MIDLAND COMMUNITY SCHOOLS
FINANCIAL STATUS REVIEW
FISCAL YEARS 2020 - 2023

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BACKGROUND

In March 2023, voters of the Midland Community School District (Midland CSD), approved general obligation (GO) bonds for the OJ addition and remodel. As the district began the process of selling the GO bonds, the district's financial advisor (Piper Sandler), the rating agencies, and possible purchasers of the bonds, raised concerns about the district's diminished solvency ratio and cash flow position. The sale of the bonds was delayed until the district could develop a 3-year plan for increasing cash and the solvency ratio. This delay and the need to increase the tax rate to levy cash has caused concerns in the community.

The district engaged a recently retired School Business Official (SBO), with over 35 years of experience in governmental accounting and 25 years as an SBO, to review the district's current financial position and make recommendations to provide the board and the community more transparency on district finances. A brief review of the fundamentals of school finances as well as the district's position regarding these fundamentals and recommendations are included in this report.

GOVERNING AUTHORITY

Iowa school districts operate under Dillon's rule as opposed to Home Rule. Under Home Rule, local governments, such as cities and counties, can provide services, raise revenue, and spend funds in any manner if it is not explicitly prohibited by statute. Under Dillon's Rule, school districts can only provide services, raise revenue, and spend funds as explicitly allowed by statute.

IOWA SCHOOL FINANCE

Iowa school districts are funded through a mechanism called the Iowa School Foundation Program. This program is commonly referred to as the state aid formula. The goals of the formula are "to equalize educational opportunity, to provide a good education for all the children of Iowa, to provide property tax relief, to decrease the percentage of school costs paid from property taxes and to provide reasonable control of school costs." Iowa Code 257.1.

Iowa school finance law is often considered a very complicated and confusing web of language reserved only for the "experts". Terms specific to Iowa School Finance such as "allowable growth", "weighted enrollment", "certified enrollment", "spending authority", and "unspent balance" make it difficult to explain the formula to the general public.

In truth, understanding Iowa school finance law is relatively simple once the principles of school finance are explained.

PRINCIPLE ONE
Iowa school districts receive and disburse funds from a variety of funds.
The state foundation formula pertains only to the General Fund.

The district is organized and operated on the basis of fund accounting with each fund being a separate accounting entity with a set of self-balancing accounts. These funds follow generally accepted accounting principles (GAAP). Funds utilized by the Midland CSD are:

General Fund – Funds received by a school district from taxes and other sources must be accounted for in the general fund, except funds required by law to be accounted for in another fund. The general fund is primarily used to provide the education program for the school district. The General Fund cannot be used for facility capital improvements which increase the scope or use of a facility but can be used for facility maintenance.

Management Fund (IC 298A.3) – The management levy is a tax that can be levied in excess of any tax limits imposed by statute. The management levy may be used for early retirement programs, unemployment compensation, tort liability, and property insurance. The amount of the levy is the amount deemed necessary by the school board to meet obligations allowed under the levy.

Student Activity Funds (IC 298A.8) – Student activity funds must be accounted for in the student activity fund. Funds from student-related activities such as admissions, activity fees, student dues, student fund-raising events, or other student-related co-curricular or extra-curricular activities are deposited in this fund.

Capital Project Funds (IC 298A.9) – A capital project fund must be established by a school district which issues bonds or other authorized indebtedness for capital projects, initiates a capital project or receives grants or other funds for capital projects, or to account for PPEL or local option sales tax revenue and related capital projects.

> **Secure an Advance Vision for Education (SAVE) Fund** – (IC 423E) – The local option sales and services tax is comprised of a one cent tax on all non-exempt goods and services sold in the state. The sales tax is used for facility related expenditures such as: construction, reconstruction, and repair, purchasing or remodeling schoolhouses, stadiums, gyms, field houses, and bus garages; procurement of sites; and site improvements. The legislature put the tax in place through 2050 subject to a vote on the District's revenue purpose statement.
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> **Physical Plant & Equipment Levy (PPEL) Fund** (IC 298A.4) – A PPEL levy may be established in any school district in the amount of 33 cents per thousand dollars of valuation. An additional levy of up to $1.34 per thousand can be approved by the voters of the district every ten years. The Midland CSD has a voter approved levy of 67 cents. The PPEL levy is used for any facility related expenditures which increase the scope or use of the facility. The levy can also be used for capital leases, to purchase furniture and equipment greater than $1,500, and to purchase buses.

