

Financial Section

# MIKUNDA, COTTRELL & Co.

*A Professional Corporation*

CERTIFIED PUBLIC ACCOUNTANTS & CONSULTANTS

3601 "C" Street, Suite 600 • Anchorage, Alaska 99503

(907) 278-8878, Fax (907) 278-5779

www.mcc-cpa.com

## Independent Auditor's Report

Members of the School Board  
Anchorage School District  
Anchorage, Alaska

We have audited the accompanying financial statements of the governmental activities, each major fund, and the aggregate remaining fund information of the Anchorage School District, as of and for the year ended June 30, 2004, which collectively comprise the District's basic financial statements as listed in the table of contents. These financial statements are the responsibility of the Anchorage School District'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 the Anchorage School District, as of June 30, 2004, and the respective changes in financial position and cash flows, where applicable, thereof and the respective budgetary comparison for the General Fund and the State and Federal Grants Special Revenue Fund 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 our report dated September 28, 2004 on our consideration of the Anchorage School District's internal control over financial reporting and our tests of its compliance with certain provisions of laws, regulations, contracts and grants. That report is an integral part of an audit performed in accordance with *Government Audit Standards* and should be read in conjunction with this report in considering the results of our audit.

Members of the School Board  
Anchorage School District

The management's discussion and analysis is not a required part of the basic financial statements but is supplementary information required by the Governmental Accounting Standards Board. 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 the Anchorage School District's basic financial statements. The combining and individual fund financial statements and other schedules, listed in the table of contents as supplementary information, are presented for purposes of additional analysis and are not a required part of the basic financial statements. Such information has been subjected to the auditing procedures applied in the audit of the basic financial statements and, in our opinion, is fairly stated in all material respects in relation to the basic financial statements taken as a whole.

The accompanying introductory and statistical sections, as listed in the table of contents, are presented for purposes of additional analysis and are not a required part of the basic financial statements. This information has not been subjected to the auditing procedures applied in the audit of the basic financial statements and, accordingly, we express no opinion on them.

*Mikunda, Cottrell & Co.*

September 28, 2004

## Management's Discussion and Analysis

As management of the Anchorage School District, we offer readers of the Anchorage School District's financial statements this narrative overview and analysis of the financial activities of the Anchorage School District for the fiscal year ended June 30, 2004. We encourage readers to consider the information presented here in conjunction with additional information that we have furnished in our letter of transmittal, which can be found on pages v-xxiii of this report. Professional standards require the inclusion of certain comparative information in the Management's Discussion and Analysis (MD&A).

### Financial Highlights

- The assets of the Anchorage School District exceeded its liabilities at the close of the most recent fiscal year by \$500,237,936 (net assets). Of this amount; \$162,920,900 (unrestricted net assets) may be used to meet the District's ongoing obligations to citizens and creditors.
- The District's total net assets decreased by \$20,214,962 due to expenditures exceeding revenues. The District's overall financial position has decreased due to the disposal of capital assets that were not fully depreciated.
- As of the close of the current fiscal year, the Anchorage School District's governmental funds reported combined ending fund balances of \$202,583,221 an increase of \$8,789,752 in comparison with the prior year. Of this total, \$45,263,227 is available for spending at the District's discretion (undesignated fund balance).
- At the end of the current fiscal year, undesignated fund balance for the General Fund was \$27,989,871 or 7.7 percent of total General Fund expenditures.

### Overview of the Financial Statements

This discussion and analysis are intended to serve as an introduction to the Anchorage School District's basic financial statements. The Anchorage School District's basic financial statements comprise three components: 1) government-wide financial statements, 2) fund financial statements, and 3) notes to the basic financial statements. This report also contains other supplementary information in addition to the basic financial statements themselves.

**Government-wide financial statements.** The government-wide financial statements are designed to provide readers with a broad overview of the Anchorage School District's finances, in a manner similar to a private-sector business.

The Statement of Net Assets presents information on all of the Anchorage School District's assets and liabilities, with the difference between the two reported as net assets. Over time, increases or decreases in net assets may serve as a useful indicator of whether the financial position of the Anchorage School District is improving or deteriorating.

