INDEPENDENT SCHOOL DISTRICT NO. 38
RED LAKE, MINNESOTA
FINANCIAL STATEMENTS
AND
INDEPENDENT AUDITORS' REPORT
JUNE 30, 2006

INDEPENDENT SCHOOL DISTRICT NO. 38
RED LAKE, MINNESOTA
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OFFICIAL DIRECTORY

School Board Members and Officers

Chairperson	**Arnold Pemberton**
Vice-Chairperson	**Keith Defoe**
Treasurer	**Roy Nelson**
Clerk	**Kathryn Beaulieu**
Director	**Dorothy Cobenais**
Director	**Tom Barrett**

Administration

Superintendent	**Stuart Desjarlait**
Business Manager	**Willie Larson**

Miller McDonald, Inc.

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DAVID J. CRONIN, C.P.A.

SANDY K. NELSON, C.P.A.
DONALD W. ZIERKE, C.P.A.
KEVIN D. ONSTAD, C.P.A.
JEFFREY T. HAUKEBO, C.P.A.

INDEPENDENT AUDITORS' REPORT

The Board of Education
Independent School District No. 38
Red Lake, Minnesota

We have audited the accompanying financial statements of the governmental activities, each major fund, and the aggregate remaining fund information of Independent School District No. 38, as of and for the year ended June 30, 2006, which collectively comprise the District's basic financial statements as listed in the table of contents. These financial statements are the responsibility of Independent School District No. 38's management. Our responsibility is to express opinions on these financial statements based on our audit.

We conducted our audit in accordance with auditing standards generally accepted in the United States of America and the standards applicable to financial audits contained in *Government Auditing Standards,* issued by the Comptroller General of the United States. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation. We believe that our audit provides a reasonable basis for our opinions.

In our opinion, the financial statements referred to above present fairly, in all material respects, the respective financial position of the governmental activities, each major fund, and the aggregate remaining fund information of Independent School District No. 38, as of June 30, 2006, and the respective changes in financial position thereof for the year then ended in conformity with accounting principles generally accepted in the United States of America.

In accordance with *Government Auditing Standards*, we have also issued a report dated August 17, 2006, on our consideration of Independent School District No. 38's internal control over financial reporting and our tests of its compliance with certain provisions of laws, regulations, contracts, and grant agreements and other matters. The purpose of that report is to describe the scope of our testing of internal control over financial reporting and compliance and the results of the testing, and not to provide an opinion on the internal control over financial reporting or on compliance. That report is an integral part of an audit performed in accordance with *Government Auditing Standards* and should be considered in assessing the results of our audit.

The management's discussion and analysis and the budgetary comparison information on pages 4 through 15 and 38 through 42, are not a required part of the basic financial statements but are supplementary information required by accounting principles generally accepted in the United States of America. We have

applied certain limited procedures, which consisted principally of inquiries of management regarding the methods of measurement and presentation of the required supplementary information. However, we did not audit the information and express no opinion on it.

Our audit was conducted for the purpose of forming opinions on the financial statements that collectively comprise Independent School District No. 38's basic financial statements. The official directory on page 1 and supplementary information on pages 43 through 45 are presented for purposes of additional analysis and are not a required part of the basic financial statements of Independent School District No. 38. The accompanying schedule of expenditures of federal awards on page 46 is presented for purposes of additional analysis as required by U.S. Office of Management and Budget Circular A-133, *Audits of States, Local Governments, and Non-Profit Organizations*, and is also not a required part of the basic financial statements of Independent School District No. 38. Such information has been subjected to the auditing procedures applied in the audit of the financial statements and, in our opinion, is fairly presented in all material respects in relation to the financial statements taken as a whole.

August 17, 2006
Bemidji, Minnesota

INDEPENDENT SCHOOL DISTRICT NO. 38
RED LAKE, MINNESOTA
MANAGEMENT'S DISCUSSION AND ANALYSIS
YEAR ENDED JUNE 30, 2006

This section of Independent School District No. 38 – Red Lake, Minnesota's, annual financial report presents our discussion and analysis of the District's financial performance during the fiscal years ended on June 30, 2005 and 2004. Please read it in conjunction with the District's financial statements, which immediately follow this section.

The Management's Discussion and Analysis (MD&A) is an element of a new reporting model that is required by the Governmental Accounting and Standards Board's (GASB) Statement No. 34 *Basic Financial Statements – and Management's Discussion and Analysis - for State and Local Governments* issued in June 1999. Statement No. 34 contains significant requirements that enhance financial reporting. These requirements are also designed to make annual reports easier for the public to understand and more useful to stakeholders. Specifically, Statement No. 34 establishes new reporting requirements that include new financial statements, expanded disclosure, and supplemental information, including the MD&A (this section).

FINANCIAL HIGHLIGHTS

Key financial highlights for the year ended June 30, 2006 include the following:

- **Net assets decreased by 127.42% from the prior year.**
- **Overall revenues were $28,720,571 and overall expenses were $28,134,383.**
- **The unreserved general fund balance increased by $1,524,259.**
  - **The reserved general fund balance increased by $104,193 Included in this increase is $44,795 that was added to the amount reserved to pay severance, compensated absences and current retiree health insurance obligations.**
- **The community service fund balance decreased by $825. There was no change in the food service fund balance.**

OVERVIEW OF THE FINANCIAL STATEMENTS

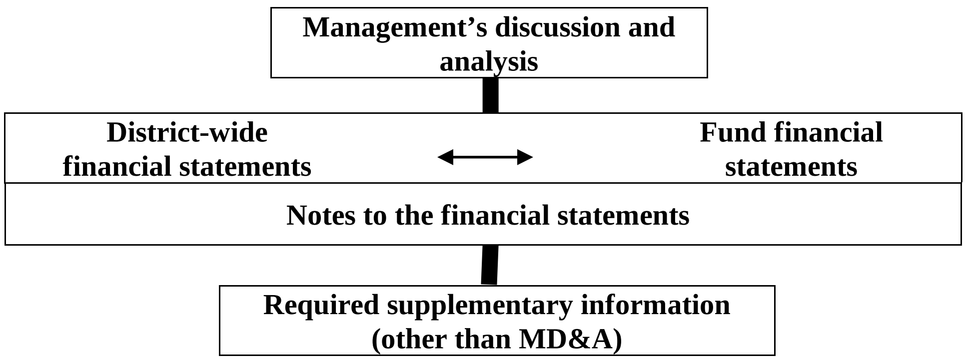
The financial section of the annual report consists of four parts – Independent Auditors' Report, required supplementary information, which includes the management's discussion and analysis (this section), the basic financial statements, and supplementary information. The basic financial statements include two kinds of statements that present different views of the District:

- **The first two statements are *district-wide financial statements* that provide both *short-term* and *long-term* information about the District's overall financial status.**
- **The remaining statements are *fund-financial statements* that focus on individual parts of the District, reporting on the District's operations in more detail than the district-wide statements.**
- **The *governmental funds statements* tell how basic services such as regular, vocational and special education were financed in the short-term as well as what remains for future spending.**

INDEPENDENT SCHOOL DISTRICT NO. 38
RED LAKE, MINNESOTA
MANAGEMENT'S DISCUSSION AND ANALYSIS
YEAR ENDED JUNE 30, 2006

OVERVIEW OF THE FINANCIAL STATEMENTS - Continued

The financial statements also include notes that explain some of the information in the statements and provide more detailed data. The statements are followed by a section of required supplementary information that further explains and supports the financial statements with a comparison of the District's general and special revenue funds budgets for the year. The following diagram explains how the various parts of this annual report are arranged and related to one another.



The major features of the District's financial statements, including the portion of the District's activities they cover and the types of information they contain, are summarized below. The remainder of the overview section of the MD&A highlights the structure and content of each of the statements.

	District-wide Statements	Fund Financial Statements Governmental Funds
Scope	Entire district except fiduciary funds	The activities of the district that are not proprietary or fiduciary, such as special education and building maintenance
Required financial statements	• Statement of net assets • Statement of activities	• Balance sheet • Statement of revenues, expenditures, and changes in fund balances
Accounting basis and measurement focus	Accrual accounting and economic resources focus	Modified accrual accounting and current financial focus
Type of assets/liability information	All assets and liabilities, both financial and capital, short-term and long-term	Generally assets expected to be used up and liabilities that come due during the year or soon thereafter; no capital assets or long-term liabilities included
Type of inflow/outflow information	All revenues and expenses during year, regardless of when cash is received or paid	Revenues for which cash is received during or soon after the end of the year; expenditures when goods or services have been received and the related liability is due and payable

District-wide Statements

The district-wide 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 includes all of the District's assets and liabilities. All of the current years' revenues and expenses are accounted for in the statement of activities regardless of when cash is received or paid.

OVERVIEW OF THE FINANCIAL STATEMENTS - Continued

The district-wide statements report the District's net assets and how they changed. Net assets – the difference between the District's assets and liabilities – are 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.**

- **To assess the overall health of the District you need to consider additional non-financial factors such as changes in the District's property tax base and the condition of school buildings and other facilities.**

In the District-wide financial statements the District's activities are shown in one category:

- **Governmental Activities – The majority of the District's basic services are included within these activities; such as regular and special education, transportation, administration, food services, and community education. Federal impact and state aids finance the majority of these activities.**

Fund Financial Statements

The fund financial statements provide more detailed information about the District's funds – focusing on its most significant or "major" funds – not the District as a whole. Funds are accounting devices the District uses to keep track of specific sources of funding and spending on particular programs.

