

Management Report

for

DaVinci Academy of Arts and Science
Ham Lake, Minnesota

June 30, 2020

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To the Board of Directors and Management of
DaVinci Academy of Arts and Science and
DaVinci Academy Affiliated Building Company
Ham Lake, Minnesota

We have prepared this management report in conjunction with our audit of DaVinci Academy of Arts and Science's (the Academy) financial statements for the year ended June 30, 2020. We have organized this report into the following sections:

- Audit Summary
- Funding Public Education in Minnesota
- Financial Trends of Your Academy
- Legislative Summary
- Accounting and Auditing Updates

We would be pleased to further discuss any of the information contained in this report or any other concerns that you would like us to address. We would also like to express our thanks for the courtesy and assistance extended to us during the course of our audit.

The purpose of this report is solely to provide those charged with governance of the Academy, management, and those who have responsibility for oversight of the financial reporting process comments resulting from our audit process and information relevant to charter school financing in Minnesota. Accordingly, this report is not suitable for any other purpose.

Malloy, Montague, Karnowski, Radosevich & Co., P.A.

Minneapolis, Minnesota
October 22, 2020

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AUDIT SUMMARY

The following is a summary of our audit work, key conclusions, and other information that we consider important or that is required to be communicated to the Board, administration, or those charged with governance of the Academy.

OUR RESPONSIBILITY UNDER AUDITING STANDARDS GENERALLY ACCEPTED IN THE UNITED STATES OF AMERICA AND *GOVERNMENT AUDITING STANDARDS*.

We have audited the financial statements of the governmental activities and each major fund of the Academy as of and for the year ended June 30, 2020. Professional standards require that we provide you with information about our responsibilities under auditing standards generally accepted in the United States of America and *Government Auditing Standards*, as well as certain information related to the planned scope and timing of our audit. We have communicated such information to you verbally and in our audit engagement letter. Professional standards also require that we communicate to you the following information related to our audit.

PLANNED SCOPE AND TIMING OF THE AUDIT

We performed the audit according to the planned scope and timing previously discussed and coordinated in order to obtain sufficient audit evidence and complete an effective audit.

AUDIT OPINION AND FINDINGS

Based on our audit of the Academy's financial statements for the year ended June 30, 2020:

- We have issued an unmodified opinion on the Academy's basic financial statements.
- We reported no deficiencies in the Academy's internal control over financial reporting that we considered to be material weaknesses.
- The results of our testing disclosed no instances of noncompliance required to be reported under *Government Auditing Standards*.
- We reported no findings based on our testing of the Academy's compliance with Minnesota laws and regulations.

OTHER OBSERVATIONS AND RECOMMENDATIONS

Impact of Novel Coronavirus (COVID-19)

Starting in March 2020, the onset of the novel coronavirus (COVID-19) pandemic caused substantial volatility in economic conditions and tremendous disruption in the way schools, governments, businesses, and individuals function. Minnesota schools may experience the impact of this pandemic in a myriad of financial areas, such as: declines in investment rates of return, cash flow issues, significant increases in the number and frequency of employees working remotely, challenges in processing general and payroll disbursements, disruption of prescribed internal control procedures, delays in internal and external financial reporting, and new compliance requirements attached to potential federal relief subsidies. As your school adapts to the new normal of school operations in a post-COVID-19 world, the assessment of and responses to new risks that may accompany operational changes will be critical to the safeguarding of school resources and sound financial stewardship. We encourage management and governance to include a robust financial risk assessment process when planning responses to these challenges, and to reassess and adapt internal controls over financial transactions and reporting to align with significant changes made to daily operations, even those intended to be temporary.

SIGNIFICANT ACCOUNTING POLICIES

Management is responsible for the selection and use of appropriate accounting policies. The significant accounting policies used by the Academy are described in Note 1 of the notes to basic financial statements.

No new accounting policies were adopted and the application of existing policies was not changed during the fiscal year ended June 30, 2020. However, the Academy implemented the following governmental accounting standard during the fiscal year ended June 30, 2020:

Governmental Accounting Standards Board (GASB) Statement No. 84, *Fiduciary Activities*, which established criteria for identifying fiduciary activities of local governments. The focus of the criteria generally is on (1) whether a government is controlling the assets of the fiduciary activity, and (2) the beneficiaries with whom a fiduciary relationship exists. Separate criteria are included to identify fiduciary component units and post-employment benefit arrangements that are fiduciary activities.

We noted no transactions entered into by the Academy during the year for which there is a lack of authoritative guidance or consensus. All significant transactions have been recognized in the financial statements in the proper period.