The Statement of Activities presents information showing how the District's net assets changed during the most recent fiscal year. All changes in net assets are reported as soon as the underlying event giving rise to the change occurs, regardless of the timing of related cash flows. Thus, revenues and expenses are

reported in this statement for some items that will only result in cash flows in future fiscal periods (e.g. uncollected taxes and earned but unused vacation leave).

Both of the government-wide financial statements distinguish functions of the Anchorage School District that are principally supported by taxes and intergovernmental revenues (governmental activities). The District does not currently have any activities that are considered business-type activities. The governmental activities of the District include general administration, instruction, pupil transportation, operation maintenance of plant, community services and education, non-departmental, food services, capital projects, and interest expense.

The government-wide financial statements include only the Anchorage School District. The Anchorage School District is a component unit of the Municipality of Anchorage.

The government-wide financial statements can be found on pages 13-14 of this report.

**Schedules of budgetary comparisons.** These schedules present comparisons of actual information to the legally adopted budget. The basis of budgeting is on the modified accrual basis.

The District's financial transactions are recorded on a modified accrual basis of accounting for the various governmental fund types. The modified accrual basis of accounting is defined as that method of accounting in which revenues are recorded in the accounting period in which they become susceptible to accrual; this is, when they become both measurable and available to finance expenditures of the current period. The source of revenue not considered susceptible to accrual is Federal Impact Aid under Title VIII of the Elementary and Secondary Education Act of 1965. All other revenue sources are considered susceptible to accrual. Expenditures are recognized in the accounting period in which the liability is incurred, if measurable, except for unmatured principal and interest on long-term debt, accrued compensated absences and workers' compensation.

**Fund financial statements.** A fund is a grouping of related accounts that is used to maintain control over resources that have been segregated for specific activities or objectives. The Anchorage School District, like other state and local governments, uses fund accounting to ensure and demonstrate compliance with finance-related legal requirements. All of the funds of the Anchorage School District can be divided into two categories: governmental funds and proprietary funds.

**Governmental funds.** Governmental funds are used to account for essentially the same functions reported as governmental activities in the government-wide financial statements. However, unlike the government-wide financial statements, governmental fund financial statements focus on near-term inflows and outflows of spendable resources as well as on balances of spendable resources available at the end of the fiscal year. Such information may be useful in evaluating a government's near-term financing requirements.

Because the focus of governmental funds is narrower than that of the government-wide financial statements, it is useful to compare the information presented for governmental funds with similar information presented for governmental activities in the government-wide financial statements. By doing so, readers may better understand the long-term impact of the government's near-term financing decisions. Both the governmental fund balance sheet and the governmental fund statement of revenues, expenditures, and changes in fund balances provide a reconciliation to facilitate this comparison between governmental funds and governmental activities.

The Anchorage School District maintains six individual governmental funds. Information is presented separately in the governmental fund balance sheet and in the governmental fund statement of revenues, expenditures, and changes in fund balances for the General Fund, State and Federal Grants Special Revenue Fund, Debt Service Fund and Capital Projects Fund, all which are considered to be major funds. Data from the other two governmental funds are combined into a single, aggregated presentation. Individual fund data for each of these nonmajor governmental funds is provided in the form of combining statements and individual fund schedules elsewhere in this report.

The Anchorage School District adopts an annual appropriated budget for its General Fund, State and Federal Grants Special Revenue Fund, Food Service Special Revenue Fund and Debt Service Fund. Budgetary comparison schedules have been provided for the General Fund and State and Federal Grants Special Revenue Fund. The supplementary information also includes budgetary information for the Food Service Special Revenue Fund and Debt Service Fund to demonstrate compliance with this budget.

The basic governmental fund financial statements can be found on pages 15-23 of this report.

**Proprietary funds.** The Anchorage School District maintains an Internal Service Fund for equipment replacement. The Internal Service Fund is used to account for the financing of government equipment and vehicles. Because this service predominantly benefits governmental functions rather than business-type functions, they have been included within the governmental activities in the government-wide financial statements.

