

Covert Public Schools

**Financial Report
with Supplemental Information
June 30, 2017**

Covert Public Schools

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Independent Auditor's Report

To the Board of Education
Covert Public Schools

Report on the Financial Statements

We have audited the accompanying financial statements of the governmental activities, the major fund, and the aggregate remaining fund information of Covert Public Schools (the "School District") as of and for the year ended June 30, 2017 and the related notes to the financial statements, which collectively comprise Covert Public Schools' basic financial statements as listed in the table of contents.

Management's Responsibility for the Financial Statements

Management is responsible for the preparation and fair presentation of these financial statements in accordance with accounting principles generally accepted in the United States of America; this includes the design, implementation, and maintenance of internal control relevant to the preparation and fair presentation of financial statements that are free from material misstatement, whether due to fraud or error.

Auditor's Responsibility

Our responsibility is to express an opinion 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 from material misstatement.

An audit involves performing procedures to obtain audit evidence about the amounts and disclosures in the financial statements. The procedures selected depend on the auditor's judgment, including the assessment of the risks of material misstatement of the financial statements, whether due to fraud or error. In making those risk assessments, the auditor considers internal control relevant to the entity's preparation and fair presentation of the financial statements in order to design audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of the entity's internal control. Accordingly, we express no such opinion. An audit also includes evaluating the appropriateness of accounting policies used and the reasonableness of significant accounting estimates made by management, as well as evaluating the overall presentation of the financial statements.

We believe that the audit evidence we have obtained is sufficient and appropriate to provide a basis for our audit opinion.

To the Board of Education
Covert Public Schools

Opinion

In our opinion, the financial statements referred to above present fairly, in all material respects, the respective financial position of the governmental activities, the major fund, and the aggregate remaining fund information of Covert Public Schools as of June 30, 2017 and the respective changes in its financial position for the year then ended in accordance with accounting principles generally accepted in the United States of America.

Required Supplemental Information

Accounting principles generally accepted in the United States of America require that the management's discussion and analysis, the major fund budgetary comparison schedule, the schedule of the School District's contributions to MPSERS over the last 10 fiscal years, and the schedule of the School District's proportionate share of the net pension liability MPSERS for the last 10 fiscal years be presented to supplement the basic financial statements. Such information, although not a part of the basic financial statements, is required by the Governmental Accounting Standards Board, which considers it to be an essential part of financial reporting for placing the basic financial statements in an appropriate operational, economic, or historical context. We have applied certain limited procedures to the required supplemental information in accordance with auditing standards generally accepted in the United States of America, which consisted of inquiries of management about 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 do not express an opinion or provide any assurance on the information because the limited procedures do not provide us with sufficient evidence to express an opinion or provide any assurance.

Other Information

Our audit was conducted for the purpose of forming an opinion on the financial statements that collectively comprise Covert Public Schools' basic financial statements. The other supplemental information, as identified in the table of contents, is presented for the purpose of additional analysis and is not a required part of the basic financial statements.

The nonmajor governmental funds combining balance sheet, combining statement of revenue, expenditures, and changes in fund balances, and the schedule of bonded indebtedness are the responsibility of management and were derived from and relate directly to the underlying accounting and other records used to prepare the basic financial statements. Such information has been subjected to the auditing procedures applied in the audit of the basic financial statements and certain additional procedures, including comparing and reconciling such information directly to the underlying accounting and other records used to prepare the basic financial statements or to the basic financial statements themselves, and other additional procedures in accordance with auditing standards generally accepted in the United States of America. In our opinion, the nonmajor governmental funds combining balance sheet, combining statement of revenue, expenditures, and changes in fund balances, and the schedule of bonded indebtedness are fairly stated in all material respects in relation to the basic financial statements as a whole.

To the Board of Education
Covert Public Schools

Other Reporting Required by Government Auditing Standards

In accordance with *Government Auditing Standards*, we have also issued our report dated October 3, 2017 on our consideration of Covert Public Schools' internal control over financial reporting and on our tests of its compliance with certain provisions of laws, regulations, contracts, grant agreements, and other matters. The purpose of that report is to describe the scope of our testing of internal control over financial reporting and compliance and the results of that testing, and not to provide an opinion on internal control over financial reporting or on compliance. That report is an integral part of an audit performed in accordance with *Government Auditing Standards* in considering Covert Public Schools' internal control over financial reporting and compliance.

Plante & Moran, PLLC

October 3, 2017

Covert Public Schools

Management's Discussion and Analysis

This section of Covert Public Schools' (the "School District") annual financial report presents our discussion and analysis of the School District's financial performance during the year ended June 30, 2017. Please read it in conjunction with the School District's financial statements, which immediately follow this section.

Using this Annual Report

This annual report consists of a series of financial statements and notes to those statements. These statements are organized so the reader can understand Covert Public Schools financially as a whole. The government-wide financial statements provide information about the activities of the whole School District, presenting both an aggregate view of the School District's finances and a longer-term view of those finances. The fund financial statements provide the next level of detail. For governmental activities, these statements tell how services were financed in the short term as well as what remains for future spending. The fund financial statements look at the School District's operations in more detail than the governmental-wide financial statements by providing information about the School District's most significant fund - the General Fund, with all other funds presented in one column as nonmajor funds. The remaining statement, the statement of fiduciary net position, presents financial information about activities for which the School District acts solely as an agent for the benefit of students and parents.

Management's Discussion and Analysis (MD&A)
(Required Supplemental Information)

Basic Financial Statements

District-wide Financial Statements Fund Financial Statements

Notes to the Basic Financial Statements

(Required Supplemental Information)

Budgetary Information for Major Fund

Proportionate Share of the Net Pension Liability - MPSERS

Contributions - MPSERS

Other Supplemental Information

Reporting the School District as a Whole - District-wide Financial Statements

One of the most important questions asked about the School District is, "As a whole, what is the School District's financial condition as a result of the year's activities?" The statement of net position and the statement of activities, which appear first in the School District's financial statements, report information on the School District as a whole and its activities in a way that helps you answer this question. We prepare these statements to include all assets and liabilities, using the accrual basis of accounting, which is similar to the accounting used by most private sector companies. All of the current year's revenue and expenses are taken into account regardless of when cash is received or paid.

Covert Public Schools

Management's Discussion and Analysis (Continued)

These two statements report the School District's net position - the difference between assets and deferred outflows of resources as compared to liabilities and deferred inflows of resources, as reported in the statement of net position - as one way to measure the School District's financial health or financial position. Over time, increases or decreases in the School District's net position - as reported in the statement of activities - are indicators of whether its financial health is improving or deteriorating. The relationship between revenue and expenses is the School District's operating results. However, the School District's goal is to provide services to our students, not to generate profits as commercial entities do. One must consider many other nonfinancial factors, such as the quality of the education provided and the safety of the schools, to assess the overall health of the School District.

The statement of net position and the statement of activities report the governmental activities for the School District, which encompass all of the School District's services, including instruction, support services, community services, athletics, and food services. Property taxes, state aid, and state and federal grants finance most of these activities.

Reporting the School District's Most Significant Funds - Fund Financial Statements

The School District's fund financial statements provide detailed information about the most significant funds - not the School District as a whole. Some funds are required to be established by state law and by bond covenants. However, the School District establishes many other funds to help it control and manage money for particular purposes (the Food Services Fund is an example) or to show that it is meeting legal responsibilities for using certain taxes, grants, and other money. The governmental funds of the School District use the following accounting approach:

Governmental Funds - All of the School District's services are reported in governmental funds. Governmental fund reporting focuses on showing how money flows into and out of funds and the balances left at year end that are available for spending. They are reported using an accounting method called modified accrual accounting, which measures cash and all other financial assets that can readily be converted to cash. The governmental fund statements provide a detailed short-term view of the operations of the School District and the services it provides. Governmental fund information helps you determine whether there are more or fewer financial resources that can be spent in the near future to finance the School District's programs. We describe the relationship (or differences) between governmental activities (reported in the statement of net position and the statement of activities) and governmental funds in a reconciliation.