Debt Service Fund (IC 298A.10) – A debt service fund must be established in a school district which has issued bonds or other authorized indebtedness. The funds in the debt service fund are used to pay the interest and the principal when due on the bonds or other indebtedness. General obligation debt requires voter approval of 60%. Revenue Bonds are payable out of local option sales tax (transferred to the debt service fund) and require public hearings and are subject to reverse referendum.

Enterprise Funds – Enterprise funds account for operations financed and operated similar to private business. The intent is that the cost of providing the service on a continuing basis be financed or recovered primarily through user charges.

> **School Nutrition Fund** (IC 298A.11) – This fund accounts for the operation of a school breakfast and/or lunch program on a non-profit basis for its students.

Trust Funds (IC 298A.13) –Trust and Agency funds are used to account for assets held by a school district as a trustee or agent for individuals, private organizations, other governments and/or other funds. Expendable Trust Funds are used to account for trusts where both principal and earnings on the principal may be spent for the trust's intended purpose. Non-expendable Trusts are used to account for trusts where the principal may not be spent. These funds are held solely in a custodial capacity.

PRINCIPAL TWO

Pupil enrollment is a primary factor in determining school districts' spending authority. Several different enrollments are considered under the formula. Each type of enrollment builds upon another.

Actual Enrollment - Actual enrollment is the number of pupils in the school district and is commonly referred to as the headcount. The actual enrollment is determined on October 1st by counting the number of resident pupils enrolled in the school district on that day. School districts receive spending authority under the formula only for pupils that are enrolled and are residents of the school district.

Special Education Weighting (IC 356B.9) – Special education weighting allows a pupil to be counted at a higher value because of the increased cost to educate the pupil. Depending on the needs of the student, a weighting of 1.72, 2.21, or 3.74 can be counted for a special education pupil.

Supplemental Weighting – Supplemental weighting is designed to encourage a particular type of activity by school districts. Supplemental weighting is currently available for shared classes and teachers, for English learner students, shared operations, and for at-risk students.

PRINCIPLE THREE

The state foundation formula is "pupil driven." School districts' spending authority and funding are determined by multiplying a cost per pupil by the appropriate enrollment.

District costs determine spending authority a school district may fund. District costs are determined by per-pupil costs times the appropriate enrollment. The state aid formula establishes a value at the state level for each pupil. Depending on the program, this value is called the regular program cost or the special education cost.

Regular Program Cost Per Pupil (IC 257.10) – The regular program cost per pupil is commonly referred to as the state cost per pupil. The state cost per pupil is the basis for calculating state aid. However, the amount of state aid a school district will receive consists of only a portion (percentage) of the state cost per pupil multiplied by a school districts weighted enrollment. The regular program percentage is currently 88.5%

Special Education Cost Per Pupil (IC 257.10) – Currently the special education cost per pupil percentage equals the regular program percentage of 88.5%.

Special Education Support Costs Per Pupil (IC 257.10) – This is used to calculate the amount of state aid to be paid to Area Education Associations (AEA). Current legislation will change this calculation.

Combined Cost Per Pupil (IC 257.10) – The combined cost is the sum of the regular program cost, the special education program cost, and the special education support costs.

PRINCIPLE FOUR

The state aid formula calculates spending authority and how it is funded.

Total spending authority determines the maximum amount of a school district's budget. The budget developed by each district indicates how the district will fund the spending authority and how the funds are expended.

STATE AID FORMULA

Uniform Levy (IC 257.3) – The uniform levy is a property tax that is levied equally against the taxable property in all the school districts in the state. The uniform levy is currently $5.40 per thousand dollars of taxable valuation. The tax is levied statewide but collected at the county level and paid to each school district with all property taxes. School districts with higher taxable valuation receive more money from the uniform levy than school districts with lower taxable valuation.

State Aid (IC257.1) – State dollars are used to equalize each school district in the state up to 88.5% of the district cost per pupil. A school district with low taxable valuation will receive more state aid then a district with high valuation.

Additional Levy (IC 257.4) – To fully fund the district cost per pupil, a school district must levy additional property taxes. The dollar amount the levy generates is the same for each school district; however, the tax rate will be higher in school districts with lower taxable valuation.

Miscellaneous Income - If general fund revenue is received from sources other than the uniform levy, state aid, or the additional levy, it is classified as miscellaneous income for purposes of determining spending authority. Miscellaneous income includes, but is not limited to federal funds, state grants, instructional support programs, educational improvement programs, and SBRC supplemental aid grants.