The Internal Service Fund is presented in a separate presentation. The basic proprietary fund financial statements can be found on pages 24-26 of this report.

**Notes to the basic financial statements.** The notes provide additional information that is essential to a full understanding of the data provided in the government-wide and fund financial statements. The notes to the financial statements can be found on pages 28-50 of this report.

**Other information.** In addition to the basic financial statements and accompanying notes, this report also presents certain required supplementary information concerning the Anchorage School District's progress in funding its obligation to provide pension benefits to its employees. Required supplementary information can be found on page 47 of this report.

The combining statements referred to earlier in connection with nonmajor governmental funds and individual fund schedules can be found on pages 51-107 of this report.

The capital assets used in the operation of governmental funds can be found on pages 109-111.

**Government-wide Financial Analysis**

As noted earlier, net assets may serve over time as a useful indicator of a government's financial position. In the case of the Anchorage School District, assets exceeded liabilities by \$500,237,936 at the close of the most recent fiscal year. Table 1 compares the most recent fiscal year to the prior fiscal year.

Table 1 – Net Assets

	<u>Governmental Activities</u>	
	<u>2004</u>	<u>2003</u>
<b>ASSETS</b>		
Current and other assets	\$ 320,628,737	\$ 295,488,385
Capital assets	<u>1,006,889,068</u>	<u>930,908,735</u>
Total assets	<u>1,327,517,805</u>	<u>1,226,397,120</u>
<b>LIABILITIES</b>		
Long-term liabilities outstanding	646,490,000	554,480,000
Other liabilities	<u>180,789,869</u>	<u>151,464,222</u>
Total liabilities	<u>827,279,869</u>	<u>705,944,222</u>
<b>NET ASSETS</b>		
Invested in capital assets, net of related debt	325,639,068	347,683,735
Restricted	11,677,968	17,791,262
Unrestricted	<u>162,920,900</u>	<u>154,977,901</u>
Total net assets	<u>\$ 500,237,936</u>	<u>\$ 520,452,898</u>

By far the largest portion of the Anchorage School District's total assets reflects its investment in capital assets (e.g. land, building, machinery and equipment); less any related debt used to acquire those assets that is still outstanding. The Anchorage School District uses these capital assets to provide services to students and citizens; consequently, these assets are not available for future spending. The District's net assets invested in capital assets, net of debt was \$325,639,068. Although the District's investment in its capital assets is reported net of debt, it should be noted that the resources needed to repay this debt must be provided from other sources, since the capital assets themselves cannot be used to liquidate these liabilities.

An additional portion of the Anchorage School District's net assets (2.3 percent) represents resources that are subject to external restrictions on how they may be used. The remaining balance of unrestricted net assets (\$162,920,900) may be used to meet the government's ongoing obligations to citizens and creditors.

At the end of the current fiscal year, the Anchorage School District is able to report positive balances in all three categories of net assets for the District as a whole. The same situation held true for the prior fiscal year.

The District's net assets decreased by \$20,214,962 during the current fiscal year. Approximately \$16.6 million of the decrease in net assets resulted from the losses on the sale of capital assets. The majority of the loss resulted from the demolition of two school facilities that were subsequently reconstructed on the same sites.

Table 2 highlights the District's revenues and expenses for the fiscal year ended June 30, 2004. These two main components are subtracted to yield the change in net assets. This table utilizes the full accrual method of accounting.

Revenue is further divided into two major components: program revenues and general revenues. Program revenues are defined as charges for services, operating and capital grants and contributions. General revenues include taxes and entitlements such as State Public School Funding Program support.

Expenses are shown in programs including general administration, instruction, pupil transportation, operation and maintenance of plant, community service and education, food services, non-departmental and interest expense. The increase in General Administration expenses is mainly due to the loss on the sale of capital assets resulting from the disposal of two school facilities that were not fully depreciated.

