

Management Report  
for  
City of Mounds View, Minnesota  
December 31, 2017

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To the City Council and Management  
City of Mounds View, Minnesota

We have prepared this management report in conjunction with our audit of the City of Mounds View, Minnesota's (the City) financial statements for the year ended December 31, 2017. We have organized this report into the following sections:

- Audit Summary
- Governmental Funds Overview
- Enterprise Funds Overview
- Government-Wide Financial Statements
- Legislative Updates
- Accounting and Auditing Updates

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

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

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

Minneapolis, Minnesota  
March 28, 2018

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## AUDIT SUMMARY

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

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

We have audited the financial statements of the governmental activities, the business-type activities, each major fund, and the aggregate remaining fund information of the City as of and for the year ended December 31, 2017, and the related notes to the financial statements. Professional standards require that we provide you with information about our responsibilities under auditing standards generally accepted in the United States of America and *Government Auditing Standards*, as well as certain information related to the planned scope and timing of our audit. We have communicated such information to you verbally and in our audit engagement letter. Professional standards also require that we communicate the following information related to our audit.

### **PLANNED SCOPE AND TIMING OF THE AUDIT**

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

### **AUDIT OPINION AND FINDINGS**

Based on our audit of the City's financial statements for the year ended December 31, 2017:

- We have issued an unmodified opinion on the City's basic financial statements.
- We reported one matter involving the City's internal control over financial reporting that we consider to be a material weakness. Due to the limited size of the City's office staff, the City has limited segregation of duties in certain areas.
- The results of our testing disclosed no instances of noncompliance that are required to be reported under *Government Auditing Standards*.
- We reported no findings based on our testing of the City's compliance with Minnesota laws and regulations.

### **SIGNIFICANT ACCOUNTING POLICIES**

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

No new accounting policies were adopted and the application of existing policies was not changed during the year ended December 31, 2017, however, the City implemented the following governmental accounting standards during the fiscal year:

- Governmental Accounting Standards Board (GASB) Statement No. 79, *Certain External Investment Pools and Pool Participants*, which enhanced disclosures regarding investments.
- GASB Statement No. 82, *Pension Issues, an amendment of GASB Statements No. 67, No. 68, and No. 73*, which addressed certain issues related to pension reporting and disclosures.

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

#### **ACCOUNTING ESTIMATES AND MANAGEMENT JUDGMENTS**

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

- **Depreciation** – Management's estimates of depreciation expense are based on the estimated useful lives of the assets.
- **Pension Benefits** – The City has recorded liabilities and activity for pension benefits. Actuarial estimates of the net pension liabilities are calculated using actuarial methodologies described in GASB Statement No. 68. The actuarial calculations include significant assumptions, including projected changes, investment returns, retirement ages, proportionate share, and employee turnover.
- **Value of Land Held for Resale** – These assets are stated at the lower of cost or fair market value based on management's estimates.
- **Compensated Absences** – Management's estimate is based on current rates of pay and unused compensated absence balances.

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

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

#### **DIFFICULTIES ENCOUNTERED IN PERFORMING THE AUDIT**

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

#### **CORRECTED AND UNCORRECTED MISSTATEMENTS**

Professional standards require us to accumulate all known and likely misstatements identified during the audit, other than those that are clearly trivial, and communicate them to the appropriate level of management. Where applicable, management has corrected all such misstatements. In addition, none of the misstatements detected as a result of audit procedures and corrected by management, when applicable, were material, either individually or in the aggregate, to each opinion unit's financial statements taken as a whole.

#### **DISAGREEMENTS WITH MANAGEMENT**

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

## **MANAGEMENT REPRESENTATIONS**

We have requested certain representations from management that are included in the management representation letter dated March 28, 2018.