ACCOUNTING ESTIMATES AND MANAGEMENT JUDGMENTS

Accounting estimates are an integral part of the financial statements prepared by management and are based on management's knowledge and experience about past and current events and assumptions about future events. Certain accounting estimates are particularly sensitive because of their significance to the financial statements and because of the possibility that future events affecting them may differ significantly from those expected. The most sensitive estimates affecting the financial statements were:

General education revenue and certain other revenues are computed by applying an allowance per student to the number of students served by the Academy. Student attendance is accumulated in a state-wide database—MARSS. Because of the complexity of student accounting and because of certain enrollment options, student information is input by other schools and the MARSS data for the current fiscal year is not finalized until after the Academy has closed its financial records for the fiscal period. General education revenue and certain other revenues are computed using preliminary information on the number of students served in the resident school and also utilizing some estimates, particularly in the area of enrollment options.

Special education state aid includes an adjustment related to tuition billings to other schools for special education services, which are computed using formulas derived by the Minnesota Department of Education. Because of the timing of the calculations, this adjustment for the current fiscal year is not finalized until after the Academy has closed its financial records for the fiscal period. The impact of this adjustment on the receivable and revenue recorded for state special education aid is calculated using preliminary information available to the Academy.

The Academy has recorded activity in the Statement of Net Position for pension benefits. This obligation is calculated using actuarial methodologies described in GASB Statement No. 68. This actuarial calculation includes significant assumptions, including projected changes, investment returns, retirement ages, proportionate share, and employee turnover.

The depreciation of capital assets involves estimates pertaining to useful lives.

We evaluated the key factors and assumptions used by management to develop the estimates discussed above in determining that they are reasonable in relation to the financial statements taken as a whole.

Certain financial statement disclosures are particularly sensitive because of their significance to financial statement users. The disclosures included in the notes to the basic financial statements related to pension benefits are particularly sensitive due to the materiality of the liabilities, and the large and complex estimates involved in determining the disclosures.

The financial statement disclosures are neutral, consistent, and clear.

DIFFICULTIES ENCOUNTERED IN PERFORMING THE AUDIT

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

CORRECTED AND UNCORRECTED MISSTATEMENTS

Professional standards require us to accumulate all known and likely misstatements identified during the audit, other than those that are clearly trivial, and communicate them to the appropriate level of management. There were no misstatements detected as a result of audit procedures that were material, either individually or in the aggregate, to each opinion unit's financial statements taken as a whole.

DISAGREEMENTS WITH MANAGEMENT

For purposes of this letter, a disagreement with management is a financial accounting, reporting, or auditing matter, whether or not resolved to our satisfaction, that could be significant to the financial statements or the auditor's report. We are pleased to report that no such disagreements arose during the course of our audit.

MANAGEMENT REPRESENTATIONS

We have requested certain representations from management that are included in the management representation letter dated October 22, 2020.

MANAGEMENT CONSULTATIONS WITH OTHER INDEPENDENT ACCOUNTANTS

In some cases, management may decide to consult with other accountants about auditing and accounting matters, similar to obtaining a "second opinion" on certain situations. If a consultation involves application of an accounting principle to the Academy's financial statements or a determination of the type of auditor's opinion that may be expressed on those statements, our professional standards require the consulting accountant to check with us to determine that the consultant has all the relevant facts. To our knowledge, there were no such consultations with other accountants.

OTHER AUDIT FINDINGS OR ISSUES

We generally discuss a variety of matters, including the application of accounting principles and auditing standards, with management each year prior to retention as the Academy's auditors. However, these discussions occurred in the normal course of our professional relationship and our responses were not a condition to our retention.

OTHER MATTERS

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

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

We were not engaged to report on the introductory section, which accompanies the financial statements, but is not RSI. Such information has not been subjected to the auditing procedures applied in the audit of the basic financial statements and, accordingly, we do not express an opinion or provide any assurance on it.

FUNDING PUBLIC EDUCATION IN MINNESOTA

Due to its complexity, it would be impossible to fully explain the funding of public education in Minnesota within this report. A summary of legislative changes affecting charter schools included later in this report gives an indication of how complicated the funding system is. This section provides some state-wide funding and financial trend information.

BASIC GENERAL EDUCATION REVENUE

The largest single funding source for Minnesota charter schools is basic general education aid. Each year, the Legislature sets a basic formula allowance. Total basic general education revenue is calculated by multiplying the formula allowance by the number of pupil units for which a school is entitled to aid. Pupil units are calculated using a legislatively determined weighting system applied to average daily membership (ADM). Over the years, various modifications have been made to this calculation, including changes in weighting and special consideration for declining enrollment schools.

The table below presents a summary of the formula allowance for the past decade and as approved for the 2021 fiscal year. The amount of the formula allowance and the percentage change from year-to-year excludes temporary funding changes, the “roll-in” of aids that were previously funded separately, and changes that may vary dependent on actions taken by individual schools. The \$529 increase in 2015 was offset by changes to pupil weightings and the general education aid formula that resulted in an increase equivalent to approximately \$105, or 2.0 percent, state-wide.