- **Some funds are required by State law and by bond covenants.**

- **The District establishes other funds to control and manage money for particular purposes (e.g., repaying its long-term debts) or to show that is properly using certain revenues (e.g., federal grants).**

The District has one type of fund:

Governmental Funds – The majority of the District's basic services are included in governmental funds, which generally focus on (1) how cash and other financial assets that can readily be converted to cash flow in and out and (2) the balances left at year-end that are available for spending. Consequently, the governmental funds statements provide a detailed short-term view that helps to determine whether there are more or fewer financial resources that can be spent in the near future to finance the District's programs. Because this information does not encompass the additional long-term focus of the district-wide statements, we provide additional information following the governmental funds statements that explains the relationship (or differences) between them.

FINANCIAL ANALYSIS OF THE DISTRICT AS A WHOLE (DISTRICT-WIDE FINANCIAL STATEMENTS)

Net Assets

The District's combined net assets were $(613,901) at June 30, 2006 (see the following table). At June 30, 2005 the net assets were $2,239,045, with a decrease of $2,852,946 from operating activities for the year ended June 30, 2006.

The decrease amounted to a 127.42% decrease in net assets.

INDEPENDENT SCHOOL DISTRICT NO. 38
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FINANCIAL ANALYSIS OF THE DISTRICT AS A WHOLE (DISTRICT-WIDE FINANCIAL STATEMENTS) - Continued

Change in Net Assets

The decrease in net assets occurs as a result of the District's expenditures being more than its revenues for the years ended June 30, 2006 and 2005. A summary of the District's revenues and expenses, along with the percentages for each category follows:

INDEPENDENT SCHOOL DISTRICT NO. 38
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MANAGEMENT'S DISCUSSION AND ANALYSIS
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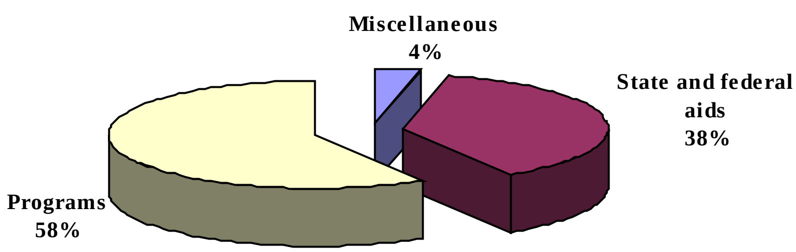
FINANCIAL ANALYSIS OF THE DISTRICT AS A WHOLE
(DISTRICT-WIDE FINANCIAL STATEMENTS) - Continued

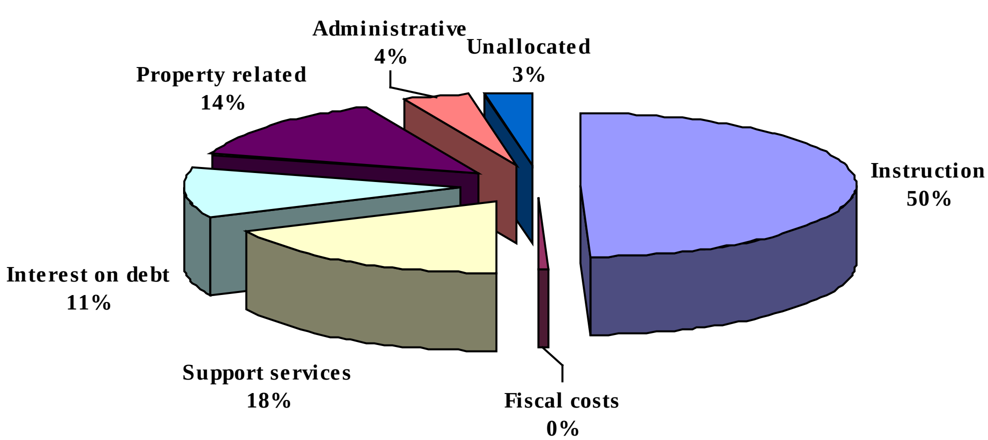
The District's total revenues consisted of program revenues of $16,875,210, aids and payments from the state and federal sources of $10,833,692 and $1,011,669 from miscellaneous other sources. Expenses totaling $31,573,517 consisted mainly of regular, vocational and exceptional instruction costs of $15,552,781; district, instructional and pupil support services of $5,670,701; site, buildings and equipment related costs of $4,409,897; interest, fiscal, and fixed-cost programs of $3,671,816; community education and services costs of $164,507; administrative costs of $1,200,039; and unallocated depreciation costs of $903,776.

The following charts express revenues and expenses for the year in broad categories:

REVENUES - $28,720,571



EXPENSES - $31,573,517



INDEPENDENT SCHOOL DISTRICT NO. 38
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FINANCIAL ANALYSIS OF THE DISTRICT AS A WHOLE (DISTRICT-WIDE FINANCIAL STATEMENTS) - Continued

The net cost of governmental activities is the total costs less program revenues applicable to each category. Total and net costs for the years ended June 30, 2006 and 2005 are as follows:

FINANCIAL ANALYSIS OF THE DISTRICT'S FUNDS (FUND FINANCIAL STATEMENTS)

Fund Balances

The financial performance of the District as a whole is reflected in its governmental funds as well. As the District completed the year, its governmental funds reported a combined fund balance of $10,173,197. This was up from $8,546,758, at the end of the prior year, an increase of $1,626,439. The increase was primarily the result of excess revenues over expenditures and other financing sources from the General Fund of $1,629,292. This consisted of an increase in unreserved general fund balance of $1,524,259 and an $105,033 increase in reserved for general fund, $44,795 of which was added to the reserve for severance and will be used to pay for severance, compensated absences, and current retiree health insurance obligations. The Community Service Fund, Capital Projects Fund and Debt Redemption Fund experienced decreases in fund balance of $825, $1,887 and $141, respectively. There was no change in the Food Service fund balance.

The District believes that prudent fiscal management requires the maintenance of a reasonable fund balance, to help in the event of unexpected conditions. The Board has adopted a Fund Balance Policy that provides for an unreserved general fund balance of at least three months average expenditures from the previous year. The calculation for the June 30, 2006 fund balance follows:

Three months average expenditures for 2003-04	**= $5,734,950**
June 30, 2006 unreserved general fund balance	**= $6,689,253**

The District surpassed its unreserved general fund balance goal by $954,303.

INDEPENDENT SCHOOL DISTRICT NO. 38
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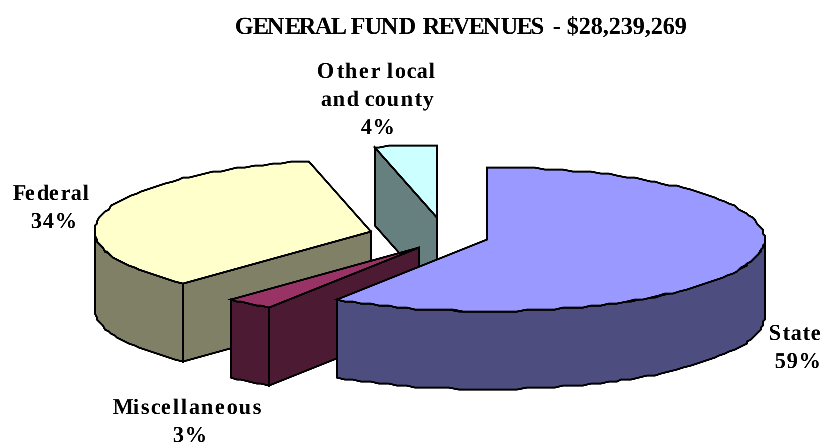
FINANCIAL ANALYSIS OF THE DISTRICT'S FUNDS (FUND FINANCIAL STATEMENTS) – Continued

Revenue and Expenditures

Revenues and other financing sources (uses) of the District's governmental funds totaled $28,720,571 while total expenditures were $28,134,383. A summary of the revenues and expenditures reported on the governmental fund financial statements are as follows:

The following graphs are presented for the general fund revenues and expenditures:



INDEPENDENT SCHOOL DISTRICT NO. 38
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MANAGEMENT'S DISCUSSION AND ANALYSIS
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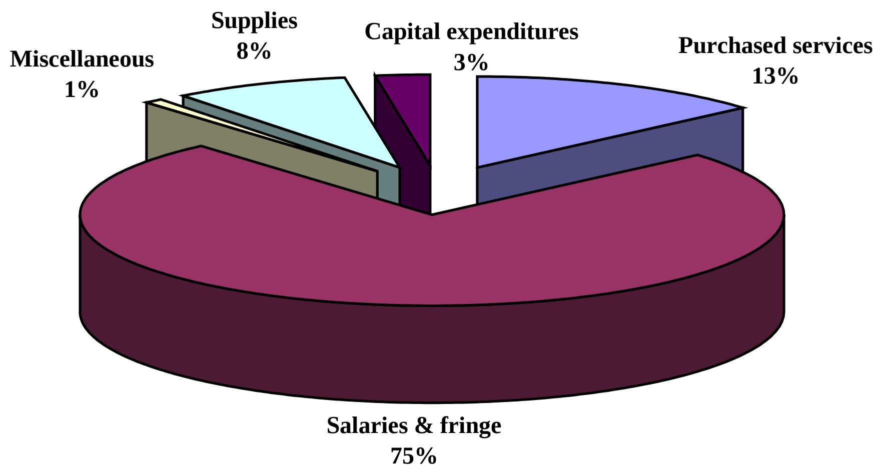
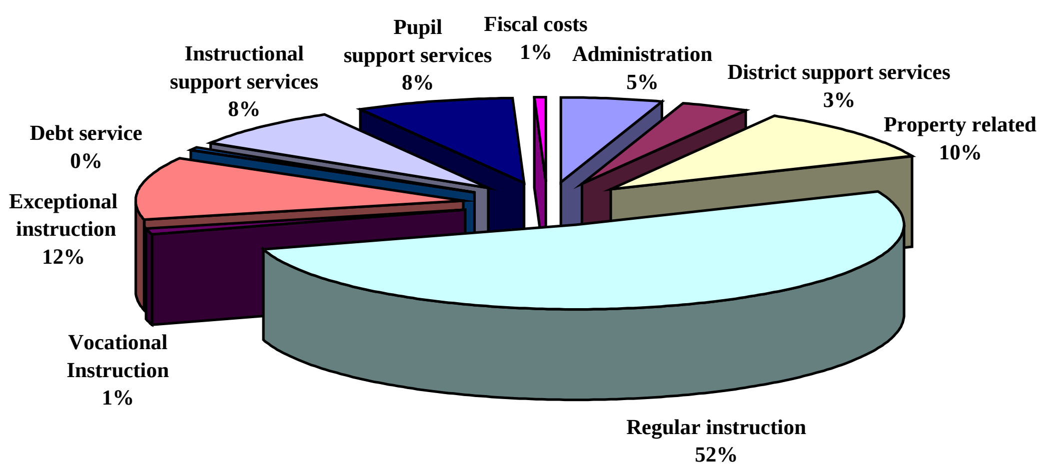
FINANCIAL ANALYSIS OF THE DISTRICT'S FUNDS (FUND FINANCIAL STATEMENTS) - Continued

GENERAL FUND EXPENSES BY OBJECT - $22,939,801



GENERAL FUND EXPENSES BY PROJECT - $22,939,801



FINANCIAL ANALYSIS OF THE DISTRICT'S FUNDS (FUND FINANCIAL STATEMENTS) – Continued

General Fund Budgetary Highlights

During the year ended June 30, 2006, the District made several revisions to it's operating budget. The first revision is planned, and necessary because an initial budget, adopted prior to June 30, 2005, was adopted for the sole purpose of satisfying the state requirement of having an adopted budget in place prior to spending funds for the next fiscal year. In the State of Minnesota a budget is also an appropriating document. The first revision occurred in the fall of 2005 after student enrollment numbers, staffing levels and other significant informational items were made available. Other revisions occurred as financial information became available that was of a significant nature and therefore necessitated a revision.

The District's general fund final budget anticipated that revenues would exceed expenditures and other financing uses by $2,169,628. The actual results for the year reported a surplus of revenues over expenditures and other financing uses of $1,629,292. The difference was due primarily to the increase in transfers out.

CAPITAL ASSETS AND DEBT ADMINISTRATION

Capital Assets

Additions during the year ended June 30, 2006 totaled $1,852,738 and consisted of $526,622 of building improvements and additions, $225,068 of equipment and $1,101,048 of construction in progress. Disposals during the year ended June 30, 2006 totaled $545,552 and consisted of $24,842 of equipment and $520,710 of construction in progress.

Long-Term Debt

At June 30, 2006 the District's long-term indebtedness totaled $50,603,938. This consisted of capital leases payable of $122,787, capital loans payable of $33,836,983, defaulted interest on capital loan of $13,495,293, severance payable of $1,143,610 and compensated absences payable of $2,005,265.

INDEPENDENT SCHOOL DISTRICT NO. 38
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MANAGEMENT'S DISCUSSION AND ANALYSIS
YEAR ENDED JUNE 30, 2006

FACTORS BEARING ON THE DISTRICT'S FUTURE

Student Enrollment

The 2005 Minnesota State Legislature adopted a provision holding the District harmless for the 2005-06 and 2006-07 school years. This provision allows the District to use the actual ADM for the school year or the ADM on March 21, 2005, which ever is greater. As this management discussion and analysis is written, the District's current enrollment is approximately 150 students less than it was in the 2004-05 school year. This provision applies only to state aids. Federal funds (impact aid and ESEA entitlements) will continue to be calculated using actual ADM. The future financial effects of this provision on the District follow.

1. **State aids will increase due to the ADM hold harmless provision and statutory increases in the funding formula for fiscal 2006 and 2007.**

2. **Impact Aid received in the 2006-07 school year will likely show a decrease. The aid calculated for the 2006-07 school year will use the student enrollment from the fall of 2005. An enrollment decrease of 150 students will mean a reduction in Impact Aid of approximately $500,000 for the 2006-07 school year.**

3. **ESEA program (Title I, II, III, IV, and V) funds are calculated on student enrollment and economic status'. An enrollment decrease will mean a reduction in ESEA funds for the 2006-07 school year.**

The District is likely to experience an increase in staff turnover as we move into the 2006-07 school year. The greatest percentage of turnover is estimated at the high school. The District will need to utilize financial resources and large amounts of time to provide training to new staff members. In addition, the District will need to commit additional resources to substitute staff as existing staff members will utilize sick leave to deal with the effects of March 21st.

Political Environment

The political environment at the State level will have a significant effect on future finances. The state legislature sets the amount of revenue from aids and levies that Minnesota school districts will receive. Currently the general education basic allowance, from which the District receives the single largest state aid, is set at $4,601, but will not increase for the next fiscal year. The current Governor of the State of Minnesota has expressed a priority of reducing taxes and cutting state spending. The state of Minnesota faced a very large budget deficit for its biennium ending June 30, 2005 and since K-12 education accounts for approximately 40% of the State's general fund spending, and 25% of overall State spending, neither the Governor nor the legislature were particularly friendly in keeping school districts harmless during the 2003 legislative session. Future revenues of the District and other Minnesota districts could depend heavily on which political party gains control of the legislature and the Governor's office in the November 2005 elections.

Also, the political environment at the Federal level has a significant effect on future finances. The District receives Federal Impact Aid, which is 23% of the District's budget. Federal Impact Aid is not forward funded. The District is a member of the National Association of Federally Impact Schools (NAFIS) which provides Congress and the President with statistical information on the Indian and military students and land base. NAFIS members support a bipartisan coalition on both the U.S. Senate and U.S. House of Representatives to support Federal Impact Aid funding.

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MANAGEMENT'S DISCUSSION AND ANALYSIS
YEAR ENDED JUNE 30, 2006

The voters of the District approved a Yes or No Ballot Question at a Special Election called by the School Board on November 3, 2003. The Question was should the District incur indebtedness in the amount of $33,173,792 with a maximum effort capital loan from the State of Minnesota. The proposal calls for the remodeling of the present high school wing into the middle school complex. The District received authorization during the 2005 Minnesota legislative session for an $18,000,000 state capital loan under the Maximum Effort Loan Program in Minnesota Statutes 126C.69. The state requires the Red Lake School District to make a financial contribution of $66,739.65 toward the project.

On November 8, 2005, the voters of the Red Lake School District approved a Yes or No Ballot Question at a Special Election called by the School Board. The question was to approve a Maximum Effort Loan of $55,381,570 for the school district buildings. The district will be pursuing the bonding request during the 2006 legislative session.

On November 8, 2005, the voters of the Red Lake School District approved a Yes or No Ballot Question at a Special Election called by the School Board. The question was to approve an increase in the general education referendum revenue by $447.10 per resident marginal cost pupil unit. The additional revenue will be used to finance school operations.

Labor Force

Labor contracts have been negotiated for the two-year period beginning July 1, 2003 thru June 30, 2005. Exclusive of capital projects and debt service, salaries, wages and benefits account for 72% of the District's expenses.

CONTACTING THE DISTRICT'S FINANCIAL MANAGEMENT

This financial report is designed to provide the District's citizens, taxpayers, customers, and creditors with a general overview of the District's finances and to demonstrate the District's accountability for the money it receives. If you have any questions about this report or would like additional information, contact Willie Larson, Business Manager, at the District Administration Office, East of the Red Lake Middle School, Red Lake Minnesota 56671.

INDEPENDENT SCHOOL DISTRICT NO. 38
RED LAKE, MINNESOTA
NOTES TO FINANCIAL STATEMENTS
JUNE 30, 2006

NOTE 1 – Summary of Significant Accounting Policies

The financial statements of Independent School District No. 38 have been prepared in conformity with U. S. generally accepted accounting principles (GAAP) as applied to governmental units. The Governmental Accounting Standards Board (GASB) is the accepted standard setting body for establishing governmental accounting and financial reporting principles. The GASB has issued codification of governmental accounting and financial reporting standards dated June 30, 2006. This codification and subsequent GASB pronouncements are recognized as U.S. generally accepted accounting principles for state and local government.