## **MANAGEMENT CONSULTATIONS WITH OTHER INDEPENDENT ACCOUNTANTS**

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

## **OTHER AUDIT FINDINGS OR ISSUES**

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

## **OTHER MATTERS**

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

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

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

## GOVERNMENTAL FUNDS OVERVIEW

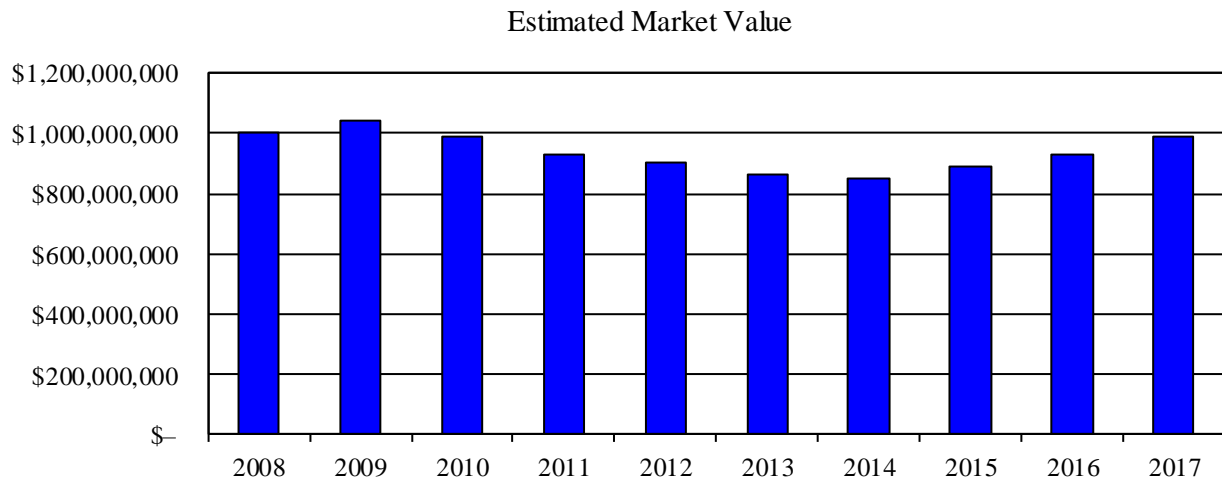
This section of the report provides you with an overview of the financial trends and activities of the City's governmental funds, which includes the General, special revenue, debt service, and capital project funds. These funds are used to account for the basic services the City provides to all of its citizens, which are financed primarily with property taxes. The governmental fund information in the City's financial statements focuses on budgetary compliance, and the sufficiency of each governmental fund's current assets to finance its current liabilities.

### PROPERTY TAXES

Minnesota cities rely heavily on local property tax levies to support their governmental fund activities. For the 2016 fiscal year, local ad valorem property tax levies provided 39.8 percent of the total governmental fund revenues for cities over 2,500 in population, and 36.4 percent for cities under 2,500 in population.

The total market value of property in Minnesota cities increased about 5.6 percent for the 2017 levy year, which followed an increase of 5.7 percent for the levy year 2016. The market values used for levying property taxes are based on the previous fiscal year (e.g., market values for taxes levied in 2017 were based on assessed values as of January 1, 2016), so the trend of change in these market values lags somewhat behind the housing market and economy in general.