Table 2 – Program Revenues and Expenses

<u>Governmental Activities</u>		
Revenues:	<u>2004</u>	<u>2003</u>
Program revenues:		
Charges for services and sales	\$ 6,887,621	\$ 6,793,468
Operating grants and contributions	69,845,791	64,714,837
Capital grants and contributions	38,721,389	27,294,178
General revenue:		
Appropriation from		
Municipality of Anchorage	144,983,658	142,954,582
Public school funding program	205,100,316	207,129,272
Federal impact aid	14,054,338	11,417,018
Investment earnings	2,320,920	3,531,249
State tuition program	46,784	680,658
Other	<u>2,194,195</u>	<u>1,935,482</u>
Total revenues	<u>484,155,012</u>	<u>466,450,744</u>
Program expenses:		
General administration *	\$ 26,454,531	\$ 11,965,357
Instruction	380,596,221	357,948,970
Pupil transportation	16,219,676	15,316,591
Operation and maintenance of plant	19,298,372	18,379,710
Community service and education	2,193,218	1,949,296
Non-departmental	3,956,114	2,724,000
Food services	12,406,855	11,834,319
Interest expense	<u>43,244,987</u>	<u>30,652,583</u>
Total expenses	<u>504,369,974</u>	<u>450,770,826</u>
Increase/(decrease) in net assets	(20,214,962)	15,679,918
Net asset beginning of year	<u>520,452,898</u>	<u>504,772,980</u>
Net assets ending	<u>\$ 500,237,936</u>	<u>\$ 520,452,898</u>

\* In 2004, the amount under General administration includes \$16,648,548 of asset disposals resulting in a loss of depreciation that has been recorded as an expense in the government-wide Statement of Activities.

Table 3 discloses cost of services for the governmental activities. The total cost of services column contains all costs related to the programs and the net cost column shows how much of the total amount is not covered by program revenues. Succinctly put, net costs are costs that must be covered by unrestricted state revenues (e.g. State Public School Funding Program) or local taxes. The difference in these two columns would represent restricted grants, fees and donations.

Table 3 – Governmental Activities

Programs	<u>Total Cost of Services 2004</u>	<u>Net Cost of Services 2004</u>
General administration	\$ 26,454,531	\$ 26,446,086
Instruction	380,596,221	334,429,341
Pupil transportation	16,219,676	(799,778)
Operating and maintenance of plant	19,298,372	19,099,817
Community service and education	2,193,218	1,656,047
Non-departmental	3,956,114	3,927,372
Food service	12,406,855	(367,310)
Capital projects	--	(38,721,389)
Interest expense	<u>43,244,987</u>	<u>43,244,987</u>
Total expenses	<u>\$ 504,369,974</u>	<u>\$ 388,915,173</u>

### Financial Analysis of the Government’s Funds

Anchorage School District uses fund accounting to ensure and demonstrate compliance with finance-related legal requirements.

Governmental funds – the focus of the Anchorage School District’s governmental funds is to provide information on near-term inflows, outflows and balances of spendable resources. Such information is useful in assessing the District’s financing requirements. In particular, unreserved fund balance may serve as a useful measure of a government’s net resources available for spending at the end of the fiscal year.

As of the end of the current fiscal year, the Anchorage School District’s governmental funds reported combined ending fund balances of \$202,583,221, an increase of \$8,789,752 in comparison with the prior year. Approximately 23 percent of this total amount (\$46,434,083) constitutes unreserved fund balance, which may be available for spending at the District’s discretion. The remainder of the fund balance is reserved to indicate that it is not available for new spending because it has already been committed 1) encumbrances \$112,381,858, 2) inventory \$2,588,401, 3) Federal Impact Aid \$11,988,897, 4) prepaids \$1,526,575, 5) accrued compensated absences \$7,701,634, 6) self-insurance \$9,229,661, and 7) debt services \$10,732,112.

The General Fund is the chief operating fund of the District. At the end of the current fiscal year, unreserved fund balance of the General Fund was \$27,989,871, while total fund balance reached \$69,868,684. As a measure of the General Fund’s liquidity, it may be useful to compare both unreserved fund balance and total fund balance to total fund expenditures. Unreserved fund balance represents 7.7

percent of total General Fund expenditures, while total fund balance represents 19.2 percent of that same amount.