Fiscal Year Ended June 30,	Formula Allowance	
	Amount	Percent Increase
2011	\$ 5,124	– %
2012	\$ 5,174	1.0 %
2013	\$ 5,224	1.0 %
2014	\$ 5,302	1.5 %
2015	\$ 5,831	2.0 %
2016	\$ 5,948	2.0 %
2017	\$ 6,067	2.0 %
2018	\$ 6,188	2.0 %
2019	\$ 6,312	2.0 %
2020	\$ 6,438	2.0 %
2021	\$ 6,567	2.0 %

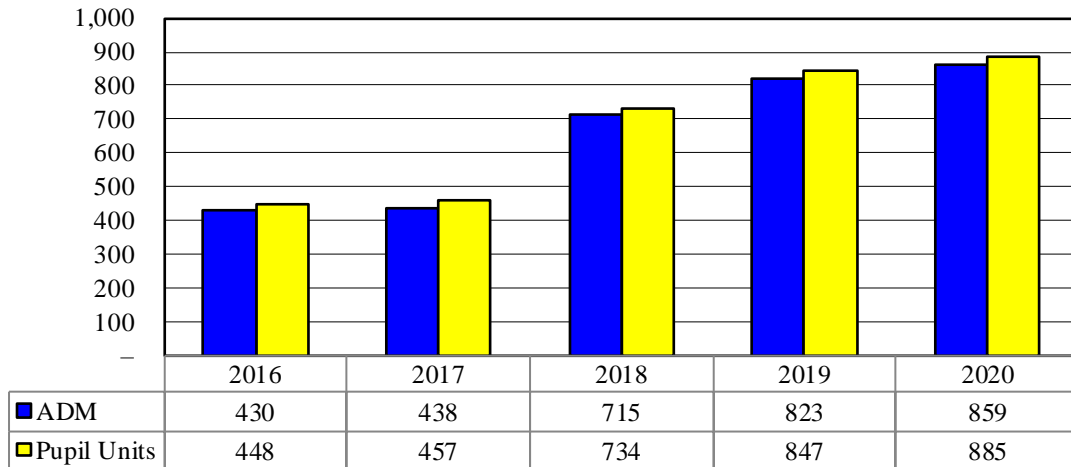
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FINANCIAL TRENDS OF YOUR ACADEMY

AVERAGE DAILY MEMBERSHIP (ADM) AND PUPIL UNITS

The following graph summarizes the ADM and pupil units served by the Academy over the last five years:

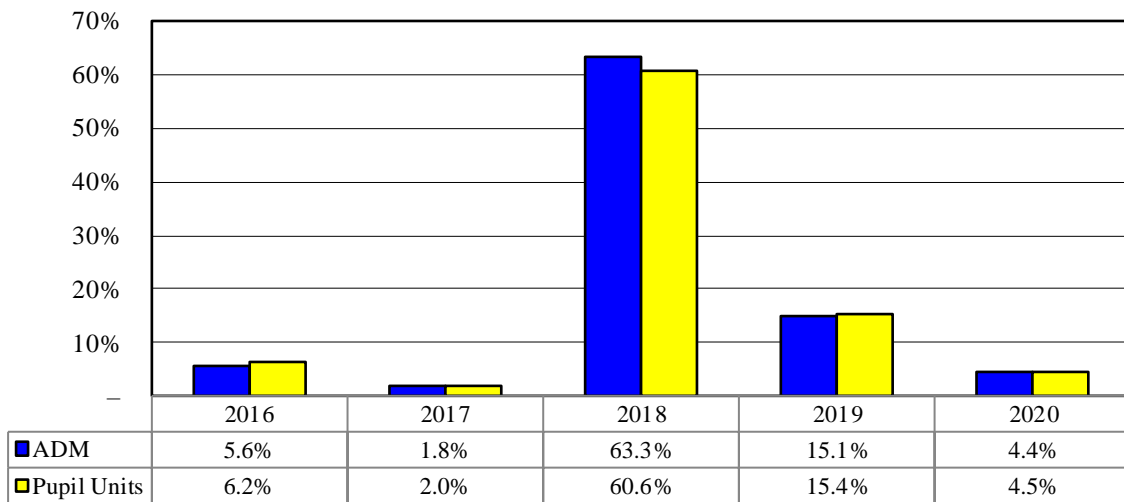
Students (ADM and Pupil Units)



The Academy’s ADM served for 2020 is estimated to be 859, which increased by 36 (4.4 percent) from the prior year.

The following graph shows the rate of ADM changes and the relationship of the resulting pupil units:

Change in ADM and Pupil Units



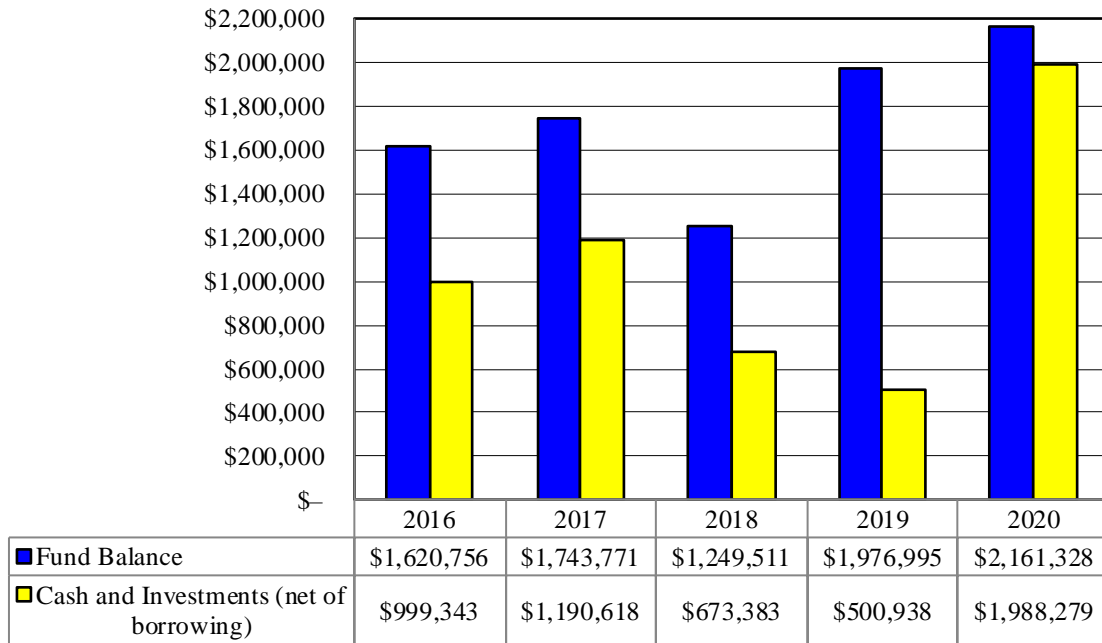
The Academy served approximately 885 pupil units for 2020, an increase of 38 (4.5 percent) from the previous year.

ADM is a measure of students attending class, which is then converted to pupil units (the base for determining revenue) using a statutory formula. Not only is the original budget based on ADM estimates, the final audited financial statements are based on updated, but still estimated, ADM since the counts are not finalized until around January of the following year. When viewing revenue budget variances, one needs to consider these ADM changes and the impact of the prior year final adjustments which affect this year’s revenue.

GENERAL FUND OPERATIONS AND FINANCIAL POSITION

The following graph displays the Academy's General Fund financial position over the last five years:

General Fund Financial Position
Year Ended June 30,



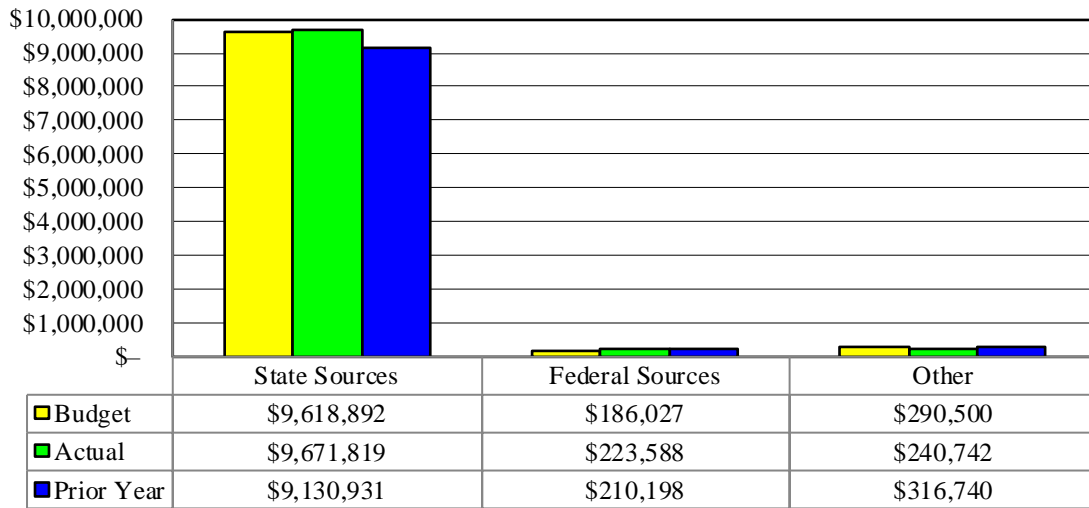
The Academy's General Fund ended 2020 with a total fund balance of \$2,161,328, an increase of \$184,333 from the prior year. The General Fund cash and investments balance (net of borrowing) at year-end was \$1,988,279, an increase of \$1,487,341 from the prior year. The increase in fund balance is a result of current year operations and the increase in cash balance relates to a decrease in the amount due from the state of Minnesota at June 30, 2020.

Fund balance as a percentage of expenditures is one key measure of the Academy's financial health. The resources represented by this fund balance are critical to the Academy's ability to maintain adequate cash flow throughout the year, to retain its programs, and to cushion against the impact of unexpected costs or funding shortfalls. The General Fund's fund balance of \$2,161,328 represented 21.8 percent of annual expenditures based on 2020 expenditure levels.

