service Fund and the Athletics Fund.
- Capital Projects Funds – consisting of the Sinking Fund, Building & Site Fund and Roof Repair Fund.

In the fund financial statements, purchased capital assets are reported as expenditures in the year of acquisition. Assets are not capitalized at the fund level. The issuance of debt is recorded as a financial resource. The current year's payments of principal and interest on long-term obligations are recorded as expenditures. Future debt obligations are not recorded at the fund level.

The District is the trustee, or fiduciary, for its student activity funds. All of the District's fiduciary activities are reported in a separate statement of fiduciary assets and liabilities. We exclude these activities from the District's other financial statements because the District cannot use these assets to finance its operations. The District is responsible for ensuring that the assets reported in these funds are used for their intended purposes.

Financial Analysis of the District as a Whole

As stated earlier, the summary of net assets provides the perspective of the District as a whole. The District's net assets increased 8.39% to \$34,276,277 as a result of operations in the current year. Table 1 provides a summary of the District's net assets as of June 30, 2010, and June 30, 2009:

Public Schools of Petoskey
Condensed Statement of Net Assets
Table 1

	<u>Governmental Activities</u>		<u>Percentage Change</u>
	<u>2010</u>	<u>2009</u>	
Assets			
Current assets	\$ 10,387,297	\$ 9,776,084	6.25%
Deferred bond refunding costs	514,705	571,895	(10.00)%
Capital assets, net of accumulated depreciation	<u>47,228,548</u>	<u>46,719,575</u>	<u>1.09%</u>
Total assets	<u>58,130,550</u>	<u>57,067,554</u>	<u>1.86%</u>
Liabilities			
Current liabilities	4,115,621	3,908,045	5.31%
Premium on bond refunding	420,199	466,894	(11.11)%
Long-term liabilities	<u>19,524,724</u>	<u>21,068,574</u>	<u>(7.91)%</u>
Total liabilities	<u>24,060,544</u>	<u>25,443,513</u>	<u>(5.75)%</u>
Invested in capital assets, net of related debt	28,618,615	26,391,415	8.44%
Restricted	3,464,101	3,359,951	3.10%
Unrestricted	<u>1,987,290</u>	<u>1,872,675</u>	<u>6.12%</u>
Total net assets	<u>\$ 34,070,006</u>	<u>\$ 31,624,041</u>	<u>7.73%</u>

Capital assets net of related debt, \$28,618,615, is the original cost of the District's capital assets, less depreciation, less the long-term debt outstanding used to finance the acquisition of those assets. This debt will be repaid mainly from voter-approved property taxes collected as the debt and interest payments come due. Restricted net assets of \$3,464,101 are shown separately to recognize legal constraints from debt covenants and enabling legislation. These constraints limit the District's ability to use those net assets for day-to-day operations.

The remaining amount of net assets of \$1,987,290 was unrestricted and represents the accumulated results of all past years' operations. The operating results of the General Fund will have a significant impact on the change in unrestricted net assets from year to year.

The results of this year's operations of the District as a whole are reported in the statement of activities, summarized in Table 2, which shows the changes in net assets for fiscal year 2010 and 2009.

Public Schools of Petoskey
Condensed Statement of Change in Net Assets
Table 2

	<u>Governmental Activities</u>		<u>Percentage</u>
	<u>2010</u>	<u>2009</u>	<u>Change</u>
Revenue			
Program Revenues			
Charges for services	\$ 709,869	\$ 809,618	(12.32)%
Grants and contributions	5,384,848	4,940,747	8.99%
General Revenues			
Property taxes	20,752,638	19,167,014	8.27%
State foundation allowance	4,331,760	5,689,068	(23.86)%
Other	<u>219,341</u>	<u>915,800</u>	<u>(76.05)%</u>
Total revenues	<u>31,398,456</u>	<u>31,522,247</u>	<u>(0.39)%</u>
Expenses			
Instruction	17,485,598	17,523,345	(0.22)%
Support services	7,304,958	7,770,774	(6.00)%
Community services	38,593	45,520	(15.22)%
Food services	999,884	985,027	1.51%
Athletics	600,604	594,196	1.08%
Interest/fees on long-term debt	881,218	941,297	(6.38)%
Depreciation (unallocated)	<u>1,641,636</u>	<u>1,533,765</u>	<u>7.03%</u>
Total expenses	<u>28,952,491</u>	<u>29,393,924</u>	<u>(1.50)%</u>
Increase in net assets	<u>\$ 2,445,965</u>	<u>\$ 2,128,323</u>	<u>14.92%</u>

Of the District's total revenues available to operate the District, 2.26% or \$709,869 came from fees charged to those who benefited from the programs. Revenues from other governments or organizations that subsidize certain programs with grants and other directed types of funding approximated 17.15% or \$5,384,848.