UNSPENT AUTHORIZED BUDGET (UAB)

The last element of a school district's spending authority is the UAB, also called unspent balance. The term "unspent balance" is somewhat misleading in that it does not refer to a cash balance but rather to unspent spending authority. Under the formula, the unspent balance consists of unbudgeted spending authority, budgeted but not funded spending authority, and budgeted, funded but unspent spending authority.

UAB CALCULATION

Combined District Cost
+ Actual Miscellaneous Revenue
+ Prior Year Unspent Balance
= Total Spending Authority
- Actual Expenditures
= Current Unspent Balance

UAB from one year is added to the spending authority the next year. Although a district may have unspent spending authority, it may not have funds available to expend it. Once a portion of unspent balance is spent, it is gone forever. Ideally, unspent balance should only be used for one-time expenditures.

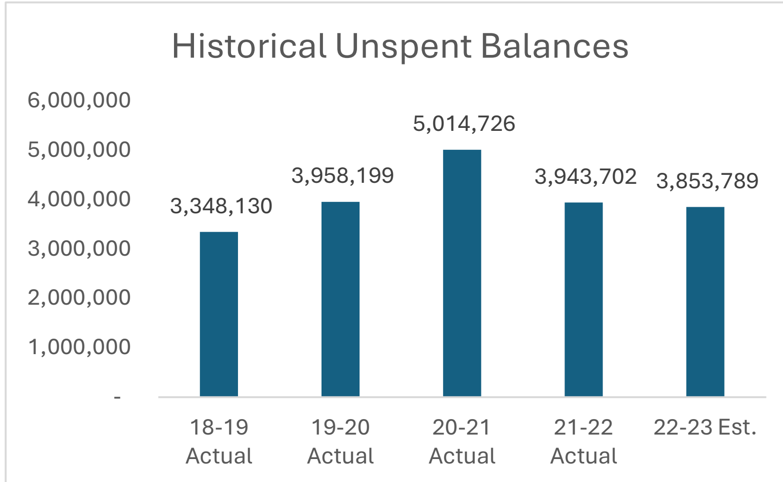
MIDLAND CSD SPENDING AUTHORITY

The review began with an analysis of the district's annual spending authority as well as the district's UAB. As mentioned previously, under Dillion's Rule, the district must have authority from the school aid formula to spend funds in the general fund. Most spending authority is generated by the formula and is funded through the formula by a mix of property taxes and state aid.

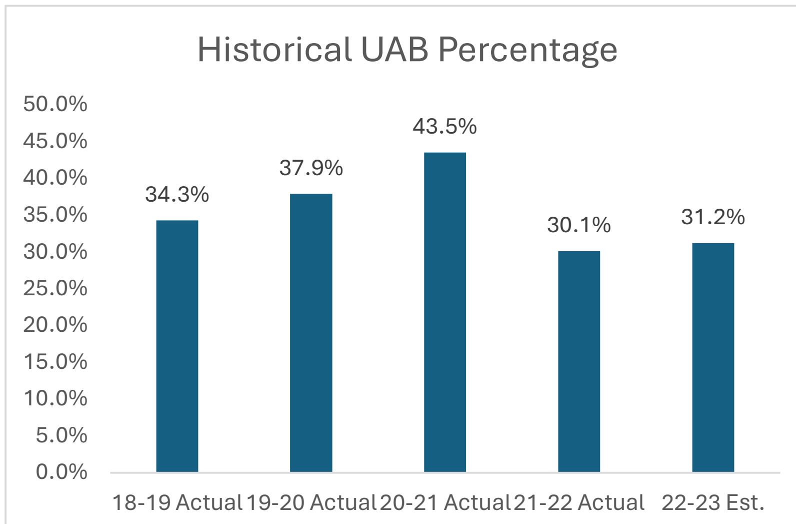
Districts are required to provide the necessary services to certain groups of students regardless of the amount of funding received. Special Education and English Learner (EL) students often require services where the expenditures exceed the amount of funding generated by the formula. These are known as the special ed deficit and EL excess costs. The Department of Education's School Budget Review Committee (SBRC) must approve all spending authority not generated directly by the school aid formula. The special ed deficit, EL excess costs, and authority needed for increased enrollment or increased open enrollment out are submitted and approved as class action for all districts in the state. Although spending authority is granted for these applications, it does not come with funding. The only way to generate funding for the additional spending authority is through the cash reserve levy (100% property taxes) which itself does not generate spending authority.