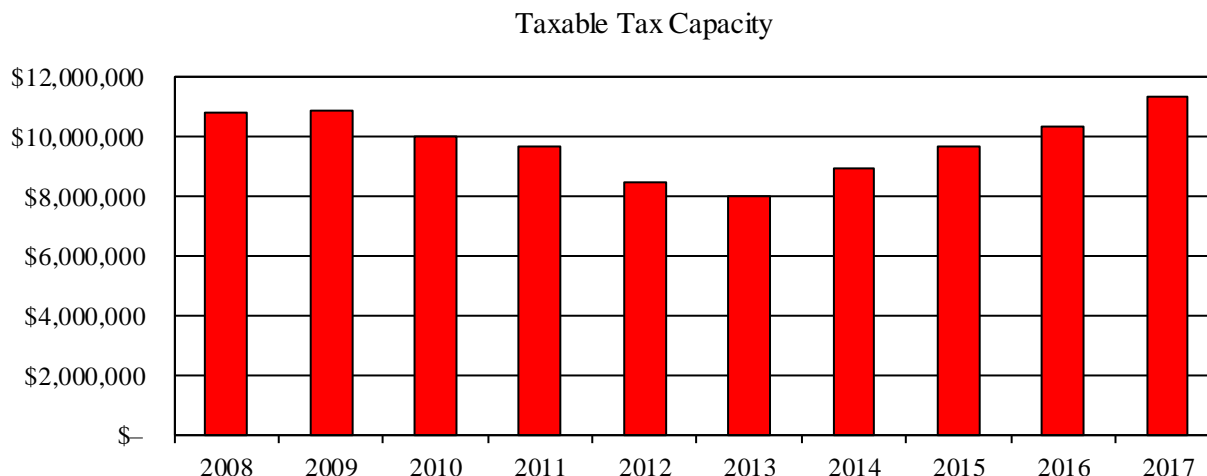
The City's taxable market value increased 4.3 percent for taxes payable in 2016 and increased 6.7 percent for taxes payable in 2017. The following graph shows the City's changes in taxable market value over the past 10 years:





Tax capacity is considered the actual base available for taxation. It is calculated by applying the state's property classification system to each property's market value. Each property classification, such as commercial or residential, has a different calculation and uses different rates. Consequently, a city's total tax capacity will change at a different rate than its total market value, as tax capacity is affected by the proportion of the City's tax base that is in each property classification from year-to-year, as well as legislative changes to tax rates. The City's tax capacity increased 7.1 percent for 2016 and increased 10.0 percent for 2017.

The following graph shows the City's change in tax capacities over the past 10 years:



The following table presents the average tax rates applied to city residents for each of the last three levy years, along with comparative state-wide and metro area average rates from the two most recent years for which the information is available:

Rates expressed as a percentage of net tax capacity							
	All Cities State-Wide		Seven-County Metro Area		City of Mounds View		
	2015	2016	2015	2016	2015	2016	2017
Average tax rate							
City	46.9	46.5	43.4	43.0	42.9	40.1	38.0
County	44.7	44.1	42.9	42.3	58.9	58.9	55.8
School	27.1	27.5	28.3	28.6	27.4	26.3	25.3
Special taxing	6.9	6.9	8.8	8.7	10.9	10.7	9.0
Total	<u>125.6</u>	<u>125.0</u>	<u>123.4</u>	<u>122.6</u>	<u>140.1</u>	<u>136.0</u>	<u>128.1</u>

Note: State-wide and metro area average tax rates are not available for 2017.

There are a number of factors contributing to the City's higher than average total tax rate. As presented in the table above, the City portion is below both averages provided. The general decrease in current year rates also reflects the increase in taxable tax capacity discussed earlier.

## GOVERNMENTAL FUND BALANCES

The following table summarizes the changes in the fund balances of the City's governmental funds during the year ended December 31, 2017, presented both by fund balance classification and by fund:

<b>Governmental Funds Change in Fund Balance</b>			
	Fund Balance as of December 31,		Increase (Decrease)
	<u>2017</u>	<u>2016</u>	
<b>Fund balances of governmental funds</b>			
Total by classification			
Restricted	\$ 3,147,858	\$ 2,965,913	\$ 181,945
Assigned	10,796,442	11,147,939	(351,497)
Unassigned	<u>3,710,891</u>	<u>3,538,754</u>	<u>172,137</u>
Total – governmental funds	<u>\$ 17,655,191</u>	<u>\$ 17,652,606</u>	<u>\$ 2,585</u>
Total by fund			
General	\$ 9,476,539	\$ 9,445,463	\$ 31,076
TIF District No. 5 Special Revenue	830,026	792,770	37,256
Special Projects Capital Projects	1,758,629	1,044,359	714,270
Street Improvement Capital Projects	1,903,752	2,825,485	(921,733)
Nonmajor funds	<u>3,686,245</u>	<u>3,544,529</u>	<u>141,716</u>
Total – governmental funds	<u>\$ 17,655,191</u>	<u>\$ 17,652,606</u>	<u>\$ 2,585</u>

In total, the fund balances of the City's governmental funds increased by \$2,585. Restricted fund balance increased by \$181,945, primarily in amounts restricted for tax increment purposes. Assigned fund balances decreased \$351,111, primarily in amounts assigned for street reconstruction within the Street Improvement Capital Projects Fund. Favorable operations in the General Fund contributed to the unassigned fund balance increase of \$172,137.