A. Reporting Entity

The District's policy is to include in the financial statements all funds, departments, agencies, boards, commissions, and other component units for which the District is considered to be financially accountable.

Component units are legally separate entities for which the District (primary government) is financially accountable, or for which the exclusion of the component unit would render the financial statements of the primary government misleading. The criteria used to determine if the primary government is financially accountable for a component units include whether or not the primary government appoints the voting majority of the potential component unit's governing body, is able to impose its will on the potential component unit, is in a relationship of financial benefit or burden with the potential component unit, or is fiscally depended upon by the potential component unit.

Based on these criteria, there are no organizations considered to be component units of the District.

Student activities are determined primarily by student participants under the guidance of an adult and are generally conducted outside of school hours. The School Board does have a fiduciary responsibility in establishing broad policies and ensuring that appropriate financial records are maintained for student activities. The District's School Board has elected to control or exercise oversight responsibility with respect to the underlying student activities. Accordingly, the student activity accounts are included in these financial statements.

B. Financial Statement Presentation

The District-wide financial statements (i.e. the Statement of Net Assets and the Statement of Activities) display information about the reporting government as a whole. These statements include all the financial activities of the District.

INDEPENDENT SCHOOL DISTRICT NO. 38
RED LAKE, MINNESOTA
NOTES TO FINANCIAL STATEMENTS
JUNE 30, 2006

NOTE 1 – Summary of Significant Accounting Policies - Continued

The Statement of Activities demonstrates the degree to which the direct expenses have a given function or segment is offset by program revenues. Direct expenses are those that are clearly identifiable with a specific function or segment. The District does not allocate indirect expenses. Program revenues, include charges to customers or applicants who purchase, use, or directly benefit from goods, services, or privileges provided by a given function or capital requirements of a particular function or segment. Operating grants include operating-specific and discretionary grants while the capital grants column includes only capital-specific grants. Taxes and other items not properly included among program revenues are reported instead as general revenues.

The District applies restricted resources first when an expense is incurred for purposes for which both restricted and unrestricted net assets are available. Depreciation expense that can be specifically identified by function is included in the direct expenses of each function.

As a general rule the District does not engage in inter-fund activities, therefore there is no need to eliminate inter-fund activity from the District-wide financial statements.

Separate fund financial statements are provided for governmental funds. All individual governmental funds are reported in separate columns in the fund financial statements.

Proprietary funds are used to report business-type activities carried on by a school district. No activities of the District were determined to be of this nature, so no proprietary funds are present in the financial statements.

C. Measurement Focus and Basis of Accounting

The accounting and financial reporting treatment applied is determined by its measurement focus and basis of accounting. The District-wide financial statements are reported using the economic resources measurement focus and the accrual basis of accounting. Revenues are recorded when earned and expenses are recorded when a liability is incurred, regardless of the timing or related cash flows.

Governmental fund financial statements are reported using the current financial resources measurement focus and the modified accrual basis of accounting. The modified accrual basis of accounting recognizes expenses when incurred, except principal and interest on general long-term debt which is recognized when due, and revenue under the following principles:

> **Property tax revenue is recorded under the intact levy concept, whereby taxes collectible during a calendar year are recorded as revenue in the fiscal year beginning within the year of collection. A portion of the 2005 payable 2006 levy has been recognized as revenue during the current year, as discussed in Note 4.**
>
> **State aids are recorded as revenue in the fiscal year for which the aids are designated by statute.**
>
> **Other revenues are recognized when susceptible to accrual, i.e., when they become both measurable and available. “Measurable” means the amount of the transaction can be determined and “available” means collectible within the current period or soon enough thereafter to be used to pay liabilities of the current period.**

INDEPENDENT SCHOOL DISTRICT NO. 38
RED LAKE, MINNESOTA
NOTES TO FINANCIAL STATEMENTS
JUNE 30, 2006

NOTE 1 – Summary of Significant Accounting Policies - Continued

Description of Funds

The existence of the various District funds has been established by the Minnesota Department of Education, and is accounted for as an independent entity. The operations of each fund are accounted for with a separate set of self-balancing accounts that comprise it assets, liabilities, fund equity, revenues and expenditures.

GASB Statement No. 34 specified that the accounts and activities of each of the District's most significant governmental funds (termed "major funds") be reported in separate columns on the fund financial statements. Although only the general fund is major by definition, the District has elected to present all governmental funds as major funds. A description of the funds in this report is as follows:

Governmental Funds

General Fund – Accounts for all financial resources and transactions relating to the administration, instruction, pupil transportation, and maintenance of the District, which are not accounted for in other District funds.

Special Revenue Funds – Accounts for the proceeds of specific revenue sources (other than expendable trust and major capital projects) that are legally restricted to expenditures for specified purposes. The District's special revenue funds and their purposes are as follows:

Food Service Fund – Accounts for all activities associated with the preparation and serving of regular and incidental meals, lunches or snacks in connection with school activities.

Community Service Fund – Accounts for the revenues and expenditures related to recreation, public use of school facilities, non-public pupils, adult education programs, and early childhood and family development.

Capital Projects Fund – Accounts for the acquisition or construction of major capital assets, generally financed through the issuance of general long-term debt.

Debt Redemption Fund – Accounts for the accumulation of resources for, and the payment of general long-term debt principal, interest and related costs.

D. Assets, Liabilities, Net Assets and Fund Balances

Cash and Cash Equivalents – Cash balances for all funds except Capital Project funds are maintained on a combined basis and invested, to the extent possible, in allowable investments. The District's general policy is to report money market investments at amortized cost and to report nonparticipating interest-earning investment contracts using a cost-based measure. However, if the fair value of an investment is significantly affected by the impairment of the credit standing of the issuer or by other factors, it is reported at fair value. All other investments are reported at fair value unless a legal contract exists which guarantees a higher value. The term "nonparticipating" means that the investment's value does not vary with market interest rate changes.

NOTE 1 – Summary of Significant Accounting Policies - Continued

Property Taxes Receivable – Property taxes receivable represents current and delinquent taxes receivable at June 30, 2006. Current taxes receivable represent real and personal property tax levies certified the previous December and collectible in the current calendar year, which have not been received by the District. Delinquent property taxes receivable represent taxes collectible for the 1999 through 2005 calendar years that remain uncollected.

Due From Other Governmental Units– Amounts due from other governmental units consist of amounts primarily due from the other Minnesota school districts, Beltrami County, the Minnesota Department of Education and from the Federal Government through the Minnesota Department of Education for state and federal aids and grants under various specific programs are reported at estimated amounts based on available information at the date of the report. Adjustments and prorations may be made by the applicable agencies based on the amount of funds available for distribution and may result in differing amounts actually being received. The differences between the receivable recorded and the actual amount received will be recognized as a revenue adjustment in the subsequent year. Federal and state revenues are recorded as revenue at the time of receipt or when they are both measurable and available.

Inventories – Purchased inventory is recorded at the lower of cost (first-in, first-out) or market method. Inventory consists of purchased food commodities, supplies and donated United States Department of Agriculture (USDA) commodities. The donated USDA commodities are stated at standardized cost as determined by the USDA.

Capital Assets – Capital assets are capitalized at historical cost, or estimated historical cost based on an inventory dated June 30, 2002. Donated assets are recorded as capital assets at their estimated fair market value at the date of donation. The District maintains a threshold level of $5,000 or more for capitalizing capital assets. The system for accumulation of fixed assets cost data does not provide the means for determining the percentage of assets valued at actual and those valued at estimated cost.

Capital assets are recorded in the District-wide financial statements, but are not reported in the Fund financial statements. Capital assets are depreciated using the straight-line method over their estimated useful lives. Since surplus assets are sold for an immaterial amount when declared as no longer needed for public school purpose by the District, no salvage value is taken into consideration for depreciation purposes. Useful lives vary from 20 to 50 years for land improvements and buildings, and 5 to 15 years for equipment.

Capital assets not being depreciated include land and construction in progress, if any.

The District does not possess any material amounts of infrastructure capital assets, such as sidewalks and parking lots. Such items are considered to be part of the cost of buildings or other improvable property.

Deferred Revenue – Deferred revenue represents revenues, other than property taxes, collected before they are earned.

Deferred Revenue – Delinquent Property Taxes – Deferred revenue – delinquent property taxes represents property taxes for the years 1999 through 2005 that remain uncollected.

INDEPENDENT SCHOOL DISTRICT NO. 38
RED LAKE, MINNESOTA
NOTES TO FINANCIAL STATEMENTS
JUNE 30, 2006

NOTE 1 – Summary of Significant Accounting Policies - Continued

Property Taxes Levied for Subsequent Years' Expenditures – Current levies of local taxes, including portions assumed by the State that will be recognized as revenue in the next fiscal year beginning July 1, 2006, are included in this account to indicate that, while they are current assets, they will not be recognized as revenue until the following year.