The district has a history of very strong UAB. The accompanying charts show that the UAB has remained above $3 million while the UAB percentage has not dipped below 30%. Generally, a UAB percentage above 15% is considered strong. Districts are not allowed to exceed total annual spending authority and the UAB or they will be required to file a workout plan with the SBRC until they have a positive UAB. Midland CSD's strong UAB means they are in good standing with the SBRC.

The UAB increased by $1,056,527 in FY21 and decreased by $1,071,024 for a net decrease of $14,497 between the two years. This was due to a timing issue with the federal COVID funds (ESSER). Due to the amount of federal funds the Iowa Department of Education (DE) received for all schools in a very short time, payments to districts were not always made timely. Also, the ESSER funds allowed for reimbursement for expenses back to March of 2020 although funds were not available until the fall of 2020. It also created accounting challenges for deferring inflows and outflows for federal funds not received within the 60-day accrual period (August 31st), that most districts in Iowa had not experienced before.



The timing difference was reconciled in the FY21 audit (received spring 2022) and an auditor's downward adjustment was made in the amount of $742,989. An auditor's adjustment reconciles the fund balance filed with the DE in the Certified Annual Report (CAR) to the fund balance determined in the audit. This simply puts revenues and or expenditures in the correct year for the audit and corrects the ending fund balance for the CAR in the next year.

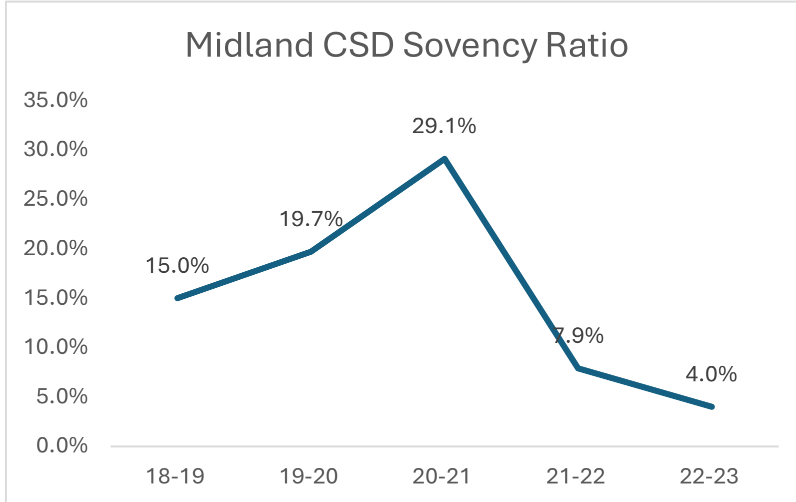


Spending authority decreased by $89,913 in FY23. However, despite the fact that the district filed the June 30, 2023 ESSER claim of $199,390 by the July 15, 2023 deadline, the DE failed to process it within the accrual period. The funds were not received by the District until January 2024. Had these funds been received timely, they would have been recognized as revenue in FY23 and the district's UAB would have increased by approximately $110,000.

In FY19 and FY20, the district's UAB increased by $759,962 and $610,069 respectfully (appendix A2). This indicates the district was spending considerably less than its annual spending authority. Expenditures increased significantly in FY22 due to the receipt of federal funds and what appears to be an effort to right size expenditures to the annual authority. As shown by the graphs, the spending authority was of consistent amount FY20-FY23 after adjusting for the timing difference in FY21. Most districts do budget near or at the annual spending authority. However as mentioned above, some of the annual authority does not come with funding and must be funded by the cash reserve levy.

MIDLAND CSD CASH RESERVE LEVY/SOLVENCY RATIO

Districts have a mechanism to fund cash flow needs and unfunded spending authority known as the cash reserve levy. The cash reserve levy generates property taxes and can be levied when the fund balance from the prior year is less than 20% of the prior year expenditures. For instance, the allowed cash reserve levy for the FY24 budget was based on the June 30, 2022 fund balance and expenditures. Midland's fund balance was such they were above the statutory limit to levy cash reserve for FY20 - FY23 (appendix A1.) The fund balance as of June 30, 2022 fell below the 20% limit and the district was eligible to levy cash reserve for the FY24 budget in the amount of $1,813,559 but did not levy any cash. Another fact for determining the need to levy cash reserve is the district's solvency ratio, which measures uncommitted fund balance. The district's solvency ratio decreased from 15% (FY19) to 8% in FY22 and to 4% in FY23. In general, a solvency ratio below 10% is cause for concern.