Covert Public Schools

Management's Discussion and Analysis (Continued)

The School District as Trustee - Reporting the School District's Fiduciary Responsibilities

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

The School District as a Whole

Recall that the statement of net position provides the perspective of the School District as a whole. Table I provides a summary of the School District's net position as of June 30, 2017 and 2016:

TABLE I

	Governmental Activities	
	June 30	
	2017	2016
	(in millions)	
Assets		
Current and other assets	\$ 6.83	\$ 5.44
Capital assets	12.90	12.64
Total assets	19.73	18.08
Deferred Outflows of Resources	0.98	0.78
Total assets and deferred outflows of resources	20.71	18.86
Liabilities		
Current liabilities	1.63	1.61
Long-term liabilities	15.06	15.41
Total liabilities	16.69	17.02
Deferred Inflows of Resources	0.30	0.30
Total liabilities and deferred inflows of resources	16.99	17.32
Net Assets		
Invested in capital assets - Net of related debt	4.79	4.05
Unrestricted	(1.07)	(2.51)
Total net assets	<u>\$ 3.72</u>	<u>\$ 1.54</u>

The above analysis focuses on the net position (see Table I). The change in net position of the School District's governmental activities is discussed below (see Table 2).

Covert Public Schools

Management's Discussion and Analysis (Continued)

The School District's net position was \$3.72 million at June 30, 2017. Net investment in capital assets totaling \$4.79 million compares the original cost, less depreciation of the School District's capital assets, to long-term debt used to finance the acquisition of those assets. Most of the debt will be repaid from general operating tax collections. Restricted net position is reported separately to show legal constraints from debt covenants and enabling legislation that limit the School District's ability to use that net position for day-to-day operations. The remaining amount of net position (\$1.07 million) was unrestricted.

The (\$1.07) million in unrestricted net position of governmental activities represents the accumulated results of all past years' operations. The unrestricted net position balance enables the School District to meet working capital and cash flow requirements as well as to provide for future uncertainties. The operating results of the General Fund will have a significant impact on the change in unrestricted net position from year to year.

The results of this year's operations for the School District as a whole are reported in the statement of activities (Table 2), which shows the changes in net position.

TABLE 2

	Governmental Activities	
	2017	2016
	(in millions)	
Revenue		
Program revenue:		
Charges for services	\$ 0.01	\$ 0.01
Operating grants and contributions	1.40	1.36
General revenue:		
Property taxes	7.68	6.59
State aid	-	0.01
Other	0.02	0.04
Total revenue	9.11	8.01
Functions/Program Expenses		
Instruction	2.58	2.40
Support services	3.01	2.95
Athletics	0.11	0.08
Food services	0.36	0.34
Community services	0.09	0.07
Interest on long-term debt	0.35	0.37
Depreciation (unallocated)	0.43	0.41
Total functions/program expenses	6.93	6.62
Increase in Net Assets	2.18	1.39
Net Assets - Beginning of year	1.54	0.15
Net Assets - End of year	\$ 3.72	\$ 1.54

Covert Public Schools

Management's Discussion and Analysis (Continued)

As reported in the statement of activities, the cost of all of our governmental activities this year was \$6.93 million. Certain activities were partially funded from those who benefited from the programs in the amount of \$0.01 million or by other districts and organizations that subsidized certain programs with grants and contributions in the amount of \$1.40 million. We paid for the remaining "public benefit" portion of our governmental activities with \$7.68 million in taxes and \$0.02 million in other revenue (i.e., interest and general entitlements).

As discussed above, the net cost shows the financial burden that was placed on the State and the School District's taxpayers by each of these functions. Since property taxes for operations constitute the vast majority of district operating revenue sources, the Board of Education and administration must annually evaluate the needs of the School District.

The School District's Funds

As we noted earlier, the School District uses funds to help it control and manage money for particular purposes. Looking at funds helps the reader consider whether the School District is being held accountable for the resources taxpayers and others provide to it and may provide more insight into the School District's overall financial health.

As the School District completed this year, the governmental funds reported a combined fund balance of approximately \$5,775,000, which is an increase of approximately \$1,374,000 from last year. The primary reasons for the increase are as follows:

In the General Fund, our principal operating fund, the fund balance increased approximately \$1,373,000 to \$5,756,000. The change is mainly due to spending limitations in anticipation of reduced tax revenue.

Our Special Revenue Funds remained stable from the prior year, showing a net increase of approximately \$2,000.

General Fund Budgetary Highlights

Over the course of the year, the School District revises its budget as it attempts to deal with unexpected changes in revenue and expenditures. State law requires that the budget be amended to ensure that expenditures do not exceed appropriations. The final amendment to the budget was adopted just before year end. A schedule showing the School District's original and final budget amounts compared with amounts actually paid and received is provided in required supplemental information of these financial statements.

There were revisions made to the 2016-2017 General Fund original budget. Budgeted revenue increased approximately \$1,456,000 due to increased receipt of property tax revenue, as well as increased revenue from state and federal sources.

Budgeted expenditures increased approximately \$1,038,000 to closer align expenditures with expected amounts.

Covert Public Schools

Management's Discussion and Analysis (Continued)

Capital Assets and Debt Administration

Capital Assets

As of June 30, 2017, the School District had \$12.90 million invested in a broad range of capital assets, including land, buildings, vehicles, furniture, and equipment, net of depreciation. This amount represents a net increase (including additions, disposals, and depreciation) of approximately \$0.26 million, or 2.1 percent, from last year.

	2017	2016
Land	\$ 40,000	\$ 40,000
Construction in progress	-	-
Buildings and building improvements	22,787,223	22,195,261
Buses and other vehicles	667,475	677,928
Furniture and equipment	851,676	841,811
Total capital assets	24,346,374	23,755,000
Less accumulated depreciation	11,443,153	11,113,658
Net capital assets	<u>\$ 12,903,221</u>	<u>\$ 12,641,342</u>

We anticipate some additional capital additions as we continue the roof repair project in the 2017-2018 fiscal year. We present more detailed information about our capital assets in the notes to the financial statements.

Debt

At the end of this year, the School District had \$8.11 million in bonds outstanding versus \$8.59 million in the previous year, a change of 5.6 percent. Those bonds consisted of the following:

	2017	2016
General obligation bonds	<u>\$ 8,110,946</u>	<u>\$ 8,589,376</u>

The School District's general obligation bond rating has remained stable at BBB. The State limits the amount of general obligation debt that schools can issue to 15 percent of the assessed value of all taxable property within the School District's boundaries. If the School District issues "qualified debt," i.e., debt backed by the State of Michigan, such obligations are not subject to this debt limit. The School District's outstanding unqualified general obligation debt of \$8.11 million is below the statutorily imposed limit.

Other obligations include accrued vacation pay and sick leave. We present more detailed information about our long-term liabilities in the notes to the financial statements.

Covert Public Schools

Management's Discussion and Analysis (Continued)

Economic Factors and Next Year's Budgets and Rates

Our elected officials and administration consider many factors when setting the School District's 2017-2018 fiscal year budget. One of the most important factors affecting the budget is property tax revenue, as the School District is considered out-of-formula and therefore does not receive the per pupil foundation allowance from the State that most schools receive. Due to ongoing disputes with one major taxpayer, our tax revenue has seen large variances over the past few years. Because of the uncertainty regarding what the entity's tax liability will be for the 2017 levy, as well as the uncertainty of receiving a full payment from that entity, we continue to budget our tax revenue on the low end of the estimates. With this lower expected tax revenue, we have also budgeted our expenditures to be in line with the lower expected revenue and we continue to make every effort to reduce expenditures throughout the School District.

In July 2015, the School District settled a labor contract with the CEA teacher union. CEA members' salaries increased 2 percent in 2015-2016, and will increase 1 percent in 2016-2017 and 2017-2018. In September 2015, the School District settled a labor contract with the SEIU union. SEIU members' hourly rates will increase 2 percent in 2015-2016, 2016-2017, and 2017-2018. Both of these union pay increases were built into the 2017-2018 budget adopted in June 2017.

Contacting the School District's Management

This financial report is intended to provide our taxpayers, parents, and investors with a general overview of the School District's finances and to show the School District's accountability for the money it receives. If you have any questions about this report or need additional information, we welcome you to contact the Business Office.