GENERAL FUND REVENUE AND EXPENDITURES

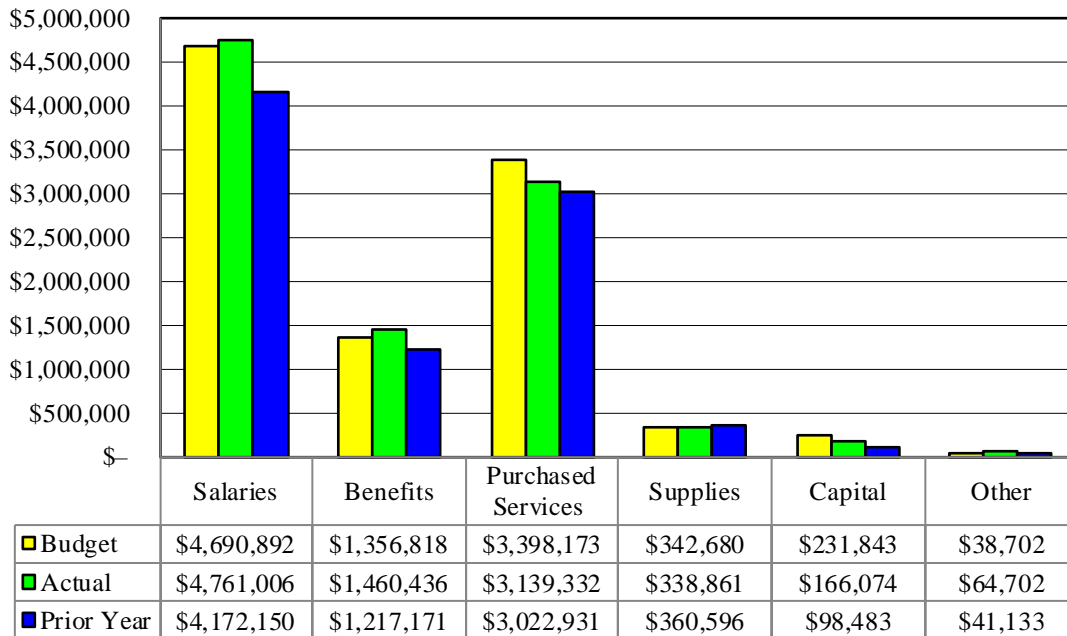
The following graphs summarize the Academy's General Fund revenue and expenditures for 2020:

General Fund Revenue
Budget and Actual



Total General Fund revenues for 2020 were \$10,136,149, an increase of \$478,280 from the prior year, and \$40,730 over budget. State sources were \$540,888 more than the prior year, due to the increase in the number of students in the current year.

General Fund Expenditures
Budget and Actual



Total General Fund expenditures for 2020 were \$9,930,411, an increase of \$1,017,947 from the prior year, and \$128,697 under budget. Expenditures were under budget, mainly from lower than anticipated school site operating costs, due to the stay at home order that occurred in fiscal 2020. A large portion of the increase from the prior year was in salaries and benefits, which were \$832,121 higher than last year, due to an increase in staffing and wage rates. Purchased services increased \$116,401, which was the result of an increase special education costs. Capital outlay increased \$67,591, mainly for the school site.

FOOD SERVICE SPECIAL REVENUE FUND

The Academy's Food Service Special Revenue Fund expenditures exceeded revenues by \$21,405 in fiscal 2020. The Academy transferred \$21,405 from the General Fund to prevent a fund balance deficit in this fund created by deficit spending. It is important that the Food Service Special Revenue Fund be self-sustaining, so as not to place an additional burden on the General Fund.

COMMUNITY SERVICE SPECIAL REVENUE FUND

The Academy's Community Service Special Revenue Fund expenditures exceeded revenues by \$135,890 in fiscal 2020, decreasing fund balance to \$11,640. The decrease to fund balance was \$85,238 less than anticipated in the Academy's budget.

DAVINCI ACADEMY AFFILIATED BUILDING COMPANY (BUILDING COMPANY)

The Building Company is a Minnesota nonprofit organization classified by the Internal Revenue Service as a 501(c)(3) tax-exempt organization by reason of its function as a "supporting organization" of the Academy. The Building Company is being operated exclusively in support of the Academy and, in particular, to purchase, own, and construct a public schoolhouse on real estate for lease to the Academy.

At June 30, 2020, the Building Company ended the year with a fund balance of \$2,904,422. This fund balance is further segregated by a \$2,793,367 fund balance restricted for debt service and a balance of \$111,055 restricted for Building Company capital purposes.

ENTITY-WIDE FINANCIAL STATEMENTS

The Academy's financial statements include fund-based information that focuses on budgetary compliance, and the sufficiency of the Academy's current assets to finance its current liabilities. The governmental reporting model also requires the inclusion of two entity-wide financial statements designed to present a clear picture of the Academy as a single, unified entity. These entity-wide financial statements provide information on the total cost of delivering educational services, including capital assets and long-term liabilities.