The fund balance of the District's General Fund decreased by \$1,952,018 during the current fiscal year. Key factors are as follows:

- The District anticipated using \$5,465,650 of fund balance for one-time expenditures. Actual expenditures exceeded revenues by \$2,158,693.
- Net revenues were less than budgeted by \$770,911. Contributing factors were:
  - The E-rate funding denial. The E-rate contract extension application for FY 2003-2004 was denied. The denial of funding is being appealed to the Federal Communications Commission (FCC). Due to the backlog of other pending cases across the country, it could take from twelve to eighteen months for a ruling on the appeal.
  - Revenue from the Alaska Public Schools Funding Program was less than budgeted as a result of actual number of students being less than budgeted as well as the actual number of level three students who receive special education services.
  - Revenue realized from interest earnings was less than budgeted due to the very slow recovery from a soft economy.
  - Federal Impact Aid exceeded budgeted revenues due to prior year receipts. The amount of Federal Impact Aid revenue each year is uncertain because it is subject to pro-ration based on the annual funding appropriated by Congress. The receipt of additional Impact Aid funding helped offset the lower receipt of revenues in other accounts.
- On a budgetary basis, expenditures and encumbrances were less than budgeted by \$2,397,953, with the largest portion in the area of instruction. Three contributing factors for a smaller variance than prior years were mid-year utility rate increases, closer budgeting of the average teacher salary and a major increase to workers' compensation experiences.

Grants reported in the State and Federal Grants Special Revenue Fund are cost reimbursable grants; therefore, expenditures are equal to revenues. Expenditures and revenues for the State and Federal Grants Special Revenue Fund for the current year were \$37,825,192 or an increase of 15.1 percent over prior year.

The Debt Service Fund has a total fund balance of \$10,732,112 all of which is reserved for payment of debt service. The net decrease in the fund balance of \$7,059,150 was the result of anticipated use of fund balance partially offset by increased revenues from the State Aid for School Construction program, which was \$2,801,634 over budget.

The Capital Projects Fund total fund balance on June 30, 2004 was \$116,256,169 or an increase of 17.1 percent over the prior year. There is \$100,768,087 reserved for encumbrances, \$659 reserved for prepaid items, \$198,300 reserved for accrued compensated absences, \$945,856 designated for authorized construction, and \$14,343,267 undesignated.

### **General Fund Budgetary Highlights**

The General Fund expenditure budget increased from the original amount of \$367,595,037 by \$421,650 on June 28, 2004. The final amended budget was \$368,016,687. The budgeted expenditure increase,

supported by fund balance, was for one-time requirements that were not funded in the FY 2004-2005 budget.

**Capital Assets and Debt Administration**

**Capital assets.** The Anchorage School District’s investment in capital assets for its governmental activities as of June 30, 2004 amounts to \$1,006,889,068 (net of accumulated depreciation). This investment in capital assets includes land, land improvement, buildings, equipment and vehicles, and construction in progress. The total increase in the District’s investment in capital assets for the current year was 8.2 percent.

As described in Note Two of the Financial Statements, the District has a significant number of construction projects that are currently in various stages of planning or construction. A brief summary of the major projects is as follows:

- Bartlett High School Phases 1 & 2 Renovation
- Chugiak High School Phases 2 & 3 Renovation
- East High School Phase 3 Renovation
- New Eagle River Area High School Construction
- Service High School Phase 2A Renovation
- South Anchorage High School Construction
- Wendler Middle School Renovation
- Chugach Elementary School Renovation
- Polaris K-12 School Renovation

The following table shows ending balances of capital assets invested in various categories. The District recognized a total increase of \$75,980,333 less the depreciation expense.

Table 4 – Capital Assets as of June 30 (Net of Depreciation)

	<u>Governmental Activities</u>	
	<u>2004</u>	<u>2003</u>
Land	\$ 31,389,247	\$ 25,435,602
Land improvements	13,959,867	12,652,038
Buildings, equipment and vehicles	763,322,333	670,341,030
Construction in progress	198,217,621	222,480,065
Totals	<u>\$ 1,006,889,068</u>	<u>\$ 930,908,735</u>

A summary of project-length Capital Projects Fund expenditures is included as Schedule D-3 in the financial section of this report.