Covert Public Schools

Statement of Net Position June 30, 2017

	Governmental Activities
Assets	
Cash and investments (Note 3)	\$ 5,781,899
Receivables (Note 4)	371,007
Inventories	11,357
Prepaid costs and other assets	60,097
Restricted assets (Note 8)	602,371
Capital assets - Net (Note 5)	<u>12,903,221</u>
Total assets	19,729,952
Deferred Outflows of Resources - Deferred outflows related to pensions (Note 10)	
	<u>982,202</u>
Total assets and deferred outflows of resources	20,712,154
Liabilities	
Accounts payable	58,334
Accrued payroll-related liabilities	309,705
Other accrued liabilities	61,424
Due to other governmental units	80,874
Property tax payable (Note 8)	602,371
Noncurrent liabilities (Note 7):	
Due within one year	512,791
Due in more than one year	7,678,051
Net pension liability (Note 10)	<u>7,382,198</u>
Total liabilities	16,685,748
Deferred Inflows of Resources	
	<u>307,011</u>
Total liabilities and deferred inflows of resources	<u>16,992,759</u>
Net Position	
Net investment in capital assets	4,792,275
Unrestricted	<u>(1,072,880)</u>
Total net position	<u><u>\$ 3,719,395</u></u>

Covert Public Schools

Statement of Activities Year Ended June 30, 2017

Functions/Programs	Program Revenue			Governmental
	Expenses	Charges for Services	Operating Grants and Contributions	Activities Net (Expense) Revenue and Changes in Net Position
Primary government - Governmental activities:				
Instruction	\$ 2,576,521	\$ -	\$ 773,621	\$ (1,802,900)
Support services	3,012,201	513	298,198	(2,713,490)
Athletics	105,665	2,991	-	(102,674)
Food services	363,270	3,974	271,721	(87,575)
Community services	94,209	1,289	51,469	(41,451)
Interest on long-term debt	354,636	-	-	(354,636)
Depreciation expense (unallocated)	425,649	-	-	(425,649)
Total primary government	<u>\$ 6,932,151</u>	<u>\$ 8,767</u>	<u>\$ 1,395,009</u>	(5,528,375)
General revenue:				
Property taxes, levied for general purposes				7,677,902
Interest and investment earnings				3,663
Other				26,525
Total general revenue				<u>7,708,090</u>
Change in Net Position				2,179,715
Net Position - Beginning of year				<u>1,539,680</u>
Net Position - End of year				<u>\$ 3,719,395</u>

Covert Public Schools

Governmental Funds Balance Sheet June 30, 2017

	General Fund	Nonmajor Governmental Funds	Total Governmental Funds
Assets			
Cash and investments (Note 3)	\$ 5,762,929	\$ 18,970	\$ 5,781,899
Receivables (Note 4)	360,269	10,738	371,007
Due from other funds (Note 6)	20,032	-	20,032
Inventories	1,732	9,625	11,357
Prepaid costs and other assets	54,513	990	55,503
Restricted assets (Note 8)	602,371	-	602,371
	<u>\$ 6,801,846</u>	<u>\$ 40,323</u>	<u>\$ 6,842,169</u>
Total assets			
Liabilities and Fund Balances			
Liabilities			
Accounts payable	\$ 56,339	\$ 1,995	\$ 58,334
Accrued payroll-related liabilities	307,409	2,296	309,705
Due to other governmental units	79,727	1,147	80,874
Property tax payable (Note 8)	602,371	-	602,371
Due to other funds (Note 6)	-	15,438	15,438
	<u>1,045,846</u>	<u>20,876</u>	<u>1,066,722</u>
Total liabilities			
Fund Balances			
Nonspendable:			
Inventory	1,732	9,625	11,357
Prepaid costs and other assets	54,513	990	55,503
Committed - Bookstore	-	12,091	12,091
Unassigned	5,699,755	(3,259)	5,696,496
	<u>5,756,000</u>	<u>19,447</u>	<u>5,775,447</u>
Total fund balances			
Total liabilities and fund balances	<u>\$ 6,801,846</u>	<u>\$ 40,323</u>	<u>\$ 6,842,169</u>

Covert Public Schools

Governmental Funds Reconciliation of the Balance Sheet of Governmental Funds to the Statement of Net Position June 30, 2017

Fund Balance Reported in Governmental Funds	\$	5,775,447
Amounts reported for governmental activities in the statement of net position are different because:		
Capital assets used in governmental activities are not financial resources and are not reported in the funds:		
Cost of capital assets	\$	24,346,374
Accumulated depreciation	<u>(11,443,153)</u>	12,903,221
Deferred outflows related to pension payments made subsequent to the measurement date		982,202
Long-term liabilities are not due and payable in the current period and are not reported in the governmental funds:		
Bonds payable including unamortized discounts	(8,110,946)	
Compensated absences	<u>(79,896)</u>	(8,190,842)
Accrued interest payable is not included as a liability in governmental funds		(61,424)
Net pension obligations do not present a claim on current financial resources and are not reported as fund liabilities		(7,382,198)
Deferred inflows related to pension investment returns, changes in assumptions, and funding received through state appropriations for contributions to the pension plan after the measurement date are not reported in the governmental funds		<u>(307,011)</u>
Net Position of Governmental Activities	\$	<u>3,719,395</u>

Covert Public Schools

Governmental Funds Statement of Revenue, Expenditures, and Changes in Fund Balances Year Ended June 30, 2017

	General Fund	Nonmajor Governmental Funds	Total Governmental Funds
Revenue			
Local sources	\$ 7,719,591	\$ 3,991	\$ 7,723,582
State sources	588,565	11,893	600,458
Federal sources	565,816	259,828	825,644
Total revenue	8,873,972	275,712	9,149,684
Expenditures			
Current:			
Instruction	2,629,948	-	2,629,948
Support services	3,039,993	-	3,039,993
Athletics	105,665	-	105,665
Food services	-	365,250	365,250
Community services	94,209	-	94,209
Debt service:			
Principal	485,155	-	485,155
Interest	358,966	-	358,966
Capital outlay	695,458	845	696,303
Total expenditures	7,409,394	366,095	7,775,489
Excess of Revenue Over (Under) Expenditures	1,464,578	(90,383)	1,374,195
Other Financing Sources (Uses)			
Transfers in (Note 6)	-	92,000	92,000
Transfers out (Note 6)	(92,000)	-	(92,000)
Net Change in Fund Balances	1,372,578	1,617	1,374,195
Fund Balances - Beginning of year	4,383,422	17,830	4,401,252
Fund Balances - End of year	\$ 5,756,000	\$ 19,447	\$ 5,775,447

Covert Public Schools

Governmental Funds Reconciliation of the Statement of Revenue, Expenditures, and Changes in Fund Balances of Governmental Funds to the Statement of Activities Year Ended June 30, 2017

Net Change in Fund Balances - Total Governmental Funds \$ 1,374,195

Amounts reported for governmental activities in the statement of activities are different because:

Governmental funds report capital outlays as expenditures; however, in the statement of activities, these costs are allocated over their estimated useful lives as depreciation:

Depreciation expense	\$ (425,649)	
Capitalized capital outlay	<u>687,528</u>	261,879

Bond issuance discounts reported as expenditures in the funds and amortized in the statement of activities (6,725)

Repayment of bond principal is an expenditure in the governmental funds, but not in the statement of activities (where it reduces long-term debt) 485,155

Interest expense is recorded in the statement of activities when incurred; it is not reported in governmental funds until paid 4,330

Change in pension expense related to deferred items 69,653

Revenue in support of pension contributions made subsequent to measurement date (31,093)

Compensated absences are recorded when earned in the statement of activities. In the current year, more were paid out than earned 22,321

Change in Net Position of Governmental Activities \$ 2,179,715

Covert Public Schools

Fiduciary Funds Statement of Fiduciary Net Position June 30, 2017

	Student Activities <u>Agency Funds</u>
Assets	
Cash and investments (Note 3)	\$ 127,581
Receivables (Note 4)	<u>50</u>
Total assets	<u>\$ 127,631</u>
Liabilities	
Due to student activities	\$ 123,037
Due to other funds (Note 6)	<u>4,594</u>
Total liabilities	<u>\$ 127,631</u>

Covert Public Schools

Notes to Financial Statements June 30, 2017

Note I - Nature of Business and Significant Accounting Policies

The accounting policies of Covert Public Schools (the "School District") conform to accounting principles generally accepted in the United States of America (GAAP) as applicable to governmental units. The following is a summary of the significant accounting policies used by the School District:

Reporting Entity

The School District is governed by an elected seven-member Board of Education. The accompanying financial statements have been prepared in accordance with criteria established by the Governmental Accounting Standards Board for determining the various governmental organizations to be included in the reporting entity. These criteria include significant operational financial relationships that determine which of the governmental organizations are a part of the School District's reporting entity and which organizations are legally separate component units of the School District. Based on the application of the criteria, the School District does not contain any component units.