Theoretically, net position represents the resources the Academy has leftover to use for providing services after its debts are settled. However, those resources are not always in expendable form, or there may be restrictions on how resources can be used. Therefore, the statement divides net position into three components: net investment in capital assets, restricted net position, and unrestricted net position. The following table presents a summarized conversion of the Academy's governmental fund balances (as individually discussed earlier) to net position, and separate components of net position for the last two years:

	June 30,		Change
	2019	2020	
Total net position – governmental activities			
Total fund balances – governmental funds	\$ 4,864,990	\$ 5,077,390	\$ 212,400
Capital assets, net of depreciation	22,197,942	21,792,503	(405,439)
Bonds payable, net of premium	(26,056,749)	(25,896,687)	160,062
Interest payable on bonds	(628,333)	(625,183)	3,150
Pension liabilities, net of deferred outflows/inflows	(3,003,608)	(3,641,054)	(637,446)
Total net position – governmental activities	<u>\$ (2,625,758)</u>	<u>\$ (3,293,031)</u>	<u>\$ (667,273)</u>
Net position			
Net investment in capital assets	\$ (1,830,210)	\$ (1,824,945)	\$ 5,265
Restricted	233,017	151,005	(82,012)
Unrestricted	<u>(1,028,565)</u>	<u>(1,619,091)</u>	<u>(590,526)</u>
Total net position	<u>\$ (2,625,758)</u>	<u>\$ (3,293,031)</u>	<u>\$ (667,273)</u>

Total net position decreased by \$667,273, mainly due to changes in the Academy's proportionate share of the Public Employees Retirement Association and the Teachers Retirement Association pension plans reported on the entity-wide financial statements.

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LEGISLATIVE SUMMARY

The 2020 Minnesota Legislature session was expected to be short and focused on making tweaks to the biennial budget. By early March, it became clear the session would unfold differently than anyone could have predicted. As the novel coronavirus (COVID-19) spread reached Minnesota, Governor Walz issued an Executive Order declaring a peacetime emergency. The declaration was enacted, which allowed his administration to quickly impose measures aimed at mitigating the COVID-19 health threat. These measures, which were issued through dozens of executive orders over the months that would follow, included shuttering certain businesses, closing schools, limiting social gatherings, and requiring Minnesotans who are not essential employees to stay home.

Also, in response to concerns over the spread of COVID-19, the Legislature approved a resolution allowing the House and Senate to adjourn. Any meetings convened during the break in normal operations would be restricted to issues around COVID-19 preparedness and response. The regular session continued in April and May, with sporadic virtual committee hearings and floor sessions marked by social distancing and remote participation. Governor Walz also called the Legislature into a special session in June and July, mainly to discuss police reform and COVID-19 pandemic issues.

The following is a brief summary of specific legislative changes from the 2020 regular and special sessions or previous legislative sessions impacting Minnesota charter schools in future years.

Coronavirus Aid, Relief, and Economic Security (CARES) Act – The CARES Act provides federal economic relief to protect the American people from the public health and economic impacts of COVID-19. This CARES funding includes an Education Stabilization Fund, which in turn contains two major sources of funding for schools:

1. Governor’s Emergency Education Relief (GEER) Fund

These funds were allocated to schools to support schools getting children back to school in the fall, while prioritizing the safety of students and staff. These funds support operational costs, such as: cleaning supplies and disinfectant sprayers, screening supplies, personal protective equipment, and increased transportation costs associated with transporting students in a socially distant manner. These funds also support student, family, and educator needs, such as technology devices and internet access, technology training, tutors or mentors to address learning loss, translation services, school-age care for essential workers, and professional development focused on learning models. These funds are available for use from July 1, 2020, through December 30, 2020. To spend funds from this source, an expenditure must be a reasonably necessary expense that is directly related to the COVID-19 pandemic, and the expenditure must not be one that was planned for in the current school year budget.

2. Elementary and Secondary School Emergency Relief (ESSER) Fund

These funds are divided into two streams: a formula-based allocation and state-directed grants. The formula-based allocation to districts and charter schools is based on their allocations under Title I, Part A of the Elementary and Secondary Education Act (ESEA). These funds can be used for a wide range of expenses to meet local needs. These funds were available through September 30, 2020.

State-directed grants, provided to districts and charter schools that do not receive a formula-based allocation, districts and charter schools that receive less than \$10,000 from their formula-based allocation, and districts and charter schools whose share of students from historically underserved populations is more than their share of other ESSER funds, can be used for a combination of supplementing GEER funds for summer school programming, supporting mental health, and meeting the needs of historically underserved populations.

Special Education Aid – Fiscal year (FY) 2020 expenditures for employees and contracted services that would have been eligible for state aid in the absence of school closure due to COVID-19, must be included as eligible expenditures for calculation of aid and for tuition billing, regardless of whether special education services were actually provided during the closure.

General Education Revenue – The Legislature had previously approved annual increases of 2 percent to the basic general education formula allowance for the FY 2020–2021 biennium. The per pupil allowance will increase \$129 to \$6,567 for FY 2021.