## GOVERNMENTAL FUNDS REVENUE AND EXPENDITURES

The following table presents the per capita revenue of the City's governmental funds for the past three years, along with state-wide averages.

We have included the most recent comparative state-wide averages available from the Office of the State Auditor to provide a benchmark for interpreting the City's data. The amounts received from the typical major sources of governmental fund revenue will naturally vary between cities based on factors such as the City's stage of development, location, size and density of its population, property values, services it provides, and other attributes. It will also differ from year-to-year due to the effect of inflation and changes in its operation. Also, certain data in these tables may be classified differently than how they appear on the City's financial statements in order to be more comparable to the state-wide information, particularly in separating capital expenditures from current expenditures.

We have designed this section of our management report using per capita data in order to better identify unique or unusual trends and activities of the City. We intend for this type of comparative and trend information to complement, rather than duplicate, information in the management's discussion and analysis. An inherent difficulty in presenting per capita information is the accuracy of the population count, which for most years is based on estimates.

<b>Governmental Funds Revenue per Capita</b>						
With State-Wide Averages by Population Class						
Year	State-Wide			City of Mounds View		
	December 31, 2016			2015	2016	2017
Population	2,500-10,000	10,000-20,000	20,000-100,000	12,444	13,007	13,161
Property taxes	\$ 460	\$ 432	\$ 455	\$ 352	\$ 333	\$ 346
Tax increments	26	26	42	129	120	124
Franchise and other taxes	35	43	45	65	61	63
Special assessments	59	44	59	5	3	2
Licenses and permits	35	33	42	16	14	24
Intergovernmental revenues	313	275	152	114	125	115
Charges for services	110	92	103	23	23	24
Other	91	57	54	49	43	48
<b>Total revenue</b>	<b>\$ 1,129</b>	<b>\$ 1,002</b>	<b>\$ 952</b>	<b>\$ 753</b>	<b>\$ 722</b>	<b>\$ 746</b>

A city's stage of development, along with the way a city finances various capital projects, will impact the mix of revenue sources it receives.

The City's governmental fund revenues for 2017 were \$9,805,043, an increase of \$423,623 from the prior year. On a per capita basis, the City received \$746 in governmental fund revenue for 2017, an increase of \$24 from the prior year.

The City has historically generated much higher tax increment revenue than average because of the amount of redevelopment within the City. On a per capita basis, most revenue categories increased slightly over the prior year. The largest change in the table above occurred in property tax revenues, which increased \$13 per capita from the prior year, with an increase in the certified levy. Intergovernmental revenues decreased by \$10 per capita due to receiving more aid from the state in the prior year for street reconstruction and an infiltration grant from the Metropolitan Council.

The expenditures of governmental funds will also vary from state-wide averages and from year-to-year, based on the City’s circumstances. Expenditures are classified into three types as follows:

- **Current** – These are typically the general operating-type expenditures occurring on an annual basis, and are primarily funded by general sources such as taxes and intergovernmental revenues.
- **Capital Outlay and Construction** – These expenditures do not occur on a consistent basis, more typically fluctuating significantly from year-to-year. Many of these expenditures are project-oriented, and are often funded by specific sources that have benefited from the expenditure, such as special assessment improvement projects.
- **Debt Service** – Although the expenditures for debt service may be relatively consistent over the term of the respective debt, the funding source is the important factor. Some debt may be repaid through specific sources such as special assessments or redevelopment funding, while other debt may be repaid with general property taxes.