Net Assets – Net assets represent the difference between assets and liabilities in the District-wide financial statements. Net assets invested in capital assets, net of related debt consists of capital assets, net of accumulated depreciation, reduced by the outstanding balance of any long-term debt used to build or acquire the capital assets. Net assets are reported as restricted in the District-wide financial statements when there are limitations imposed on their use through external restrictions imposed by creditors, grantors, or laws or regulations of other governments.

Fund Equity – In the fund financial statements fund balances of the District are either reserved or unreserved. Reserved fund balances represent available resources dedicated for special purposes. Unreserved fund balances represent resources available for current and future year's expenditures.

F. Compensated Absences

Vacation and Sick Leave – Teachers and principals do not receive paid vacation but are paid only for the number of days they are required to work each year, 179 days for teachers and 199 days for principals. Employees, (other than teachers and principals) earn vacation pay. Employees lose vacation time if not taken before August 15 and are not compensated for any unused time upon termination or retirement. Therefore, a liability for vacation was not recorded in the financial statements.

All employees are entitled to accrue sick leave days at various rates for each year of employment, with limits. Sick days do not vest, and accordingly, employees can be paid personal leave only when sick or for emergencies. Since the employees accumulating rights to receive compensation for future absences are contingent upon the absences being accrued by future illness and such amounts cannot be reasonably estimated, a liability for accrued sick leave is not recorded in the financial statements.

Severance Pay – A maximum of five full-time teacher employees per year who have attained the age of 50 and accumulated 15 years of full-time service are eligible to receive severance benefits in the amount of accumulated unused sick leave up to a maximum of one year's pay. The teacher's daily rate of pay at the time of retirement is used to calculate this amount. Selection of teachers granted severance pay is based on seniority in the District. Severance is paid in one lump sum or equal annual installments over a period of time, at the discretion of the District, not to exceed two years from the effective date of severance.

Full-time principals who have completed a minimum of 15 years of service in the District and are a minimum of 50 years of age or have completed a minimum of 20 years of service in the District regardless of age are eligible for severance pay. Eligible administrators shall receive the greater of 100 days pay or accumulated sick leave, whichever is greater, not to exceed one year's pay. Severance shall be paid by the District in one lump sum or equal annual installments not to exceed two years from the effective date of severance. The Superintendent is not eligible to receive severance upon the termination of employment.

INDEPENDENT SCHOOL DISTRICT NO. 38
RED LAKE, MINNESOTA
NOTES TO FINANCIAL STATEMENTS
JUNE 30, 2006

NOTE 1 – Summary of Significant Accounting Policies - Continued

Non-licensed employees who have completed 10 years of service in the District will receive 30 percent of the accumulated sick leave days as pay figured on the employees' average daily pay when leaving the District. Non-licensed employees who have completed 15 years of service in the District will receive 60 percent of the accumulated sick leave days as pay figured on the employees' average daily pay when leaving the District.

Non-licensed employees hired after February 1, 2005 are not eligible to participate, but may participate in the District's Matching Deferred Compensation Plan. Non-licensed employees hired prior to February 1, 2005 may participate in both the Matching Deferred Compensation Plan and the Severance Plan. Upon retirement and employee's severance pay will be calculated and all matching contributions under the provision of the matching deferred compensation plan contributed by the District will be subtracted from the qualifying severance amount.

Compensated Absences Payable – Compensated absences are provided under collective bargaining agreements for retired teachers and administrators. Currently, 17 former teachers are receiving benefits. The District pays in full the premium for a medical insurance plan for each teacher that is granted early retirement upon submission of written resignation accepted by the Board. The teacher must have completed at least 15 years of service with the District and be at least 50. Upon request of the teacher, said plan will be single or family and will be paid each year until the person becomes eligible for Medicare. Said plan will be the same plan negotiated in the Agreement for 1991-93. Only those teachers who commenced employment by the District as a teacher prior to March 1, 1989 are eligible for benefits under this section. Expenditures for compensated absences are recognized as premiums become due. The District's contributions are financed on a pay-as-you-go-basis.

F. Use of Estimates

The preparation of financial statements in conformity with accounting principles generally accepted in the United States of America requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities and disclosure of contingent assets and liabilities at the date of the financial statements and the reported amounts of revenues and expenses during the reporting period. Actual results could differ from those estimates.

NOTE 2 – Stewardship, Compliance, and Accountability

A. Fund Balance Defecits

Fund Balance deficits exist in the following funds at June 30, 2006:

General Fund:	
Reserved for Health and Safety	$ 30,218
Community Service Fund:	
Reserved for School Readiness	12,017

The above deficits will be eliminated by receipt of subsequent revenues.

NOTE 2 – Stewardship, Compliance, and Accountability – Continued

B. Expenditures in Excess of Budget

The Food Service Fund revealed expenditure in excess of the budgeted amount by$1,644 for the year ended June 30, 2006.

NOTE 3 – Deposit and Investments

A. Deposits

Authority - In accordance with Minnesota Statutes, the District maintains deposits at those depository banks authorized by the Board. All such depositories are members of the Federal Reserve System. Minnesota Statutes require that all District deposits be protected by insurance, surety bond or collateral. The market value of collateral pledged must equal 110% of the deposits not covered by insurance or bonds. Authorized collateral includes treasury bills, notes and bonds; issues of U.S. Government agencies; general obligations rated "A" or better, revenue obligations rated "AA" or better; irrevocable standard letters of credit issued by the Federal Home Loan Bank; and certificates of deposit. Minnesota Statutes require that securities pledged as collateral be held in safekeeping in a restricted account at the Federal Reserve Bank or in an account at a trust department of a commercial bank or other financial institution not owned or controlled by the financial institution furnishing the collateral.

Custodial Credit Risk – The custodial credit risk for deposits is the risk that in the event of a bank failure, the District's deposits may not be recovered. The District's policy for custodial credit risk is to maintain compliance with Minnesota statutes that require all the District's deposits to be protected by insurance, surety bond, or pledged collateral. As a result, the District was not exposed to credit risk during the year.

INDEPENDENT SCHOOL DISTRICT NO. 38
RED LAKE, MINNESOTA
NOTES TO FINANCIAL STATEMENTS
JUNE 30, 2006

NOTE 3 – Deposit and Investments

B. Investments

Authority

Minnesota Statutes authorize the District to invest in the following types of investments:

1. **securities which are direct obligations or are guaranteed or insured issues of the United States, its agencies, its instrumentalities, or organizations created by an act of congress, except mortgage-backed securities defined as "high risk" by Minnesota Statutes;**

2. **mutual funds through shares of registered investment companies provided the mutual fund receives certain ratings depending on its investments;**

3. **general obligations of the State of Minnesota and its municipalities, and in certain state agency and local obligations of Minnesota and other states provided such obligations have certain specified bond ratings by a national bond rating service;**
4.
5. **bankers' acceptances of United States banks;**

6. **commercial paper issued by United States corporations or their Canadian subsidiaries that is rated in the highest quality category by two nationally recognized rating agencies and maturities in 270 days or less; and**

7. **with certain restrictions, in repurchase agreements, securities lending agreements, joint powers investment trusts, and guaranteed investment contracts.**

The District has not adopted a formal investment policy. The District's only investment is through the Minnesota School District Liquid Asset Fund Plus (MSDLAF+), which is an external investment pool that meets the definition of a 2a7-like pool. Because the District's only investment is through the MSDLAF+ there are no disclosure requirements for custodial credit risk, concentration of credit risk, interest rate risk and foreign currency risk.

Credit Risk – The MSDLAF+ is rated AAAm by Standard and Poor's. The rating signifies excellent safety of investment principal and superior capacity to maintain a $1.00per share net asset value.

NOTE 4 – Property Taxes

The School Board certifies property tax levies in December of each year to Beltrami County for collection in the following year. In Minnesota, counties act as collection agents for all property taxes.

The County spreads all levies over assessable property. Such taxes become a lien on January 2, and are recorded as receivables by the District at that date.

Property taxes may be paid by taxpayers in two equal installments, on May 15, and October 15. The County provides tax settlements to districts and other local governments three times a year, on or before April 15, June 30 and December 30.

INDEPENDENT SCHOOL DISTRICT NO. 38
RED LAKE, MINNESOTA
NOTES TO FINANCIAL STATEMENTS
JUNE 30, 2006

NOTE 4 – Property Taxes - Continued

Prior year's taxes, which remain unpaid at June 30, are classified as delinquent taxes receivable and the portion not receivable within 60 days is offset by deferred revenue because they are not available to finance current expenditures.

The maximum amount of property taxes the District may levy is subject to state levy limitations.

The total net tax capacity for levy year 2005 (payable in 2006) was $10,347 with a market value of $619,100. The tax capacity rate was 38.098%.

Current property taxes receivable consist of the current tax levy less collection prior to June 30. The current tax levy, net of a state mandated property tax shift, is offset by property taxes levied for subsequent years, a deferred revenue account.