Special Education Revenue – The Legislature had previously approved enhancements to special education funding designed to hold the state average cross subsidy per pupil constant at the FY 2019 level of \$820 per average daily membership (ADM) for FY 2021. The changes included:

- Establishing a new component of the state special education funding formula, known as cross subsidy reduction aid. Cross subsidy reduction aid will equal a percentage of each district’s “initial cross subsidy” for the prior fiscal year, with the percentages set at 6.43 percent for 2021. Initial cross subsidy is defined as the district’s nonfederal special education costs, including transportation, less state special education aid after tuition adjustments and general education aid attributable to students receiving special education services outside of the regular classroom for at least 60.00 percent of the school day. Charter schools are not eligible for cross subsidy reduction aid.
- Updating the pupil-driven portion of the initial special education aid formula to use FY 2018 data beginning in FY 2021, rather than continuing to use 2011 data adjusted for inflation.
- Phasing out the special education aid cap over two years, with the cap eliminated for FY 2021 and beyond.
- Reducing the tuition rate paid by the resident school district for open enrolled special education students served by another district or charter school from 90 percent of unfunded costs to 80 percent for FY 2021 and later. Charter schools will be eligible for additional special education aid from the state to fully offset the impact of the tuition rate change.
- Reducing the hold harmless guarantee by changing the formula to reduce reliance on the FY 2016 base year so that schools where special education expenditures have fallen or grown slowly since FY 2016 do not benefit disproportionately from the hold harmless guarantee compared to other schools. The percentage of FY 2019 regular program costs used to calculate the hold harmless will decrease to 85.0 percent for FY 2021, 80.0 percent for FY 2022, and 75.0 percent for FY 2023. In addition, the annual inflation adjustment used to calculate the hold harmless will be reduced by 0.2 percent annually from the 4.6 percent factor used in FY 2019 until the adjustment reaches 2.0 percent.

Safe Schools Supplemental Aid – In a previous legislative session, a one-time appropriation of \$30 million was made for Safe Schools Supplemental Aid in FY 2020, contingent upon the closing balance of the state’s General Fund for FY 2019 exceeding the balance projected at the end of the 2019 legislative session. All school districts and charter schools with adjusted ADM for FY 2018 will receive 2020 Safe Schools Supplemental Aid equal to approximately \$34.72 per FY 2018 adjusted ADM. The law requires the Safe Schools Supplemental Aid to be used as follows: for a charter school, Safe Schools Supplemental Aid must be reserved and used only for costs associated with safe schools activities authorized under Minnesota Statutes, Section 126C.44, or building lease expenses not funded by charter school building lease aid that are attributable to facility security enhancements made by the landlord after March 1, 2019.

Pension Benefit Reforms – The 2018 pension bill included a number of reforms to the various defined benefit pension plans across the state, including the plans administered by the Teachers Retirement Association (TRA), St. Paul Teachers Retirement Fund Association (SPTRFA), and the Public Employees Retirement Association (PERA). Employee contribution rates were increased by 0.25 percent beginning in FY 2024 for the TRA plan and beginning in FY 2023 for the SPTRFA plan. The pension adjustment component of the general education aid formula was increased by an amount equal to the product of the salaries paid to members of these two plans times the school’s pension adjustment rate for the fiscal year to help offset the cost of the employer contribution increases.

Fund Transfers – Allows a school district, charter school, or a cooperative unit to make certain operating fund transfers for fiscal years 2020 and 2021 only. Requires that a fund transfer be revenue neutral for the school and not affect its receipt of state or federal aid. Allows transfer of operating fund transfers from certain programs that are not already assigned to or encumbered by staff salary and benefits, or otherwise encumbered by federal law, for the following purposes:

- To provide care to eligible children during the school day.
- To pay additional transportation costs incurred between March 30, 2020 and the end of the 2019–2020 school year, needed to implement the Governor’s Executive Order for providing distance learning instruction and meal delivery.
- To pay for additional costs related to technology needed to provide distance learning instruction.
- To pay the portion of staff salary and benefits of employees paid through the Community Service Fund normally funded by fees that were refunded, waived, or otherwise not paid during the closure, distance learning, and extended distance learning periods.
- To pay the portion of Food Service Fund staff salary and benefits normally funded by meal reimbursement revenue during the closure, distance learning, and extended distance learning periods.

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ACCOUNTING AND AUDITING UPDATES

The following is a summary of GASB standards expected to be implemented in the next few years. Due to the COVID-19 outbreak, the GASB has delayed the original implementation dates of these and other standards as described below.

GASB STATEMENT NO. 87, *LEASES*

A lease is a contract that transfers control of the right to use another entity's nonfinancial asset as specified in the contract for a period of time in an exchange or exchange-like transaction. Examples of nonfinancial assets include buildings, land, vehicles, and equipment. Any contract that meets this definition should be accounted for under this lease guidance, unless specifically excluded in this statement.

Governments enter into leases for many types of assets. Under the previous guidance, leases were classified as either capital or operating depending on whether the lease met any of the four tests. In many cases, the previous guidance resulted in reporting lease transactions differently than similar nonlease financing transactions.