The City’s expenditures per capita of its governmental funds for the past three years, together with state-wide averages, are presented in the following table:

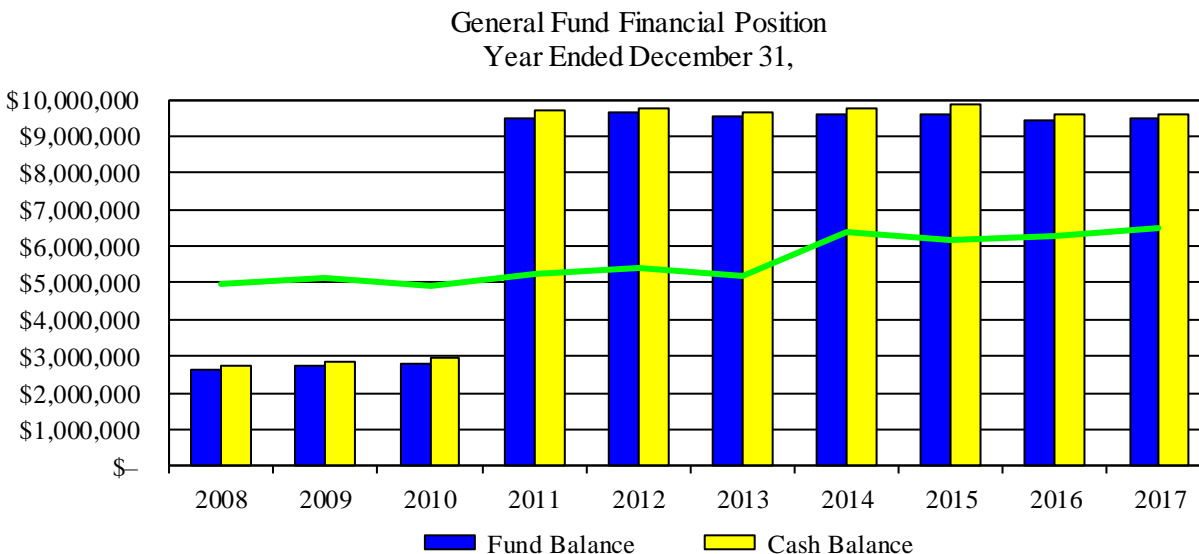
<b>Governmental Funds Expenditures per Capita</b> With State-Wide Averages by Population Class						
Year	State-Wide			City of Mounds View		
	December 31, 2016			2015	2016	2017
Population	2,500–10,000	10,000–20,000	20,000–100,000	12,444	13,007	13,161
<b>Current</b>						
General government	\$ 145	\$ 114	\$ 97	\$ 79	\$ 77	\$ 83
Public safety	263	250	273	249	241	246
Street maintenance and lighting	126	123	95	46	46	66
Culture and recreation	93	109	95	81	83	70
All other	74	77	91	153	149	158
Total current	<u>701</u>	<u>673</u>	<u>651</u>	<u>608</u>	<u>596</u>	<u>623</u>
Capital outlay and construction	381	370	301	424	365	588
<b>Debt service</b>						
Principal	196	163	115	31	14	11
Interest and fiscal	48	38	34	5	3	8
Total debt service	<u>244</u>	<u>201</u>	<u>149</u>	<u>36</u>	<u>17</u>	<u>19</u>
Total expenditures	<u>\$ 1,326</u>	<u>\$ 1,244</u>	<u>\$ 1,101</u>	<u>\$ 1,068</u>	<u>\$ 978</u>	<u>\$ 1,230</u>

Total expenditures in the City’s governmental funds for 2017 were \$16,194,668, an increase of \$3,467,501 from the prior year. On a per capita basis, the City expended a total of \$1,230 in 2017, an increase of \$252 from the previous year.

As the above table reflects, the City’s expenditures per capita have historically been below the state-wide average. The increase in expenditures was largely in capital outlay and construction. In the current year the City issued \$6,000,000 in general obligation bonds used to finance the construction of a new public works facility.