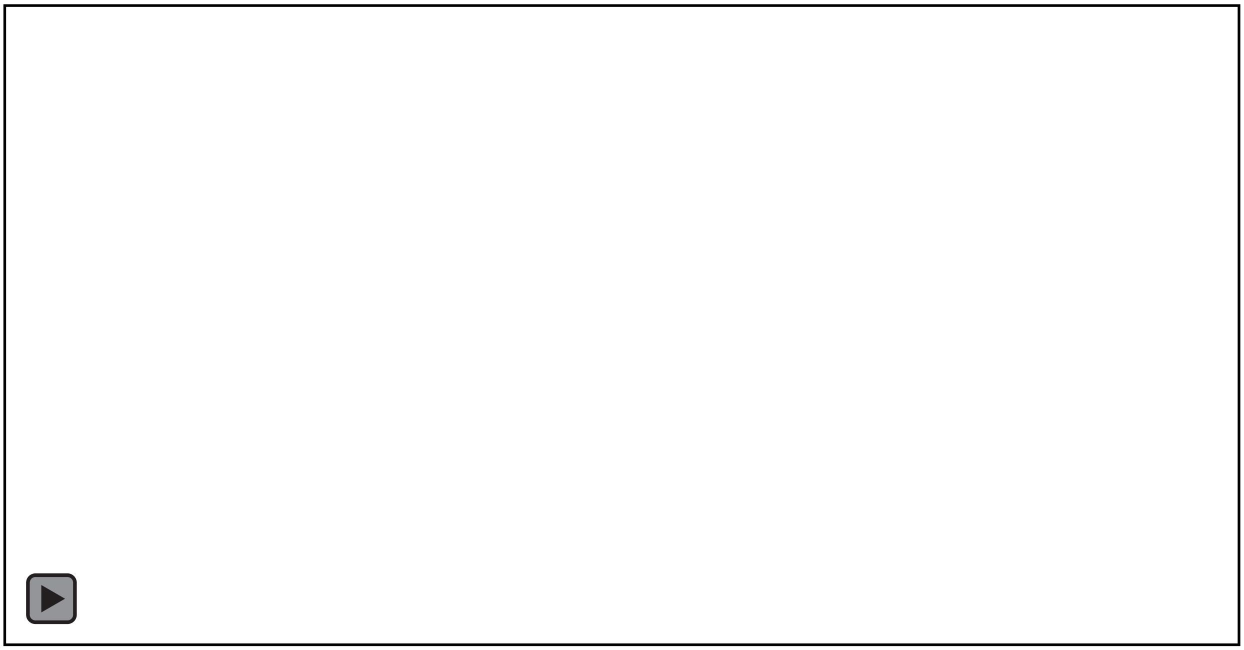
NOTE 5 – Due From Other Governmental Units

Amounts due from other governmental units at June 30, 2006 are as follows:

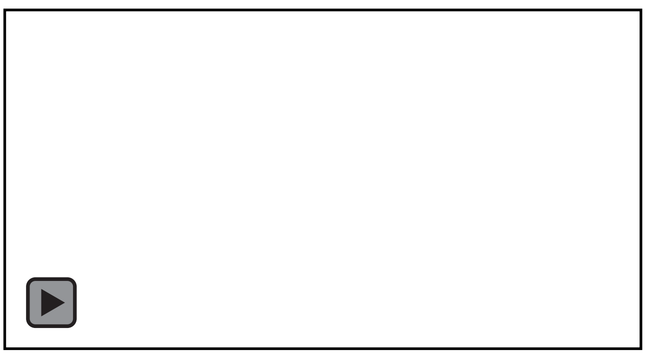
INDEPENDENT SCHOOL DISTRICT NO. 38
RED LAKE, MINNESOTA
NOTES TO FINANCIAL STATEMENTS
JUNE 30, 2006

NOTE 6 – Capital Assets

Capital asset activity for the year ended June 30, 2006 is as follows:



Depreciation expense was charged to the following program services:



NOTE 7 – Pension Plans

A. Teachers Retirement Association

Plan Description

All teachers employed by the District are covered by defined benefit plans administered by the Teachers Retirement Association (TRA). TRA members belong to either the Coordinated or the Basic Plan. Coordinated Plan members are covered by Social Security and Basic Plan members are not. All new members must participate in the Coordinated Plan. The Plans are established and administered in accordance with Minnesota Statutes, Chapters 354 and 356.

TRA provides retirement benefits as well as disability benefits to members and benefits to survivors upon death of eligible members. Benefits are established by Minnesota State Statute and vest after three years of service credit. The defined retirement benefits are based on a member's highest average salary for any five consecutive years of allowable service, age, and years of credit at termination of service.

Two methods are used to compute benefits for TRA's Coordinated and Basic Plan members. Members first employed before July 1, 1989 receive the greater of the Tier I or Tier II as described:

Tier I:

Step Rate Formula	Coordinated	Basic
1st ten years	1.2 percent per year	2.2 percent per year
all years after	1.7 percent per year	2.7 percent per year

With these provisions:

a) **Normal retirement age is 65 with less than 30 years of allowable service and age 62 with 30 or more years of allowable service.**

b) **3 percent per year early retirement reduction factors for all years under normal retirement age.**

c) **Unreduced benefits for early retirement under a Rule-of-90 (age plus allowable service equals 90 or more).**

or

Tier II: A level formula of 1.7 percent per year for coordinated members and 2.7 percent per year for basic members. These percents apply to all years of service. Actuarially equivalent early retirement reduction factors with augmentation are used for early retirement before the normal age of 65. These reduction factors average approximately 4 to 5.5 percent per year.

Members first employed after June 30, 1989 receive only the Tier II calculation with a normal retirement age that is their retirement age for full Social Security retirement benefits, but not to exceed age 66.

NOTE 7 – Pension Plans - Continued

Six different types of annuities are available to members upon retirement. The No Refund Life Plan (A-1) is a lifetime annuity that ceases upon death of the retiree - no survivor annuity is payable. A retiring member may also choose to provide survivor benefits to a designated beneficiary(ies) by selecting one of the five plans which have survivorship features. Vested members may also leave their contributions in the TRA Fund upon termination of service in order to qualify for a deferred annuity at retirement age. Members terminating service are also eligible for a refund of their employee contributions plus interest.

The benefit provisions stated apply to active plan participants. Vested, terminated employees who are entitled to benefits but not yet receiving them are bound by the provisions in effect at the time they last terminated their public service.

TRA publicly issues a Comprehensive Annual Financial Report (CAFR) presenting financial statements, supplemental information on funding levels, and further information on benefit provisions. The report may be accessed at the TRA web site www.tra.state.mn.us. Alternatively, a copy of the report may be obtained by writing or calling TRA:

Teachers Retirement Association
60 Empire Drive Suite 400
St. Paul MN 55103-1855
(651) 296-6449
(800) 657-3853

Funding Policy

Minnesota Statutes Chapter 354 sets the rates for employer and employee contributions. These statutes are established and amended by the state legislature. As of June 30, 2005, Coordinated and Basic Plan members are required to contribute 5.0 percent and 9.0 percent, respectively, of their annual covered salary. Employer contribution rates matched the rates paid by the member of 5.0 percent for Coordinated members and 9.0 percent for Basic members. Total covered salaries for all TRA members statewide during fiscal year 2005, was approximately $3.122 billion.

The District's contributions for the years ending June 30, 2006, 2005, and 2004 were $420,762, $426,652, and $99,830, respectively, equal to the required contributions for each year as set by state statute.

B. Public Employees Retirement Association

Plan Description

All full-time and certain part-time non-certified teacher employees of the District are covered by defined benefit plans administered by the Public Employees Retirement Association of Minnesota (PERA). PERA administers the Public Employees Retirement Fund (PERF) that is a cost-sharing, multiple-employer retirement plan. The plan is established and administered in accordance with Minnesota Statutes, Chapters 353 and 356.

NOTE 7 – Pension Plans - Continued

PERF members belong to either the Coordinated Plan or the Basic Plan. Coordinated Plan members are covered by Social Security and Basic Plan members are not. All new members must participate in the Coordinated Plan.

PERA provides retirement benefits as well as disability benefits to members, and benefits to survivors upon death of eligible members. Benefits are established by State Statute, and vest after three years of credited service. The defined retirement benefits are based on a member's highest average salary for any five successive years of allowable service, age, and years of credit at termination of service.

Two methods are used to compute benefits for PERA's Coordinated and Basic Plan members. The retiring member receives the higher of a step-rate benefit accrual formula (Method 1) or a level accrual formula (Method 2). Under Method 1, the annuity accrual rate for a Basic Plan member is 2.2 percent of average salary for each of the first 10 years of service and 2.7 percent for each remaining year. The annuity accrual rate for a Coordinated Plan member is 1.2 percent of average salary for each of the first 10 years and 1.7 percent for each remaining year. Under Method 2, the annuity accrual rate is 2.7 percent of average salary for Basic Plan members and 1.7 percent for Coordinated Plan members for each year of service. For PERF members hired prior to July 1, 1989, whose annuity is calculated using Method 1, a full annuity is available when age plus years of service equal 90. Normal retirement age is 65 for Basic and Coordinated members hired before July 1, 1989. Normal retirement age is the age for unreduced Social Security benefits capped at age 66 for Coordinated members hired on or after July 1, 1989. A reduced retirement annuity is also available to eligible members seeking early retirement.