District-wide and Fund Financial Statements

The district-wide financial statements (i.e., the statement of net position and the statement of activities) report information on all of the nonfiduciary activities of the School District. For the most part, the effect of interfund activity has been removed from these statements. Governmental activities, which normally are supported by taxes and intergovernmental revenue, are reported separately from business-type activities, which rely to a significant extent on fees and charges for support. All of the School District's district-wide activities are considered governmental activities.

The statement of activities demonstrates the degree to which the direct expenses of a given function or segment are offset by program revenue. Direct expenses are those that are clearly identifiable with a specific function. Program revenue includes (1) charges to customers or applicants who purchase, use, or directly benefit from goods, services, or privileges provided by a given function and (2) grants and contributions that are restricted to meeting the operational or capital requirements of a particular function. Taxes, intergovernmental payments, and other items not properly included among program revenue are reported instead as general revenue.

Separate financial statements are provided for governmental funds and a fiduciary fund, even though the latter is excluded from the district-wide financial statements. Major individual governmental funds are reported as separate columns in the fund financial statements.

Note 1 - Nature of Business and Significant Accounting Policies (Continued)

Measurement Focus, Basis of Accounting, and Financial Statement Presentation

District-wide Financial Statements - The district-wide financial statements are reported using the economic resources measurement focus and the accrual basis of accounting. Revenue is recorded when earned and expenses are recorded when a liability is incurred, regardless of the timing of related cash flows. Property taxes are recognized as revenue in the year for which they are levied. Grants, categorical aid, and similar items are recognized as revenue as soon as all eligibility requirements imposed by the provider have been met.

As a general rule, the effect of interfund activity has been eliminated from the district-wide financial statements.

When an expense is incurred for purposes for which both restricted and unrestricted net position or fund balance are available, the School District's policy is to first apply restricted resources. When an expense is incurred for purposes for which amounts in any of the unrestricted fund balance classifications could be used, it is the School District's policy to spend funds in this order: committed, assigned, and unassigned.

Amounts reported as program revenue include (1) charges to customers or applicants for goods, services, or privileges provided; (2) operating grants and contributions; and (3) capital grants and contributions. Internally dedicated resources are reported as general revenue rather than as program revenue. Likewise, general revenue includes all taxes and unrestricted state aid.

Fund Financial Statements - Fund financial statements are reported using the current financial resources measurement focus and the modified accrual basis of accounting. Revenue is recognized as soon as it is both measurable and available. Revenue is considered to be available if it is collected within the current period or soon enough thereafter to pay liabilities of the current period. Revenue not meeting this definition is classified as a deferred inflow of resources. For this purpose, the School District considers revenue to be available if it is collected within 60 days of the end of the current fiscal period. Expenditures generally are recorded when a liability is incurred, as under accrual accounting. However, debt service expenditures, as well as expenditures related to compensated absences and claims and judgments, are recorded only when payment is due.

Property taxes, unrestricted state aid, intergovernmental grants, and interest associated with the current fiscal period are all considered to be susceptible to accrual and so have been recognized as revenue of the current fiscal period. All other revenue items are considered to be available only when cash is received by the School District.

**Note I - Nature of Business and Significant Accounting Policies
(Continued)**

Fiduciary fund statements are also reported using the economic resources measurement focus and the accrual basis of accounting.

The School District reports the following major governmental fund:

General Fund - The General Fund is the School District's primary operating fund. It accounts for all financial resources of the School District, except those required to be accounted for in another fund.

Additionally, the School District reports the following fund types:

Special Revenue Funds - Special Revenue Funds are used to account for the proceeds of specific revenue sources that are restricted to expenditure for specified purposes. The School District's Special Revenue Funds include the Food Services and Bookstore Funds. The main sources of revenue for the Food Services Fund are food sales to students and grants from the state and federal governments. The main source of revenue for the Bookstore Fund is collections from certain activities. Any operating deficit generated by these activities is the responsibility of the General Fund.

Agency Fund - The Agency Fund accounts for resources held on behalf of other individuals and governments. The School District presently maintains the Student Activities agency fund to record transactions of student groups for school and school-related purposes. The funds are segregated and held in trust for the students.

Assets, Liabilities, and Net Position or Equity

Cash and Investments - Cash and investments include cash on hand, demand deposits, and short-term investments with a maturity of three months or less when acquired. Investments are stated at fair value.

Receivables and Payables - In general, outstanding balances between funds are reported as "due to/from other funds." Activities between funds that are representative of lending/borrowing arrangements outstanding at the end of the fiscal year are referred to as "advances to/from other funds."

Covert Public Schools

Notes to Financial Statements June 30, 2017

Note 1 - Nature of Business and Significant Accounting Policies (Continued)

All trade and property tax receivables are shown net of an allowance for uncollectible amounts. As of June 30, 2017, the School District has \$15,718,913 in property tax receivables from the largest taxpayer in the School District. The total receivable is the difference between the total property taxes levied and the amount received from the taxpayer from 2012 through 2017. The School District has recorded an allowance for uncollectible amounts on the entire uncollected balance, as the collectibility of the outstanding receivable is unknown. The School District considers all other receivables to be fully collectible; accordingly, no allowance for uncollectible amounts is recorded on the remaining other receivables. Property taxes are assessed as of December 31 and the related property taxes become a lien on July 1 of the following year. These taxes are billed on July 1. Taxes are considered delinquent on March 1 of the following year. At this time, penalties and interest are assessed and the total obligation is added to the county tax rolls.

At year end, the total uncollected property taxes from the largest taxpayer are as follows:

	Tax Levy		Total at
	2016	2011-2015	June 30, 2017
Property tax levy	\$ 5,621,872	\$ 17,649,693	\$ 23,271,565
Amount collected	<u>(2,343,538)</u>	<u>(5,209,114)</u>	<u>(7,552,652)</u>
Total receivable	3,278,334	12,440,579	15,718,913
Allowance for uncollectible receivable	<u>(3,278,334)</u>	<u>(12,440,579)</u>	<u>(15,718,913)</u>
Net receivable	<u>\$ -</u>	<u>\$ -</u>	<u>\$ -</u>

Inventories and Prepaid Costs - Inventories are valued at cost on a first-in, first-out basis. Inventories of governmental funds are recorded as expenditures when consumed rather than when purchased. Certain payments to vendors reflect costs applicable to future fiscal years and are recorded as prepaid costs in both district-wide and fund financial statements.

Restricted Assets - Restricted assets represent a property tax payment received from a taxpayer that was challenged and subsequently settled in March 2016. This amount has been classified as a restricted asset. See Note 8 for further details.

Covert Public Schools

Notes to Financial Statements June 30, 2017

Note I - Nature of Business and Significant Accounting Policies (Continued)

Capital Assets - Capital assets, which include land, buildings, equipment, and vehicles, are reported in the applicable governmental column in the district-wide financial statements. Capital assets are defined by the School District as assets with an initial individual cost of more than \$5,000 and an estimated useful life in excess of two years. Such assets are recorded at historical cost or estimated historical cost if purchased or constructed. Donated capital assets are recorded at estimated fair market value at the date of donation. Costs of normal repair and maintenance that do not add to the value or materially extend asset life are not capitalized. The School District does not have infrastructure-type assets.

Buildings, equipment, and vehicles are depreciated using the straight-line method over the following useful lives:

Buildings and building additions	15 to 50 years
Buses and other vehicles	8 years
Furniture and other equipment	5 to 20 years

Compensated Absences (Vacation and Sick Leave) - The liability for compensated absences reported in the district-wide statements consists of earned but unused accumulated vacation and sick leave benefits. A liability for these amounts is reported in governmental funds as it comes due for payment. The liability has been calculated for employees who are currently eligible to receive termination benefits.

Long-term Obligations - In the district-wide financial statements, long-term debt and other long-term obligations are reported as liabilities in the statement of net position. Bond premiums and discounts are deferred and amortized over the life of the bonds using the straight-line method. Bonds payable are reported net of the applicable bond premium or discount. Bond issuance costs are reported as debt service expenditures.

In the fund financial statements, governmental fund types recognize bond premiums and discounts, as well as bond issuance costs, during the current period.