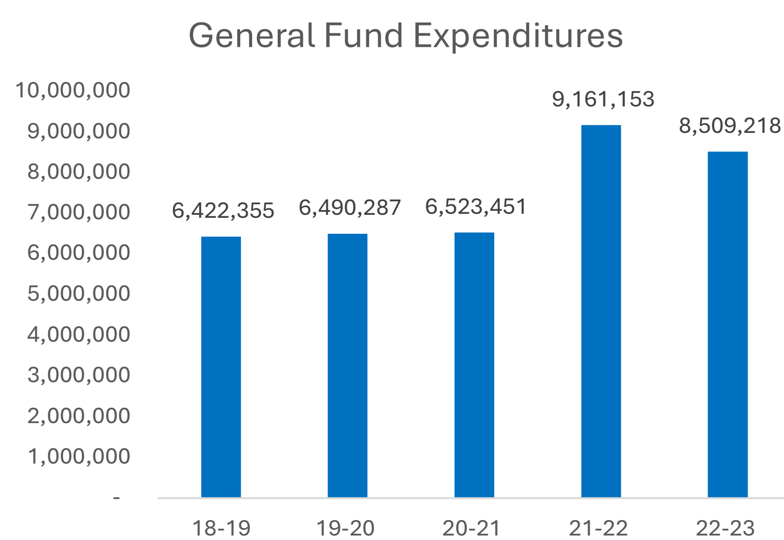


During the FY24 budget process (spring of 2023), the district had a special election for GO bonds. At the time, it was the desire of the Board and the Superintendent to not propose a tax rate increase as they were asking the voters to approve a bond issue. This is a common position for Boards to take, however; the Board must fully understand the consequences and possible alternatives so that the district's solvency ratio remains such that cash flow does not become a concern.

As mentioned previously, the district appeared to increase expenditures to annual spending authority starting in FY22. There is nothing wrong with spending the annual authority, however; because portions of the authority are not funded, the fund balance will continue to drop and eventually there will be a need for a cash reserve levy to fund authority and to provide cash flow. Alternatives would have included considering other portions of the tax rate to decrease to offset a cash reserve levy or to reduce expenditures. In FY24 the district pre-levied $436,299 on existing GO bonds. The district could have chosen not to pre-levy and to levy an equivalent amount of cash for FY24. Another alternative could have been to use sales tax revenue to reduce the tax levy for debt service while levying for cash. As of FY23 the balance in the SAVE fund was $1.3 million or approximately twice the annual revenue received from sales tax. For this alternative, the district would need to carefully review its planned use for sales tax over the next couple of years.

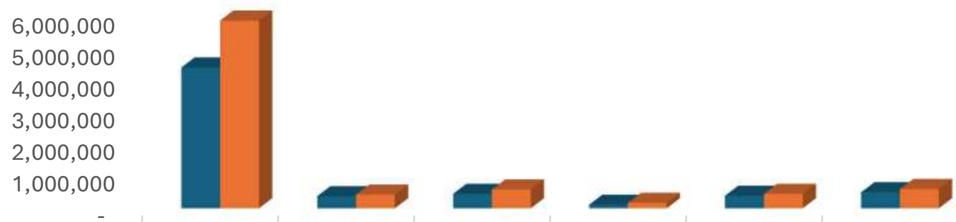
MIDLAND CSD EXPENDITURE ANALYSIS

Expenditures increased significantly between FY21 and FY22 from $6.5 million to $9.2 million. While approximately $400,000 was due to ESSER funds, most of it was increased instruction expenditures not due to the receipt of federal funds. Instructional salaries and benefits increased the most (appendix A4.) Other increases were due to decisions not to share a Superintendent, add a shared payroll staff position, and to replace a part-time custodian with a full-time position.



Such a significant increase in expenditures would normally raise a concern about spending authority. However, as previously stated expenditures were within the annual spending authority. Expenditures decreased in FY23 as ESSER funds were fully spent.