Local property taxes, in the amount of \$20,752,638 or 66.09%, supported the remaining portion of the governmental activities. Property tax revenue remained steady due to the higher revenue created by increased property values being offset by reductions in tax rates implemented during the year. The property tax revenue comes mainly from the 18 mills on all non-homestead property, which we are required to levy by the State in order to receive our full State foundation allowance. The District enjoys the support of the community in maintaining our facilities, as \$1,946,461 of the \$20,752,638 in tax revenue is generated by a special millage specifically for capital expenditures. The proceeds and expenditures of this special millage are accounted for exclusively in the District's Sinking Fund. This special millage was renewed by voters in May 2005, and will expire on December 31, 2012.

The State foundation allowance accounted for 13.79% or \$4,331,760 of the revenue available. This revenue is determined by a formula that incorporates pupil headcount, the annual per pupil allowance, and the non-homestead property taxable values of the District.

The expense portion of Table 2 shows the financial support of each functional area required during the year. Being in the business of educating children, the largest expenses were incurred in instruction, which accounted for \$17,485,598 or 60.39% of total expenses. Support services cost \$7,304,958 or 25.23% of total expenses, which include such items as transportation, maintenance, security, supervision, counseling, health care, and a variety of similar services that support the District's mission of educating children.

The District experienced an increase in net assets of \$2,445,965 or a 14.92% increase from the fiscal 2009 increase in net assets of \$2,128,323. Overall, revenue decreased 0.39%, while expenses decreased by 1.50%. Finally, it should be noted that under the accrual basis of accounting, property taxes collected for debt service are recognized as revenue, while only interest on the debt is recognized as expense. The increase in net assets differs from the change in fund balance and a reconciliation appears later in the financial statements. Finally, the district's net assets were increased by \$31,172 with a corresponding increase in receivables in order to correctly reflect the receivable related to the Durant Bonds.

Financial Analysis of the District's Funds

As noted earlier, the District uses funds to help control and manage money for particular purposes. Looking at funds helps the reader consider whether the District is being accountable for the resources taxpayers and others provide, and may provide more insight in the District's overall financial health. As the District completed this year, the governmental funds reported a combined fund balance of \$6,199,426, which is an increase of \$1,103,442 from the prior year.

Of the combined governmental fund balances, 27.38% or \$1,697,126 constitutes *unreserved fund balance*, which is available for spending at the District's discretion. The remainder of the combined fund balances, or \$4,502,300, is *reserved* to indicate that it is not available for spending at the District's discretion. Of the reserved fund balance, \$3,078,145 is earmarked for capital improvements and \$385,956 is earmarked for payments on long-term debt. The remaining reserved fund balance is earmarked for inventory and prepaid items.

The General Fund is the principal operating fund of the District. At the end of the current fiscal year, unreserved fund balance of the General Fund was \$1,643,777, while total fund balance was \$2,570,883. As a measure of the General Fund's liquidity, it may be useful to compare both unreserved fund balance and total fund balance to total fund expenditures. Unreserved fund balance and total fund balance each represent 6.60% and 10.32%, respectively, of total General Fund expenditures and transfers.

The fund balance of the District's General Fund increased by \$935,501 during the current fiscal year, mainly due to revenue increases exceeding our cost increases. See the above discussion relative to District-wide governmental activities.

General Fund Budgetary Highlights

Over the course of the year, the District revises its budget as it attempts to deal with changes in revenues and expenditures. State law requires the budget be amended to ensure expenditures do not exceed appropriations. A schedule showing the District's original and final budget amounts, compared with amounts actually paid and received, is provided in the basic financial statements. Major changes to the General Fund original budget were:

- The District's General Fund revenues were \$24,058 less than the final amended budget, a variance of (.09)%. The actual revenue was under budget mainly due to changes in State aid.
- The District's General Fund expenditures were \$714,959 less than the final amended budget, a variance of 2.79%. The reduction of actual expenditures under budget is due to cost saving programs implemented throughout the year.