The face amount of debt issued is reported as other financing sources. Premiums received on debt issuances are reported as other financing sources, while discounts are reported as other financing uses. Issuance costs are reported as debt service expenditures.

Note 1 - Nature of Business and Significant Accounting Policies (Continued)

Contingencies - The School District is currently involved in a Michigan Tax Tribunal case with the largest taxpayer in the School District. Based on current proceedings, there is a possible reduction of the taxable values for this taxpayer. This reduction could result in a chargeback for previous property tax revenue received. In addition, this change in property tax values could result in a decrease of future expected property tax revenue. While the School District is currently not a party to the action, there is a potential significant loss resulting from this dispute. The amount of the loss is unable to be estimated at this time. The local township and the county have indicated that they will vigorously appeal and defend any reductions in taxable value that may occur.

Deferred Outflows/Inflows of Resources - In addition to assets, the statement of financial position will sometimes report a separate section for deferred outflows of resources. This separate financial statement element represents a consumption of net position or fund balance that applies to a future period and so will not be recognized as an outflow of resources (expense) until then. The School District only has one item that qualifies for reporting in this category. It is the deferred outflow related to the pension plan, as described in Note 10.

In addition to liabilities, the statement of financial position will sometimes report a separate section for deferred inflows of resources. This separate financial statement element represents an acquisition of net position that applies to a future period and so will not be recognized as an inflow of resources (revenue) until that time. The School District has two items that qualify for reporting in this category. Deferred inflows at June 30, 2017 included \$228,868 for funding received through state appropriations for contributions to the MPSERS pension plan after the measurement date, and \$78,143 related to the pension plan described in Note 10. These amounts are deferred and recognized as an inflow of resources in the period that the amounts become available.

Fund Balance - In the fund financial statements, governmental funds report the following components of fund balance:

- **Nonspendable:** Amounts that are not in spendable form or are legally or contractually required to be maintained intact
- **Restricted:** Amounts that are legally restricted by outside parties, constitutional provisions, or enabling legislation for use for a specific purpose
- **Committed:** Amounts that have been formally set aside by the Board of Education for use for specific purposes. Commitments are made and can be rescinded only via resolution of the Board of Education.
- **Assigned:** Amounts that have been set aside with the intent to spend resources on specific purposes expressed by the Board of Education

Covert Public Schools

Notes to Financial Statements June 30, 2017

Note 1 - Nature of Business and Significant Accounting Policies (Continued)

- Unassigned: Amounts that do not fall into any other category above. This is the residual classification for amounts in the General Fund and represents fund balance that has not been assigned to other funds and has not been restricted, committed, or assigned to specific purposes in the General Fund. In other governmental funds, only negative unassigned amounts are reported, if any, and represent expenditures incurred for specific purposes exceeding the amounts previously restricted, committed, or assigned to those purposes.

Comparative Data/Reclassifications - Comparative data is not included in the School District's financial statements.

Pensions - For purposes of measuring the net pension liability, deferred outflows of resources and deferred inflows of resources related to pensions, and pension expense, information about the fiduciary net position of the Michigan Public School Employees' Retirement System (MPERS) and additions to/deductions from MPERS fiduciary net position have been determined on the same basis as they are reported by MPERS. MPERS uses the economic resources measurement focus and the full accrual basis of accounting. Contribution revenue is recorded as contributions are due, pursuant to legal requirements. Benefit payments (including refunds of employee contributions) are recognized as expense when due and payable in accordance with the benefit terms. Related plan investments are reported at fair value.

Note 2 - Stewardship, Compliance, and Accountability

Budgetary Information - Annual budgets are adopted on a basis consistent with GAAP and state law for the General Fund and all special revenue funds. Capital outlay is budgeted and included in the functions for budget purposes and reported separately on the statement of revenue, expenditures, and changes in fund balances at the fund level. All annual appropriations lapse at fiscal year end.

The budget document presents information by fund and function. The legal level of budgetary control adopted by the governing body (i.e., the level at which expenditures may not legally exceed appropriations) is the function level. State law requires the School District to have its budget in place by July 1. Expenditures in excess of amounts budgeted are a violation of Michigan law. State law permits districts to amend their budgets during the year. During the year, the budget was amended in a legally permissible manner.

Encumbrance accounting is employed in governmental funds. Amounts encumbered for purchase orders, contracts, etc. are not tracked during the year. Budget appropriations are considered to be spent once the goods are delivered or the services rendered.

Excess of Expenditures Over Appropriations in Budgeted Funds - The School District did not have any significant expenditure budget variances.

Note 3 - Deposits and Investments

State statutes and the School District's investment policy authorize the School District to make deposits in the accounts of federally insured banks, credit unions, and savings and loan associations that have offices in Michigan. The School District is allowed to invest in U.S. Treasury or agency obligations, U.S. government repurchase agreements, bankers' acceptances, commercial paper rated prime at the time of purchase that matures not more than 270 days after the date of purchase, mutual funds, and investment pools that are composed of authorized investment vehicles. The School District's deposits are in accordance with statutory authority.

The School District has designated two banks for the deposit of its funds.

The investment policy adopted by the board in accordance with state statutes has authorized investments listed in the state statutory authority above.

The School District's cash and investments are subject to several types of risk, which are examined in more detail below:

Custodial Credit Risk of Bank Deposits - Custodial credit risk is the risk that in the event of a bank failure, the School District's deposits may not be returned to it. The School District does not have a deposit policy for custodial credit risk. At year end, the School District's deposit balance of \$6,675,605 had \$352,371 of bank deposits (certificates of deposit and checking and savings accounts) that were uninsured and uncollateralized. The School District believes that due to the dollar amounts of cash deposits and the limits of FDIC insurance, it is impractical to insure all deposits. As a result, the School District evaluates each financial institution with which it deposits funds and assesses the level of risk of each institution; only those institutions with an acceptable estimated risk level are used as depositories.

Custodial Credit Risk of Investments - Custodial credit risk is the risk that, in the event of the failure of the counterparty, the School District will not be able to recover the value of its investments or collateral securities that are in the possession of an outside party. The School District's investment policy does not address custodial credit risk. The School District has no investments subject to custodial credit risk as of June 30, 2017.

Interest Rate Risk - Interest rate risk is the risk that the value of investments will decrease as a result of a rise in interest rates. The School District's investment policy does not restrict investment maturities, other than commercial paper, which can only be purchased with a 270-day maturity.

Covert Public Schools

Notes to Financial Statements June 30, 2017

Note 3 - Deposits and Investments (Continued)

Credit Risk - State law limits investments in commercial paper to the top two ratings issued by nationally recognized statistical rating organizations. The School District's investment policy does not further limit its investment choices.

At year end, the maturities of investments and the credit quality ratings of debt securities (other than the U.S. government) are as follows:

<u>Investment</u>	<u>Fair Value</u>	<u>Maturities</u>	<u>Rating</u>	<u>Rating Organization</u>
Michigan Liquid Asset Fund - MAX Class	\$ 5,232	N/A	AAAm	S&P
Michigan Liquid Asset Fund - Cash Management	<u>850</u>	N/A	AAAm	S&P
Total investments	<u>\$ 6,082</u>			

Investment Restrictions - The Michigan Liquid Asset Fund - MAX Class investment may not be redeemed for at least 14 calendar days with the exception of direct investments of funds distributed by the State of Michigan. In addition, redemptions made prior to the 14-day period are subject to a penalty equal to 15 days' interest on the amount so redeemed. The Michigan Liquid Asset Fund - Cash Management investment has no limitations or restrictions on participant withdrawals except for a one-day minimum investment period.

Concentration of Credit Risk - The School District has placed a \$300,000 limit on the amount the School District may invest in any one issuer, with the exception of United States obligations, money market funds, or authorized investment pools. The School District's funds are in accordance with statutory authority.

Foreign Currency Risk - Foreign currency risk is the risk that an investment denominated in the currency of a foreign country could reduce its U.S. dollar value as a result of changes in foreign currency exchange rates. State law and the School District's policy prohibit investment in foreign currency.