**Long-Term Debt.** As of June 30, 2004 the Anchorage School District had general obligation bonds and capital lease obligations outstanding totaling \$681,250,000. Of this amount, \$681,250,000 comprises debt backed by the full faith and credit of the Municipality of Anchorage. In the current year, the District paid \$28,745,000 in principal. The Municipality of Anchorage, on behalf of the Anchorage School District, issued \$126,770,000 in general obligation bonds. More detailed information about the

District's long-term debt liabilities is presented in Note 3, Changes in Long-Term Debt, in the basic financial statements.

Table 5 – Outstanding Debt, as of June 30

	<u>Governmental Activities</u>		<u>Maturity</u>
	<u>2004</u>	<u>2003</u>	
General obligation bonds	<u>\$ 681,250,000</u>	<u>\$ 583,225,000</u>	2024

As of June 30, 2004, the School District's available authorized but unissued general obligation school bonds was \$116,985,000.

Outstanding debt on general obligation bonds of the Municipality of Anchorage, including the District, is reflected in the Municipality of Anchorage's Comprehensive Annual Financial Report for their fiscal year ended December 31, 2003.

The Municipality of Anchorage's current bond ratings are as follows:

	<u>Moody's Investors Service</u>	<u>Standard and Poor's</u>
General obligation bonds	Aa3	AA-

**Economic Factors and Next Year's Budgets and Rates**

- The official Consumer Price Index of 2.7 percent and a population growth of 1.16 percent were used in calculating the total taxes for the General Fund for FY 2004-2005. The Consumer Price Index and the population growth increased over FY 2003-2004. These two factors are major components that make up the formula that allows for collection of property taxes that support the operations of the District's General Fund.
- A revision passed by the Alaska Legislature and the Governor increased the base student allocation used in the Alaska Public School Program funding formula from \$4,169 to \$4,576. In FY 2004-2005, the Anchorage School District will receive approximately \$27,353,745 more in State funding based on a projected 49,499 students.
- Interest rates have remained flat throughout 2004 and are anticipated to grow slowly during 2005.
- The Anchorage School District has experienced a flat insurance premium renewal for property insurance. However, due to increased property values and the addition of the new South Anchorage High School as well as the renovation to Wendler Middle School, our insurance premium increased.
- Rate increases to purchased services have continued due to the fluctuations in oil production as well as the price of oil. Underlying costs to provide services and produce products, such as insurance and shipping, have been passed along to the District. In addition, maintenance materials have increased due to the diversion of these materials to overseas and natural disaster reconstruction.

- Even with close monitoring of all the utilities across the District, due to utility rate increases in some markets such as heat and electricity, the District is experiencing higher utility costs.
- The District has been notified of retirement rate increases by the Teachers Retirement System from 16 percent to 21 percent and the Public Employees Retirement System from 14.25 percent to 19.25 percent, which is estimated to increase retirement expenditures by \$13 million.
- A major driving force of the District's financial outlook is student enrollment. The District is experiencing increased migration over prior years. However, rural-urban transitioning and immigration from other countries is also occurring more so now than in the past. With this movement of the student population, coupled with the current low birth rate that would help offset those that are leaving the District if the birth rate was higher, it is anticipated that in future years the enrollment will remain flat and then decline slightly.
- The Anchorage School District has experienced a substantial increase to our workers' compensation excess insurance premium, which covers losses above the District's self-insured retention. This is due to the increase in workers' compensation experience nationwide, as well as national increases in medical and pharmaceutical costs.

All of these factors were considered in preparing the Anchorage School District's budget for the 2004-2005 fiscal year.

### **Requests for Information**

These financial statements and discussions are designed to provide our students, citizens, taxpayers, investors and creditors disclosure of the District's finances and to demonstrate a high degree of accountability for the public dollars entrusted to us. If you have questions about this report or need additional information, please write Chief Financial Officer, Anchorage School District, P.O. Box 196614, Anchorage, Alaska 99519-6614.