Capital Asset and Debt Administration

Capital Assets. By June 30, 2010, the District had invested \$73,901,408 in a broad range of capital assets, including school buildings, land, athletic facilities, furniture, and equipment. This represents a net increase (including all additions and disposals) of \$2,150,609 or 2.91% from last year. More detailed information about capital assets is available in Note III C to the financial statements.

This year's capital asset additions include boiler replacement, mechanical upgrades, District-wide door and window replacement, and computer hardware. Construction-in-progress is attributable to several projects including roofing replacement at the High School, and a District-wide energy lighting efficiency project.

**Public Schools of Petoskey
Capital Assets
Table 3**

	<u>2010</u>	<u>2009</u>
Land	\$ 3,394,351	\$ 3,394,351
Construction-in-progress	449,494	361,503
Buildings	62,129,808	60,344,486
Furniture and equipment	<u>7,927,755</u>	<u>7,650,459</u>
Total capital assets	73,901,408	71,750,799
Less accumulated depreciation	<u>26,672,860</u>	<u>25,031,224</u>
Net capital assets	<u>\$ 47,228,548</u>	<u>\$ 46,719,575</u>

Debt. At year-end, the District had \$19,524,724 in general obligation bonds and other long-term debt outstanding – a reduction of 7.33% from last year – as shown in Table 4. More detailed information about the District’s long-term debt is presented in Note III F to the financial statements, and in the Other Supplemental Information section.

**Public Schools of Petoskey
Long-Term Debt
Table 4**

	2010	2009
General obligation bonds	\$ 17,540,000	\$ 19,170,000
Other general obligation debt	1,984,724	1,898,574
Total long-term debt	\$ 19,524,724	\$ 21,068,574

In 2006, the District entered into a land contract for the purchase of land in the amount of \$700,000. The balance on the contract was \$583,173 at June 30, 2010. In 2004, the District also entered into a land contract for the purchase of land. The original amount of the 2004 land contract was \$700,000, and the remaining balance at year end is \$455,588.

Factors Bearing on the District’s Future

We considered many factors when setting the District’s 2010-11 fiscal year budget.

Approximately 81% of total General Fund revenues are from the foundation allowance. The State foundation allowance is determined by multiplying the blended student count by the foundation allowance per pupil. That makes our student count estimate one of the most important factors impacting our budget. We encountered a loss of 25 students from September 2009 to September 2010, which was a smaller loss than anticipated. In setting the budget for 2010-11, we assumed a further reduction of 13 students.

Since the District’s revenue is heavily dependent on State funding and the health of the State’s School Aid Fund, the actual revenue received depends on the State’s ability to collect the revenues to fund its appropriation to school districts. For fiscal year 2009-10, the District enjoyed a foundation allowance of \$7,316.

Going into the budget planning cycle for 2010-11, we believe the foundation allowance will decrease by \$265 per pupil, to \$6,886. We also assume that the majority of the reduction will be offset by Federal Stimulus funds. However, as no State Aid funding bill has been submitted to the legislature, it is difficult for the District to determine how accurate its assumptions will be. In reaction to the projected loss of funding coupled with increased inflationary costs, the District cut approximately \$ 1.4 million in expenses from the 2010-11 budget. These cuts were made through a combination of measures that mostly affected non-educational areas, and included some limited work force reduction. The combination of expected results in count, reductions in foundation

allowance, and increases in expenditures results in our 2010-11 budget showing an approximate increase of \$927,000 in ending fund balance. This planned increase is designed to return the fund balance to the approximately 8% of expenditure level required to meet cash flow requirements without borrowing, along with a small amount to offset any additional loss of students or state funding. At this time, no additional cost-savings measures are anticipated as the year begins.

The District's labor contract with the Petoskey Education Association, which represents the District's teachers, is set to expire in August 2010. The District's labor contract with the Petoskey Educational Support Personnel Association, which represents the District's support personnel, is set to expire in August 2010. Negotiations with both groups began in June 2010 and continue through the date of this report.

Contacting the School District's Financial Management

This financial report is designed to provide the District's citizens, taxpayers, customers, investors, and creditors with a general overview of the District's finances. It is also designed to demonstrate the District's accountability for the money it receives. If you have any questions about this report or need additional financial information, contact the Business Office, 1130 Howard Street, Petoskey, Michigan 49770.