Covert Public Schools

Notes to Financial Statements June 30, 2017

Note 4 - Receivables and Unavailable/Unearned Revenue

Receivables as of year end for the School District's individual major funds, the nonmajor funds, and the fiduciary funds in the aggregate, including the applicable allowances for uncollectible accounts, are as follows:

	General Fund	Activity Fund	Nonmajor Funds	Total
Receivables:				
Accounts receivable	\$ 19,436	\$ 50	\$ 117	\$ 19,603
Intergovernmental	340,833	-	10,621	351,454
Total receivables	<u>\$ 360,269</u>	<u>\$ 50</u>	<u>\$ 10,738</u>	<u>\$ 371,057</u>

Governmental funds report unavailable revenue in connection with receivables for revenue that is not considered to be available to liquidate liabilities of the current period. Governmental funds also report unearned revenue recognition in connection with resources that have been received but not yet earned. At the end of the current fiscal year, the School District had no unearned or unavailable revenue.

Note 5 - Capital Assets

Capital asset activity of the School District's governmental activities was as follows:

Governmental Activities	Balance July 1, 2016	Additions/ Transfers	Disposals/ Transfers	Balance June 30, 2017
Capital assets not being depreciated - Land	\$ 40,000	\$ -	\$ -	\$ 40,000
Capital assets being depreciated:				
Buildings and improvements	22,195,261	591,962	-	22,787,223
Furniture and equipment	841,811	9,865	-	851,676
Buses and other vehicles	677,928	85,701	(96,154)	667,475
Subtotal	23,715,000	687,528	(96,154)	24,306,374
Accumulated depreciation:				
Building and improvements	9,746,638	397,760	-	10,144,398
Furniture and equipment	689,092	26,104	-	715,196
Buses and other vehicles	677,928	1,785	(96,154)	583,559
Subtotal	11,113,658	425,649	(96,154)	11,443,153
Net capital assets being depreciated	12,601,342	261,879	-	12,863,221
Net capital assets	<u>\$ 12,641,342</u>	<u>\$ 261,879</u>	<u>\$ -</u>	<u>\$ 12,903,221</u>

Depreciation expense was not charged to activities as the School District considers its assets to impact multiple activities and allocation is not practical.

Covert Public Schools

Notes to Financial Statements June 30, 2017

Note 6 - Interfund Receivables, Payables, and Transfers

The composition of interfund balances is as follows:

Receivable Fund	Payable Fund	Amount
General Fund	Food Services Fund	\$ 15,438
General Fund	Student Activities Fund	4,594
	Total	<u>\$ 20,032</u>

These balances result from the time lag between the dates that goods and services are provided or reimbursable expenditures occur, transactions are recorded in the accounting system, and payments between funds are made.

Transfer in Fund	Transfer Out Fund	Amount
Food Service Fund	General Fund	<u>\$ 92,000</u>

The transfer to the Food Services Fund was provided by the General Fund for funding for the 2016-2017 school year.

Note 7 - Long-term Debt

The School District issues bonds and other contractual commitments to provide for the acquisition and construction of major capital facilities and the acquisition of certain equipment. General obligation bonds are direct obligations and pledge the full faith and credit of the School District. Other long-term obligations include compensated absences.

Long-term debt activity can be summarized as follows:

Governmental Activities	Beginning Balance	Additions	Reductions	Ending Balance	Due Within One Year
Bonds	\$ 8,702,583	\$ -	\$ 485,155	\$ 8,217,428	\$ 503,678
Issuance discounts	(113,207)	-	(6,725)	(106,482)	(6,725)
Total bonds payable	8,589,376	-	478,430	8,110,946	496,953
Employee compensated absences	102,217	-	22,321	79,896	15,838
Total governmental activities	<u>\$ 8,691,593</u>	<u>\$ -</u>	<u>\$ 500,751</u>	<u>\$ 8,190,842</u>	<u>\$ 512,791</u>

Covert Public Schools

Notes to Financial Statements June 30, 2017

Note 7 - Long-term Debt (Continued)

Years Ending June 30	Principal	Interest	Total
2018	\$ 503,678	\$ 344,482	\$ 848,160
2019	517,271	329,040	846,311
2020	531,937	313,000	844,937
2021	551,675	296,316	847,991
2022	566,489	278,757	845,246
2023-2027	2,311,378	1,110,818	3,422,196
2028-2032	2,635,000	556,040	3,191,040
2033	600,000	30,000	630,000
Total	<u>\$ 8,217,428</u>	<u>\$ 3,258,453</u>	<u>\$ 11,475,881</u>

Governmental Activities

General obligation bonds consist of the following:

Building and Site Bond is due in annual installments of \$155,000 to \$600,000 through May 1, 2033; interest of 4.10 percent to 5.00 percent	\$ 5,985,000
2007 QZAB is due in annual installments of \$179,678 to \$198,378 through November 30, 2023; interest of 2.00 percent	1,133,428
2008 QZAB is due in annual installments of \$169,000 to \$198,000 through April 8, 2023; interest of 3.25 percent	<u>1,099,000</u>
Total bonded debt	<u>\$ 8,217,428</u>

Note 8 - Restricted Assets

The School District has restricted assets of \$602,371 related to a joint escrow account with the School District's largest taxpayer related to 2011 property taxes that were under appeal. The joint escrow account was to be held until the appeal had been settled. The property tax appeal was settled during March 2016, although the School District has not been instructed to refund the amount to the taxpayer. The School District has recorded a property tax payable for \$602,371 as of June 30, 2017.

Covert Public Schools

Notes to Financial Statements June 30, 2017

Note 9 - Risk Management

The School District is exposed to various risks of loss related to property loss, torts, errors and omissions, and employee injuries (workers' compensation), as well as medical benefits provided to employees. The School District has purchased commercial insurance for medical benefits claims and participates in the SET-SEG shared-risk pool for property loss, torts, errors and omissions, and employee injuries (workers' compensation), as well as some medical benefits provided to some employees. Settled claims relating to the commercial insurance have not exceeded the amount of insurance coverage in any of the past three fiscal years. The School District is only self-funded for dental claims that have been incurred through the end of the fiscal year, including both claims that have been reported as well as those that have not yet been reported but incurred. The obligation is not material to the financial statements.

The shared-risk pool program in which the School District participates operates as a common risk-sharing management program for school districts in Michigan; member premiums are used to purchase commercial excess insurance coverage and to pay member claims in excess of deductible amounts. The pool does not maintain separate funds for members and consequently the School District's share of the total assets and total equity is unknown. Audited financial statements of the fund are available.

Note 10 - Michigan Public School Employees' Retirement System

Plan Description - The School District participates in the Michigan Public School Employees' Retirement System (MPSERS or the "System"), a statewide, cost-sharing, multiple-employer defined benefit public employee retirement system governed by the State of Michigan that covers substantially all employees of the School District. Certain school district employees also receive defined contribution retirement and healthcare benefits through the System. The System provides retirement, survivor, and disability benefits to plan members and their beneficiaries. The System also provides postemployment healthcare benefits to retirees and beneficiaries who elect to receive those benefits.

The Michigan Public School Employees' Retirement System issues a publicly available financial report that includes financial statements and required supplemental information for the pension and postemployment healthcare plans. That report is available on the web at <http://www.michigan.gov/orsschools>, or by writing to the Office of Retirement System (ORS) at 7150 Harris Drive, P.O. Box 30171, Lansing, MI 48909.

Covert Public Schools

Notes to Financial Statements June 30, 2017

Note 10 - Michigan Public School Employees' Retirement System (Continued)

Contributions - Public Act 300 of 1980, as amended, required the School District to contribute amounts necessary to finance the coverage of pension benefits of active and retired members. Contribution provisions are specified by state statute and may be amended only by action of the state legislature. Under these provisions, each school district's contribution is expected to finance the costs of benefits earned by employees during the year, with an additional amount to finance a portion of the unfunded accrued liability.

The School District's contributions are determined based on employee elections. There are seven different benefit options included in the plan available to employees based on date of hire. Contribution rates are adjusted annually by the ORS.

The range of rates is as follows:

School District

October 1, 2015 - September 30, 2016	14.56% - 18.95%
October 1, 2016 - June 30, 2017	15.27% - 19.03%

Depending on the plan selected, plan member contributions range from 0 percent up to 7.0 percent of gross wages. Plan members electing into the defined contribution plan are not required to make additional contributions.

The School District's required and actual contributions to the plan for the year ended June 30, 2017 were \$765,051, which includes the School District's contributions required for those members with a defined contribution benefit. Contributions include \$228,868 of revenue received from the State of Michigan, and remitted to the System, to fund the MPSERS Unfunded Actuarial Accrued Liability (UAAL) Stabilization Rate for the year ended June 30, 2017.