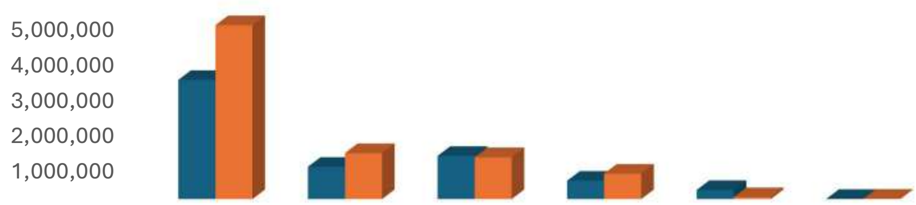
GENERAL FUND EXPENDITURES
By Function



	Instruction	Support Services	Admin	Business/HR/Tech	Transp	Operations
2021	4,440,717	381,941	456,081	110,792	396,178	504,405
2022	5,923,674	433,027	593,332	171,755	454,619	608,430

2021 2022

GENERAL FUND EXPENDITURES
By Object



	Salaries	Benefits	Purchased Services	Supplies	Equipment	Other
2021	3,368,906	914,419	1,220,558	519,516	260,080	6,636
2022	4,912,654	1,301,240	1,186,065	720,375	53,977	10,525

2021 2022

While expenditures in total decreased in FY23, operations and maintenance supplies increased by $245,365. Most of this increase is due to the cost of the repair to the roof and gym floor at the secondary building. Although it would have been more appropriate to account for this project out of either PPEL or SAVE, it had no bottom-line impact on the general fund as insurance proceeds offset the costs.

	Regular Ed	Special Ed	Local Grants	State Grants	Federal Grants	Athletics /Other
2021	978,773	612,982	165,771	399,175	184,408	64,540
2022	1,662,23	772,949	95,445	561,245	393,609	97,571

2021 2022

Accounting for capital projects should occur in PPEL or SAVE and the insurance proceeds deposited in the corresponding fund. Although there was no financial impact on the general fund, it makes supply expenditures higher than they otherwise would have been and makes year to year comparisons more difficult.

RECOMMENTATIONS

In general, the district's finances in the general fund were within statutory annual spending authority for the years reviewed, however; the failure to levy cash for FY24 has left the district in a vulnerable cash flow position in the general fund. There are several things the Board, Superintendent, and SBO may want to consider.

- The Board, Superintendent, and SBO should develop a multi-year plan to restore solvency that will satisfy the bond rating agencies and the bond market.
- The Board, Superintendent, and SBO should annually review the use of annual spending authority, special ed deficit, the ending UAB, the general fund balance reserve percentage, and the solvency ratio as of June 30th each year. This data will be available the first part of September after the district has filed its Certified Annual Report (CAR). This will guide the Board, Superintendent, and SBO on the need to levy cash reserve in the following year budget.
- The Board may want to consider a Fiscal Management board policy. Such a policy would establish target ranges for the general fund balance reserve percentage, the solvency ratio, and the UAB percentage. This policy could indicate when the Board should levy cash and could layout the requirement for the district to apply for spending authority whenever possible. The Iowa Association of School Boards has a sample policy that can be modified to the district's needs.
- When balancing the need to levy cash and the desire to not increase the property tax rate, the board should inquire about all alternatives. These include decreasing general fund expenditures, deferring a GO bond pre-levy, using save funds to offset the debt service levy needed service current year debt obligations, or determining if the fund balance in the management fund (100% property taxes) is sufficient to allow a one-year reduction in the tax rate for the fund.
- The board should receive a detailed monthly financial report which corresponds to the district's budget. A report that details revenues, expenditures, and fund balance for each fund will assist in enhancing the Board's understanding of the district's financial position at the end of each month as well as afford opportunity to learn more about Iowa school finance. A template of such a report was provided to the Board President, Superintendent, and SBO. The new format will be provided to the

Board in April for the financial status as of March 31st. The Board will need to determine if this meets its needs going forward.

- In the future, expenditures for capital projects (defined as improving the scope and use of a facility) should be accounted for in PPEL or SAVE, even if financed with insurance proceeds. Although there was no negative impact on the general fund, these types of expenditure create comparison problems and they are also not appropriate in the general fund and cannot be coded properly to clear the business rules established by the CAR. The expenditures for the gym and roof replacement should have been coded to a Facilities Acquisition and Construction function (4000s) and a construction services object (450s), which are not allowed in the general fund.
- Expenditures for the architect for the OJ remodel and addition have been charged to the general fund in FY24. The district has passed a reimbursement resolution to allow GO bond revenue to reimburse for expenditures incurred prior to the issuance of the bonds. Like the gym and roof repair, these expenditures should be charged to either PPEL or SAVE and are not appropriate in the general fund. The expenditures should be coded to a Facilities Acquisition and Construction function (4000s) and an architect object (343), which are not allowed in the general fund. The district should recode these expenditures to either PPEL or SAVE and determine the amount of reimbursement when the GO bonds are issued. This will make over $600,000 of cash immediately available in the general fund.

An appendix of the financial analysis used for the report is attached.