There are different types of annuities available to members upon retirement. A single-life annuity is a lifetime annuity that ceases upon the death of the retiree - no survivor annuity is payable. There are also various types of joint and survivor annuity options available which will be payable over joint lives. Members may also leave their contributions in the fund upon termination of public service in order to qualify for a deferred annuity at retirement age. Refunds of contributions are available at any time to members who leave public service, but before retirement benefits begin.

The benefit provisions stated in the previous paragraphs of this section are current provisions and apply to active plan participants. Vested, terminated employees who are entitled to benefits but are not receiving them yet are bound by the provisions in effect at the time they last terminated their public service.

PERA issues a publicly available financial report that includes financial statements and required supplementary information for PERF. That report may be obtained on the web at mnpera.org, by writing to PERA, 60 Empire Drive #200, St. Paul, Minnesota 55103-2088 or by calling (651) 296-7460 or 1-800-652-9026.

INDEPENDENT SCHOOL DISTRICT NO. 38
RED LAKE, MINNESOTA
NOTES TO FINANCIAL STATEMENTS
JUNE 30, 2006

NOTE 7 – Pension Plans - Continued

Funding Policy

Minnesota Statutes Chapter 353 sets the rates for employer and employee contributions. These contributions are established and amended by the state legislature. The District makes annual contributions to the pension plans equal to the amount required by state statutes. PERF Basic Plan members and Coordinated Plan members are required to contribute 9.10% and 5.10%, respectively, of their annual covered salary. The District is required to contribute the following percentages of annual covered payroll: 11.78% for Basic Plan members and 5.53% for Coordinated Plan members. The District's contributions for the years ending June 30, 2006, 2005, and 2004 were $251,531 , $250,114 and $245,684, respectively, equal to the contractually required contributions for each year as set by State Statute.

NOTE 8 – Capital Lease Obligation

The District has entered into a lease agreement as lessee for financing the acquisition of various pieces of energy conservation equipment. This lease agreement qualified as a capital lease for accounting purposes (titles transfer at the end of the lease terms) and, therefore, has been recorded at the present value of the future minimum lease payments as of the date of the inception. The following is an analysis of equipment leased under capital leases as of June 30, 2006:

Various Equipment to Achieve Energy Conservation Measures	$373,806
Year Ending June 30,	
2007	48,731
2008	48,731
2009	25,325
Total minimum lease payments	122,787
Less: Amount representing interest	9,181
Present value of future minimum lease payments	$113,606

NOTE 9 - Long-Term Debt

A summary of changes in long-term debt is as follows:

Capital Loan Payable - During the 1992 fiscal year, the District received approval for a capital loan from the State of Minnesota through the Department of Education to fund the construction of a new school building and renovations to existing buildings. The loan is in the amount of $10,000,000.

During the 2001 fiscal year, the District received approval for an additional capital loan from the State of Minnesota to fund construction and renovations for the Middle School, Ponemah Elementary and the Early Learning Center. The loan is for $11,166,000.

During the 2002 fiscal year, the District received approval for new construction and remodeling of the Red Lake High School, Ponemah Elementary and the Early Childhood Center. The loan is a capital loan from the State of Minnesota for $12,400,000. As of June 30, 2006, $11,636,676 had been expended.

During the 2005 fiscal year, the District received approval for an additional capital loan from the State of Minnesota to remodel the Red Lake High School and Middle School. As of June 30, 2006, $1,034,307 had been expended.

The District will repay the loans out of the excess of its maximum effort debt service levy over its required debt service levy, including interest at a rate equal to the weighted average annual rate payable on Minnesota state school loan bonds issued for the project and disbursed to Districts on a reimbursement basis, but in no event less than 3 ½ percent per year on the principal amount from time to time unpaid. If the capital loan is not repaid within fifty years after the date it is granted, the District's liability on the loan will be satisfied and discharged and interest thereon shall cease.

Capital Facilities Bonds – On November 20, 1995, the District issued Capital Facilities Bonds. This bond matured on December 1, 2005.

There were no authorized and un-issued bonds at June 30, 2006.

INDEPENDENT SCHOOL DISTRICT NO. 38
RED LAKE, MINNESOTA
NOTES TO FINANCIAL STATEMENTS
JUNE 30, 2006

NOTE 10 - Reserved Fund Balances

The District reserves fund balances for the following reasons:

Reserved for Health and Safety represents available resources dedicated for study and removal of hazardous substances and health and safety hazards.

Reserved for Severance Pay represents available resources dedicated for payment of separation and severance pay payable.

Reserved for Operating Capital represents available resources used to purchase equipment and facilities.

Reserved for Community Education represents the resources available to provide programming such as: non-vocational, recreational and leisure time activities, programs for adults with disabilities, non-credit summer programs, adult basic education programs, youth development and youth service programming, early childhood and family education, and extended day programs.

Reserved for Early Childhood and Family Education represents the resources available to provide for services for early childhood and family education programming.

Reserved for School Readiness represents resources available to provide for school readiness programs.

Reserved for Staff Development represents unspent staff development revenues set aside from general education revenue for staff development.

NOTE 11 - Risk Management

The District is exposed to various risks of loss related to torts; theft of, damage to, or destruction of assets; errors or omissions; injuries to employees; and natural disaster. The District has entered into a joint powers agreement with Minnesota School Districts to participate in the Minnesota School Boards Association (MSBA) Insurance Trust to cover workers' compensation liabilities, school leaders' errors and omissions, and property and casualty liabilities. For all other risks, the District has purchased commercial insurance. There were no significant reductions in insurance from the prior year. The amount of settlements did not exceed insurance coverage for the past three fiscal years.

The Self-Insured Workers' Compensation Program of MSBA Insurance Trust is a self-sustaining program and based on the premiums charged, so that total contributions plus compounded earnings on these contributions will equal the amount needed to satisfy claims, liabilities and other expenses. MSBAIT participates in the Workers' Compensation Reinsurance Association as required by law. Should the MSBAIT Self-Insured Compensation Program liabilities exceed assets, the MSBAIT may assess the District in a method and amount to be determined by MSBAIT.

The Property and Casualty Division of MSBAIT is self-sustaining and the District pays an annual premium to cover current and future losses. The MSBAIT carries reinsurance for its property lines to protect against catastrophic losses. Should the MSBAIT Property and Casualty Division liabilities exceed assets, MSBAIT may assess the District in a method and amount to be determined by MSBAIT.

INDEPENDENT SCHOOL DISTRICT NO. 38
RED LAKE, MINNESOTA
NOTES TO FINANCIAL STATEMENTS
JUNE 30, 2006

NOTE 12 - Commitments and Contingencies

General

The District participates in numerous State and Federal grant programs, which are governed by various rules and regulations of the grantor agencies. Costs charged to the respective grant programs are subject to audit and adjustment by the grantor agencies; therefore, to the extent that the District has not complied with the rules and regulations governing the grants, refunds of any money received may be required and the collectibility of any related receivable at June 30, 2006 may be impaired. In the opinion of the District, there are no significant contingent liabilities relating to compliance with the rules and regulations governing the respective grants; therefore, no provision has been recorded in the accompanying combined financial statements for such contingencies.

Litigation

On March 21, 2005 a fatal shooting incident occurred at Red Lake High School. To date, no liability claims have been asserted against the District.

NOTE 13 – Construction Project

In 2001 District voters authorized up to $37,940,000 for new construction and remodeling of the Early Childhood Center; Red Lake Elementary, Ponemah Elementary; Red Lake Middle School and Red Lake High School. The 2002 legislative session appropriated $12,400,000 for new construction and remodeling the Red Lake High School, new construction and remodeling the Ponemah Elementary School and new construction for the Early Childhood Center.

In 2003 District voters authorized up to $33,173,792 for new construction of a separate Red Lake Middle School and new construction and renovation to the Red Lake High School. The District received authorization during the 2005 legislative session for an $18,000,000 state capital loan under the Maximum Effort Loan program in Minnesota Statutes 126C.69. The state requires the Red Lake School District to make a financial contribution of $66,739.65 toward the project.

INDEPENDENT SCHOOL DISTRICT NO. 38
RED LAKE, MINNESOTA
NOTES TO REQUIRED SUPPLEMENTARY INFORMATION
JUNE 30, 2006

NOTE 1 – Budgetary Data

Budgets are prepared for District funds on the same basis and using the same accounting practices as are used to account and prepare financial reports for the funds. Budgets presented in this report for comparison to actual amounts in accordance with accounting principles generally accepted in the United States of America.

Legal Compliance – Budgets

- **The Superintendent submits to the School Board a proposed operating budget for the fiscal year commencing the following July 1. The operating budget includes proposed expenditures and the means of financing them for all funds of the District. However, the General and Special Revenue Funds are the only funds that are legally adopted through the budgetary process as documented below.**
- **The budget is legally enacted through passage of a School Board resolution by July 1.**
- **The School Board may authorize transfer of budgeted amounts between funds.**
- **Formal budgetary integration is employed as a management control devise during the year for the General and Special Revenue Funds. Formal budgetary integration is not employed for the Debt Service Fund because effective budgetary control is alternatively achieved through general obligation bond indenture provisions.**
- **General and Special Revenue Funds expenditures may not legally exceed budgeted appropriations at the total fund level without School Board approval. Monitoring of budgets is maintained at the expenditure category level.**

NOTE 2 – Expenditures in Excess of Budget

Expenditures exceed the budget in the following funds at June 30, 2006:

The above overages were considered by District management to be the result of necessary expenditures critical to operations and were approved by the School Board.