Benefits Provided - Benefit provisions of the defined benefit pension plan are established by state statute, which may be amended. Public Act 300 of 1980, as amended, establishes eligibility and benefit provisions for the defined benefit (DB) pension plan.

Depending on the plan option selected, member retirement benefits are calculated as final average compensation times years of service times a pension factor ranging from 1.25 percent to 1.50 percent. The requirements to retire range from attaining the age of 46 to 60 with years of service ranging from 5 to 30 years, depending on when the employee became a member. Early retirement is computed in the same manner as a regular pension, but is permanently reduced 0.50 percent for each full and partial month between the pension effective date and the date the member will attain age 60. There is no mandatory retirement age.

Note 10 - Michigan Public School Employees' Retirement System (Continued)

Members are eligible for nonduty disability benefits after 10 years of service and for duty-related disability benefits upon hire. Disability retirement benefits are determined in the same manner as retirement benefits but are payable immediately without an actuarial reduction. The disability benefits plus authorized outside earnings are limited to 100 percent of the participant's final average compensation with an increase of 2 percent each year thereafter.

Benefits may transfer to a beneficiary upon death and are determined in the same manner as retirement benefits, but with an actuarial reduction.

Benefit terms provide for annual cost-of-living adjustments to each employee's retirement allowance subsequent to the employee's retirement date. The annual adjustment, if applicable, is 3 percent. For some members who do not receive an annual increase, they are eligible to receive a supplemental payment in those years when investment earnings exceed actuarial assumptions.

Net Pension Liability, Deferrals, and Pension Expense - The School District reported a liability of \$7,382,198 for its proportionate share of the net pension liability at June 30, 2017. The net pension liability was measured as of September 30, 2016 and the total pension liability used to calculate the net pension liability was determined by an actuarial valuation as of September 30, 2015, which used updated procedures to roll forward the estimated liability to September 30, 2016. The School District's proportion of the net pension liability was based on a projection of its long-term share of contributions to the pension plan relative to the projected contributions of all participating reporting units, actuarially determined. At September 30, 2016, the School District's proportion was 0.029589 percent, an increase of 0.000048 percent from its proportion measured as of September 30, 2015.

Covert Public Schools

Notes to Financial Statements June 30, 2017

Note 10 - Michigan Public School Employees' Retirement System (Continued)

For the year ended June 30, 2017, the School District recognized pension expense of \$684,488, inclusive of payments to fund the MPSERS UAAL Stabilization Rate. At June 30, 2017, the School District reported deferred outflows of resources and deferred inflows of resources related to pensions from the following sources:

	Deferred Outflows of Resources Subsequent to Measurement Date	Net Deferred Inflows of Resources as of the Measurement Date
	<u> </u>	<u> </u>
Difference between expected and actual experience	\$ 92,002	\$ (17,496)
Changes of assumptions	115,415	-
Net difference between projected and actual earnings on pension plan assets	122,692	-
Changes in proportion and differences between the School District's contributions and proportionate share of contributions	9,865	(60,647)
The School District's contributions subsequent to the measurement date	<u>642,228</u>	<u>-</u>
Total	<u>\$ 982,202</u>	<u>\$ (78,143)</u>

Amounts reported as deferred outflows of resources and deferred inflows of resources related to pensions will be recognized in pension expense as follows:

Years Ending <u>June 30</u>	<u>Amount</u>
2018	\$ 39,006
2019	29,287
2020	164,030
2021	<u>29,508</u>
Total	<u>\$ 261,831</u>

In addition, the contributions subsequent to the measurement date will be included as a reduction of the net pension liability in the next year.

Covert Public Schools

Notes to Financial Statements June 30, 2017

Note 10 - Michigan Public School Employees' Retirement System (Continued)

Actuarial Assumptions - The total pension liability as of September 30, 2016 is based on the results of an actuarial valuation date of September 30, 2015 and rolled forward:

Actuarial cost method	Entry age normal cost actuarial cost method
Assumed rate of return	7.00 - 8.00 percent, net of investment and administrative expenses based on the groups
Rate of pay increases	3.50 - 12.30 percent, including wage inflation of 3.50 percent
Mortality basis	RP-2000 Combined Healthy Mortality Table, adjusted for mortality improvements to 2025 using projection scale BB
Cost-of-living pension adjustments	3.00 percent noncompounded for MIP members.

Discount Rate - The discount rate used to measure the total pension liability was 7.00 - 8.00 percent depending on the plan option. The projection of cash flows used to determine the discount rate assumed that employee contributions will be made at the current contribution rate and that employer contributions will be made at contractually required rates. Based on those assumptions, the pension plan's fiduciary net position was projected to be available to make all projected future benefit payments for current active and inactive employees. Therefore, the long-term expected rate of return on pension plan investments was applied to all periods of projected benefit payments to determine the total pension liability.

Covert Public Schools

Notes to Financial Statements June 30, 2017

Note 10 - Michigan Public School Employees' Retirement System (Continued)

The long-term expected rate of return on pension plan investments was determined using a building-block method in which best-estimate ranges of expected future real rates of return (expected returns, net of pension plan investment expense, and inflation) are developed for each major asset class. These ranges are combined to produce the long-term expected rate of return by weighting the expected future real rates of return by the target asset allocation percentage and by adding expected inflation. The target allocation and best estimates of arithmetic real rates of return for each major asset class are summarized in the following table:

Investment Category	Target Allocation	Long-term Expected Real Rate of Return
Domestic equity pools	28 %	5.9 %
Alternative investment pools	18	9.2
International equity pools	16	7.2
Fixed-income pools	10	0.9
Real estate and infrastructure pools	10	4.3
Absolute return pools	16	6.0
Short-term investment pools	2	-
Total	100 %	

On February 23, 2017, MPSERS approved a decrease in the discount rate for the September 30, 2016 annual actuarial valuation of 0.5 percent. As a result, the actuarial computed employer contributions and the net pension liability will increase for the measurement period ending September 30, 2017.

Sensitivity of the Net Pension Liability to Changes in the Discount Rate - The following presents the net pension liability of the School District calculated using the discount rate of 7.0 to 8.0 percent, depending on the plan option. The following also reflects what the School District's net pension liability would be if it were calculated using a discount rate that is 1.00 percentage point lower (6.0 - 7.0 percent) or 1.00 percentage point higher (8.0 - 9.0 percent) than the current rate:

1.00 Percent Decrease (6.0 - 7.0 Percent)	Current Discount Rate (7.0 - 8.0 Percent)	1.00 Percent Increase (8.0 - 9.0 Percent)
\$9,506,413	\$7,382,198	\$5,591,281

Pension Plan Fiduciary Net Position - Detailed information about the pension plan's fiduciary net position is available in the separately issued MPSERS financial report.

Note 10 - Michigan Public School Employees' Retirement System (Continued)

Payable to the Pension Plan - At June 30, 2017, the School District reported a payable of \$89,830 for the outstanding amount of contributions to the pension plan required for the year ended June 30, 2017, consisting of pension contribution payable plus any other amounts owed to the pension plan including the UAAL payments for July and August 2017.

Postemployment Benefits Other Than Pensions (OPEB) - Under the MPSERS act, all retirees participating in the MPSERS pension plan have the option of continuing health, dental, and vision coverage through MPSERS. Retirees electing this coverage contribute an amount equivalent to the monthly cost for Part B Medicare and 10 percent, or 20 percent for those not Medicare eligible, of the monthly premium amount for the health, dental, and vision coverage at the time of receiving the benefits. The MPSERS board of trustees annually sets the employer contribution rate to fund the benefits on a pay-as-you-go basis. Participating employers are required to contribute at that rate. The employer contribution rate ranged from 6.40 percent to 6.83 percent of covered payroll for the period from July 1, 2016 through September 30, 2016, and from 5.69 percent to 5.91 percent of covered payroll from October 1, 2016 through June 30, 2017 dependent upon the employee's date of hire and plan election as noted above. Members can choose to contribute 3 percent of their covered payroll to the Retiree Healthcare Fund and keep this premium subsidy benefit or they can elect not to pay the 3 percent contribution and instead choose the Personal Healthcare Fund, which can be used to pay healthcare expenses in retirement. Members electing the Personal Healthcare Fund will be automatically enrolled in a 2 percent employee contribution into their 457 account as of their transition date and create a 2 percent employer match into the employee's 403(b) account.