The goal of this statement is to better meet the information needs of users by improving accounting and financial reporting for leases by governments. It establishes a single model for lease accounting based on the principle that leases are financings of the right to use an underlying asset. This statement increases the usefulness of financial statements by requiring recognition of certain lease assets and liabilities for leases that previously were classified as operating leases and recognized as inflows of resources or outflows of resources based on the payment provisions of the contract.

Under this statement, a lessee is required to recognize a lease liability and an intangible right to use lease asset, and a lessor is required to recognize a lease receivable and a deferred inflow of resources, thereby enhancing the relevance and consistency of information about governments' leasing activities.

To reduce the cost of implementation, this statement includes an exception for short-term leases, defined as a lease that, at the commencement of the lease term, has a maximum possible term under the lease contract of 12 months (or less), including any options to extend, regardless of their probability of being exercised. Lessees and lessors should recognize short-term lease payments as outflows of resources or inflows of resources, respectively, based on the payment provisions of the lease contract. The requirements of this statement are effective for fiscal years beginning after June 15, 2021.

GASB STATEMENT NO. 91, *CONDUIT DEBT OBLIGATIONS*

The primary objectives of this statement are to provide a single method of reporting conduit debt obligations by issuers and eliminate diversity in practice associated with (1) commitments extended by issuers, (2) arrangements associated with conduit debt obligations, and (3) related note disclosures. This statement achieves those objectives by clarifying the existing definition of a conduit debt obligation; establishing that a conduit debt obligation is not a liability of the issuer; establishing standards for accounting and financial reporting of additional commitments and voluntary commitments extended by issuers and arrangements associated with conduit debt obligations; and improving required note disclosures.

A conduit debt obligation is defined as a debt instrument having all of the following characteristics:

- There are at least three parties involved: (1) an issuer, (2) a third party obligor, and (3) a debt holder or a debt trustee.
- The issuer and the third party obligor are not within the same financial reporting entity.
- The debt obligation is not a parity bond of the issuer, nor is it cross-collateralized with other debt of the issuer.
- The third party obligor or its agent, not the issuer, ultimately receives the proceeds from the debt issuance.
- The third party obligor, not the issuer, is primarily obligated for the payment of all amounts associated with the debt obligation (debt service payments).

This statement also addresses arrangements, often characterized as leases, that are associated with conduit debt obligations. In those arrangements, capital assets are constructed or acquired with the proceeds of a conduit debt obligation and used by third party obligors in the course of their activities.

This statement requires issuers to disclose general information about their conduit debt obligations, organized by type of commitment, including the aggregate outstanding principal amount of the issuers' conduit debt obligations and a description of each type of commitment. Issuers that recognize liabilities related to supporting the debt service of conduit debt obligations also should disclose information about the amount recognized and how the liabilities changed during the reporting period. The requirements of this statement are effective after December 15, 2021. Earlier application is encouraged.

GASB STATEMENT NO. 97, *CERTAIN COMPONENT UNIT CRITERIA, AND ACCOUNTING AND FINANCIAL REPORTING FOR INTERNAL REVENUE CODE SECTION 457 DEFERRED COMPENSATION PLANS—AN AMENDMENT OF GASB STATEMENT NO. 14 AND NO. 84, AND A SUPERSESSION OF GASB STATEMENT NO. 32*

The primary objectives of this statement are to (1) increase consistency and comparability related to the reporting of fiduciary component units in circumstances in which a potential component unit does not have a governing board and the primary government performs the duties that a governing board typically would perform; (2) mitigate costs associated with the reporting of certain defined contribution pension plans, defined contribution other post-employment benefit (OPEB) plans, and employee benefit plans other than pension plans or OPEB plans (other employee benefit plans) as fiduciary component units in fiduciary fund financial statements; and (3) enhance the relevance, consistency, and comparability of the accounting and financial reporting for Internal Revenue Code Section 457 deferred compensation plans (Section 457 plans) that meet the definition of a pension plan and for benefits provided through those plans.

The requirements of this statement that (1) are exempt primary governments that perform the duties that a government board typically performs from treating the absence of a governing board the same as the appointment of a voting majority of a governing board in determining whether they are financially accountable for defined contribution pension plans, defined contribution OPEB plans, or other employee benefit plans, and (2) limit the applicability of the financial burden criterion in paragraph 7 of Statement 84 to defined benefit pension plans and defined benefit OPEB plans that are administered through Statement 74, respectively, are effective immediately.

The requirements of this statement that are related to the accounting and financial reporting for Section 457 plans are effective for fiscal years beginning after June 15, 2021. For purposes of determining whether a primary government is financially accountable for a potential component unit, the requirements of this statement that provide that for all other arrangements, the absence of a governing board be treated the same as the appointment of a voting majority of a governing board if the primary government performs the duties that a governing board typically would perform, are effective for reporting periods beginning after June 15, 2021. Earlier application of those requirements is encouraged and permitted by requirement as specified within this statement.

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