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KEVIN D. ONSTAD, C.P.A.
JEFFREY T. HAUKEBO, C.P.A.

AUDITORS' REPORT ON COMPLIANCE BASED ON AN AUDIT OF THE FINANCIAL STATEMENTS PERFORMED IN ACCORDANCE WITH THE MINNESOTA LEGAL COMPLIANCE AUDIT GUIDE FOR LOCAL GOVERNMENT

The Board of Education
Independent School District No. 38
Red Lake, Minnesota

We have audited the financial statements of the governmental activities, each major fund, and the aggregate remaining fund information of Independent School District No. 38 as of and for the year ended June 30, 2006, which collectively comprise Independent School District No. 38's basic financial statements and have issued our report thereon dated October 26, 2005.

We conducted our audit in accordance with auditing standards generally accepted in the United States of America, and the provisions of the *Minnesota Legal Compliance Audit Guide for Local Government,* promulgated by the State Auditor pursuant to Minnesota Statutes 6.65. Accordingly, the audit included such tests of the accounting records and such other auditing procedures as we considered necessary in the circumstances.

The *Minnesota Legal Compliance Audit Guide for Local Government* covers six main categories of compliance to be tested: contracting and bidding, deposits and investments, conflicts of interest, public indebtedness, claims and disbursements, and uniform financial accounting and reporting standards for school districts. Our study included all of the listed categories.

The results of our test indicate that for the items tested, Independent School District No. 38 complied with the material terms and conditions of applicable legal provisions.

This report is intended solely for the information and use of the School Board, management of the District, Minnesota Department of Education, and the Office of the Minnesota State Auditor and is not intended to be and should not be used by anyone other than these specified parties.

August 17, 2006
Bemidji, Minnesota

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AUDITORS' REPORT ON INTERNAL CONTROL OVER FINANCIAL REPORTING AND ON COMPLIANCE AND OTHER MATTERS BASED ON AN AUDIT OF THE FINANCIAL STATEMENTS PERFORMED IN ACCORDANCE WITH GOVERNMENT AUDITING STANDARDS

The Board of Education
Independent School District No. 38
Red Lake, Minnesota

We have audited the financial statements of the governmental activities, each major fund, and the aggregate remaining fund information of Independent School District No. 38 as of and for the year ended June 30, 2006, which collectively comprise Independent School District No. 38's basic financial statements and have issued our report thereon dated October 26, 2005. We conducted our audit in accordance with auditing standards generally accepted in the United States of America and the standards applicable to financial audits contained in *Government Auditing Standards*, issued by the Comptroller General of the United States.

Internal Control Over Financial Reporting

In planning and performing our audit, we considered Independent School District No. 38's internal control over financial reporting in order to determine our auditing procedures for the purpose of expressing our opinion on the financial statements and not to provide assurance on the internal control over financial reporting. Our consideration of the internal control over financial reporting would not necessarily disclose all matters in the internal control that might be material weaknesses. A material weakness is a reportable condition in which the design or operation of one or more of the internal control components does not reduce to a relatively low level the risk that misstatements in amounts that would be material in relation to the financial statements being audited may occur and not be detected within a timely period by employees in the normal course of performing their assigned functions. We noted no matters involving the internal control over financial reporting and its operation that we consider to be material weaknesses.

Compliance and Other Matters

As part of obtaining reasonable assurance about whether Independent School District No. 38's financial statements are free of material misstatement, we performed tests of its compliance with certain provisions of laws, regulations, contracts and grants, 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 that are required to be reported under *Government Auditing Standards*.

This report is intended solely for the information and use of the School Board, management of the District, federal awarding agencies, and pass-through entities, and is not intended to be and should not be used by anyone other than these specified parties.

August 17, 2006
Bemidji, Minnesota

Miller McDonald, Inc.

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AUDITORS' REPORT ON COMPLIANCE WITH REQUIREMENTS APPLICABLE TO EACH MAJOR PROGRAM AND INTERNAL CONTROL OVER COMPLIANCE IN ACCORDANCE WITH OMB CIRCULAR A-133

The Board of Education
Independent School District No. 38
Red Lake, Minnesota

Compliance

We have audited the compliance of Independent School District No. 38 with the types of compliance requirements described in the *U.S. Office of Management and Budget (OMB) Circular A-133 Compliance Supplement* that are applicable to each of its major federal programs for the year ended June 30, 2006. Independent School District No. 38's major federal programs are identified in the summary of auditors' results section of the accompanying schedule of findings and questioned costs. Compliance with the requirements of laws, regulations, contracts and grants applicable to each of its major federal programs is the responsibility of Independent School District No. 38's management. Our responsibility is to express an opinion on Independent School District No. 38's compliance based on our audit.

We conducted our audit of compliance in accordance with auditing standards generally accepted in the United States of America; the standards applicable to financial audits contained in *Government Auditing Standards*, issued by the Comptroller General of the United States; and OMB Circular A-133, *Audits of States, Local Governments, and Non-Profit Organizations*. Those standards and OMB Circular A-133 require that we plan and perform the audit to obtain reasonable assurance about whether noncompliance with the types of compliance requirements referred to above that could have a direct and material effect on a major federal program occurred. An audit includes examining, on a test basis, evidence about Independent School District No. 38's compliance with those requirements and performing such other procedures as we considered necessary in the circumstances. We believe that our audit provides a reasonable basis for our opinion. Our audit does not provide a legal determination on Independent School District No. 38's compliance with those requirements.

In our opinion, Independent School District No. 38 complied, in all material respects, with the requirements referred to above that are applicable to each of its major federal programs for the year ended June 30, 2006.

Internal Control Over Compliance

The management of Independent School District No. 38 is responsible for establishing and maintaining effective internal control over compliance with the requirements of laws, regulations, contracts, and grants applicable to federal programs. In planning and performing our audit, we considered Independent School District No. 38's internal control over compliance with requirements that could have a direct and material effect on a major federal program in order to determine our auditing procedures for the purpose of expressing our opinion on compliance and to test and report on the internal control over compliance in accordance with OMB Circular A-133.

Our consideration of the internal control over compliance would not necessarily disclose all matters in the internal control that might be material weaknesses. A material weakness is a reportable condition in which the design or operation of one or more of the internal control components does not reduce to a relatively low level the risk that noncompliance with applicable requirements of laws, regulations, contracts, and grants caused by error or fraud that would be material in relation to a major federal program being audited may occur and not be detected within a timely period by employees in the normal course of performing their assigned functions. We noted no matters involving the internal control over compliance and its operation that we consider to be material weaknesses.

This report is intended solely for the information and use of the School Board, management of the District, federal awarding agencies and pass-through entities and is not intended to be and should not be used by anyone other than these specified parties.

August 17, 2006
Bemidji, Minnesota

INDEPENDENT SCHOOL DISTRICT NO. 38
RED LAKE, MINNESOTA
SCHEDULE OF FINDINGS AND QUESTIONED COSTS
YEAR ENDING JUNE 30, 2006

A. Summary of Auditors' Results

1.) **An unqualified report was issued.**

2.) **There were no reportable conditions in internal control reported on the audit of the financial statements.**

3.) **The audit did not disclose any noncompliance which was material to the financial statements.**

4.) **There were no reportable conditions in internal control over major federal programs.**

5.) **An unqualified report on compliance for major federal award programs was issued.**

6.) **In accordance with Section .510(a) of OMB Circular A-133, the audit did not disclose a reportable condition in internal control over major federal awards programs.**

7.) **Major programs:**

Impact Aid	**CFDA No. 84.041**
USDA_Food Service	**CFDA No. 10.553,10.555,10.559, 10.550**
Indian Education	**CFDA No. 84.060**

8.) **A $300,000 threshold was used to distinguish between Type A and Type B programs.**

9.) **Independent School District No. 38 did not qualify as a low-risk auditee.**

B. Findings Related to Financial Statements Audited in Accordance with *Government Audit Standards*.

None reported.

C. Findings and Questioned Costs for Federal Award Programs

Internal Control Findings

None reported.

Questioned Costs

None

INDEPENDENT SCHOOL DISTRICT NO. 38
RED LAKE, MINNESOTA
SCHEDULE OF FINDINGS AND QUESTIONED COSTS
YEAR ENDING JUNE 30, 2006

Prior Year Findings: None

INDEPENDENT SCHOOL DISTRICT NO. 38
RED LAKE, MINNESOTA
PRIOR YEAR AUDIT FINDINGS ON COMPLIANCE WITH MINNESOTA STATUTES AND GOVERNMENT AUDITING STANDARDS
YEAR ENDED JUNE 30, 2006

INDEPENDENT SCHOOL DISTRICT NO. 38
RED LAKE, MINNESOTA
NOTES TO THE REQUIRED SUPPLEMENTARY INFORMATION
JUNE 30, 2006