The School District's required and actual contributions to the plan for retiree healthcare benefits for the years ended June 30, 2017, 2016, and 2015 were \$168,787, \$143,314, and \$87,047, respectively. In addition, a portion ranging from 35 - 100 percent of the MPSERS Unfunded Actuarial Accrued Liability (UAAL) Stabilization Rate is considered a contribution to the retiree healthcare plan.

Note 11 - Upcoming Accounting Pronouncements

In June 2015, the Governmental Accounting Standards Board issued GASB Statement No. 75, *Accounting and Financial Reporting for Postemployment Benefits Other Than Pensions*, which addresses reporting by governments that provide postemployment benefits other than pensions (OPEB) to their employees and for governments that finance OPEB for employees of other governments. This OPEB standard will require the District to recognize on the face of the financial statements its proportionate share of the net OPEB liability related to its participation in the MPSERS plan. The statement also enhances accountability and transparency through revised note disclosures and required supplemental information (RSI). The School District is currently evaluating the impact this standard will have on the financial statements when adopted. The provisions of this statement are effective for the School District's financial statements for the year ending June 30, 2018.

In January 2017, the Governmental Accounting Standards Board issued GASB Statement No. 84, *Fiduciary Activities*, which establishes criteria for identifying fiduciary activities of all state and local governments. An activity meeting the criteria should be reported in a fiduciary fund in the basic financial statements. The School District is currently evaluating the impact this standard will have on the financial statements when adopted. The provisions of this statement are effective for the School District's financial statements for the year ending June 30, 2020.

Required Supplemental Information

Covert Public Schools

Required Supplemental Information Budgetary Comparison Schedule - General Fund Year Ended June 30, 2017

	<u>Original Budget</u>	<u>Final Budget</u>	<u>Actual</u>	<u>Over (Under) Final Budget</u>
Revenue				
Local sources	\$ 6,485,491	\$ 7,653,578	\$ 7,719,591	\$ 66,013
State sources	379,000	582,389	588,565	6,176
Federal sources	553,150	637,391	565,816	(71,575)
Total revenue	7,417,641	8,873,358	8,873,972	614
Expenditures				
Current:				
Instruction:				
Basic program	1,838,441	1,983,915	1,899,645	(84,270)
Added needs	728,916	770,199	730,303	(39,896)
Support services:				
Pupil	241,075	312,209	312,197	(12)
Instructional staff	227,159	274,213	230,908	(43,305)
General administration	711,346	986,071	685,579	(300,492)
School administration	397,501	413,733	413,724	(9)
Business services	85,885	76,200	46,710	(29,490)
Operations and maintenance	1,156,070	1,654,803	1,417,492	(237,311)
Pupil transportation services	560,883	546,174	498,549	(47,625)
Technology	208,350	179,452	130,292	(49,160)
Athletics	92,186	111,029	105,665	(5,364)
Community services	123,929	102,078	94,209	(7,869)
Debt service	844,024	844,122	844,121	(1)
Total expenditures	7,215,765	8,254,198	7,409,394	(844,804)
Transfers Out	(70,000)	(106,000)	(92,000)	14,000
Net Change in Fund Balance	131,876	513,160	1,372,578	859,418
Fund Balance - Beginning of year	4,383,422	4,383,422	4,383,422	-
Fund Balance - End of year	<u>\$ 4,515,298</u>	<u>\$ 4,896,582</u>	<u>\$ 5,756,000</u>	<u>\$ 859,418</u>

Covert Public Schools

Required Supplemental Information Schedule of Covert Public Schools' Proportionate Share of the Net Pension Liability Michigan Public School Employees' Retirement System Determined as of the Plan Year Ended September 30

	2016	2015	2014
School District's proportion of the net pension liability	0.02959 %	0.02954 %	0.02993 %
School District's proportionate share of the net pension liability	\$ 7,382,198	\$ 7,215,314	\$ 6,593,125
School District's covered employee payroll	2,509,798	2,452,581	2,555,692
School District's proportionate share of the net pension liability as a percentage of its covered employee payroll	294 %	294.19 %	257.98 %
Plan fiduciary net position as a percentage of the total pension liability	63.01000 %	62.92000 %	66.20000 %

Covert Public Schools

Required Supplemental Information Schedule of Covert Public Schools' Contributions Michigan Public School Employees' Retirement System Determined as of the Year Ended June 30

	<u>2017</u>	<u>2016</u>	<u>2015</u>
Statutorily required contribution	\$ 756,643	\$ 685,512	\$ 464,872
Contributions in relation to the statutorily required contribution	756,643	685,512	464,872
Contribution deficiency (excess)	-	-	-
School District's covered employee payroll	2,811,243	2,470,926	2,469,969
Contributions as a percentage of covered employee payroll	26.91 %	27.74 %	18.82 %

Covert Public Schools

Note to Pension Required Supplemental Information Schedules Year Ended June 30, 2017

Benefit Changes - There were no changes of benefit terms for the plan year ended September 30, 2016.

Changes in Assumptions - There were no changes of benefit assumptions for the plan year ended September 30, 2016.

Other Supplemental Information

Covert Public Schools

Other Supplemental Information Combining Balance Sheet Nonmajor Governmental Funds June 30, 2017

	Special Revenue Funds		
	Bookstore Fund	Food Services Fund	Total Nonmajor Governmental Funds
Assets			
Cash and investments	\$ 12,091	\$ 6,879	\$ 18,970
Receivables	-	10,738	10,738
Inventories	-	9,625	9,625
Prepaid costs and other assets	-	990	990
	\$ 12,091	\$ 28,232	\$ 40,323
Liabilities and Fund Balances			
Liabilities			
Accounts payable	\$ -	\$ 1,995	\$ 1,995
Accrued payroll-related liabilities	-	2,296	2,296
Due to other governmental units	-	1,147	1,147
Due to other funds	-	15,438	15,438
	-	20,876	20,876
Fund Balances			
Nonspendable - Inventory/Prepaid	-	10,615	10,615
Committed - Bookstore	12,091	-	12,091
Unassigned	-	(3,259)	(3,259)
	12,091	7,356	19,447
Total fund balances	12,091	7,356	19,447
Total liabilities and fund balances	\$ 12,091	\$ 28,232	\$ 40,323

Covert Public Schools

Other Supplemental Information Combining Statement of Revenue, Expenditures, and Changes in Fund Balances Nonmajor Governmental Funds Year Ended June 30, 2017

	Special Revenue Funds		Total Nonmajor Governmental Funds
	Bookstore Fund	Food Services Fund	
Revenue			
Local sources	\$ 12	\$ 3,979	\$ 3,991
State sources	-	11,893	11,893
Federal sources	-	259,828	259,828
Total revenue	12	275,700	275,712
Expenditures - Current			
Food services	-	365,250	365,250
Capital outlay	-	845	845
Total expenditures	-	366,095	366,095
Excess of Revenue Over (Under) Expenditures	12	(90,395)	(90,383)
Other Financing Sources - Transfers in	-	92,000	92,000
Net Change in Fund Balances	12	1,605	1,617
Fund Balances - Beginning of year	12,079	5,751	17,830
Fund Balances - End of year	<u>\$ 12,091</u>	<u>\$ 7,356</u>	<u>\$ 19,447</u>

Covert Public Schools

Other Supplemental Information Schedule of Bonded Indebtedness Year Ended June 30, 2017

June 30	2007 QZAB Principal	2008 QZAB Principal	Building and Site Bond Principal
2018	\$ 179,678	\$ 169,000	\$ 155,000
2019	183,271	174,000	160,000
2020	186,937	180,000	165,000
2021	190,675	186,000	175,000
2022	194,489	192,000	180,000
2023	198,378	198,000	190,000
2024	-	-	405,000
2025	-	-	420,000
2026	-	-	440,000
2027	-	-	460,000
2028	-	-	480,000
2029	-	-	505,000
2030	-	-	525,000
2031	-	-	550,000
2032	-	-	575,000
2033	-	-	600,000
Total principal	<u>\$ 1,133,428</u>	<u>\$ 1,099,000</u>	<u>\$ 5,985,000</u>
Principal payments due	November 30	April 8	May 1
Interest payments due	November 30	April 8	May 1 and November 1
Interest rate	2.00%	3.25%	4.10% to 5.00%
Original issue	<u>\$ 2,600,000</u>	<u>\$ 2,400,000</u>	<u>\$ 7,070,000</u>