## GENERAL FUND

The City's General Fund accounts for the financial activity of the basic services provided to the community. The primary services included within this fund are the administration of the municipal operation, police and fire protection, building inspection, streets and highway maintenance, and culture and recreation. The graph below illustrates the change in the General Fund financial position over the last 10 years. We have also included a line representing annual revenues to reflect the change in the size of the General Fund operation over the same period.



The City's General Fund cash and investments balance at December 31, 2017 was \$9,625,929, an increase of \$33,497 from the previous year. Total fund balance at year-end was \$9,476,539, an increase of \$31,076 from the prior year, as compared to the final budget that projected a \$271,500 decrease in fund balance.

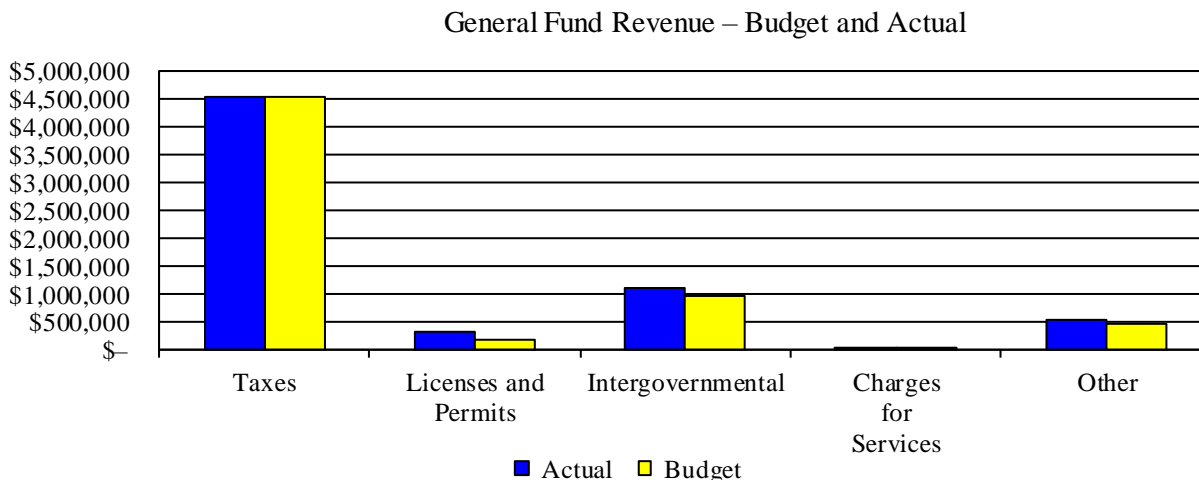
The significant change in fiscal 2011 in the General Fund cash and fund balance was the result of the City transferring the balance of the Levy Reduction Special Revenue Fund to the General Fund. The Levy Reduction Special Revenue Fund was closed with the City's implementation of the reporting requirements prescribed under GASB Statement No. 54. The resources that were previously reported in the Levy Reduction Special Revenue Fund have been assigned by the City Council to levy reduction within the General Fund.

As the graph illustrates, the City has generally been able to maintain healthy cash and fund balance levels as the volume of financial activity has fluctuated. This is an important factor because a government, like any organization, requires a certain amount of equity to operate. A healthy financial position allows the City to avoid volatility in tax rates; helps minimize the impact of state funding changes; allows for the adequate and consistent funding of services, repairs, and unexpected costs; and is a factor in determining the City's bond rating and resulting interest costs. Maintaining an adequate fund balance has become increasingly important given the fluctuations in state funding for cities in recent years.

A trend that is typical to Minnesota local governments, especially the General Fund of cities, is the unusual cash flow experienced throughout the year. The City's General Fund cash disbursements are made fairly evenly during the year other than the impact of seasonal services such as snowplowing, street maintenance, and park activities. Cash receipts of the General Fund are quite a different story. Property taxes comprise about 64 percent of the fund's total annual revenue. Approximately half of these revenues are received by the City in July and the rest in December. Consequently, the City needs to have adequate cash reserves to finance its everyday operations between these payments.

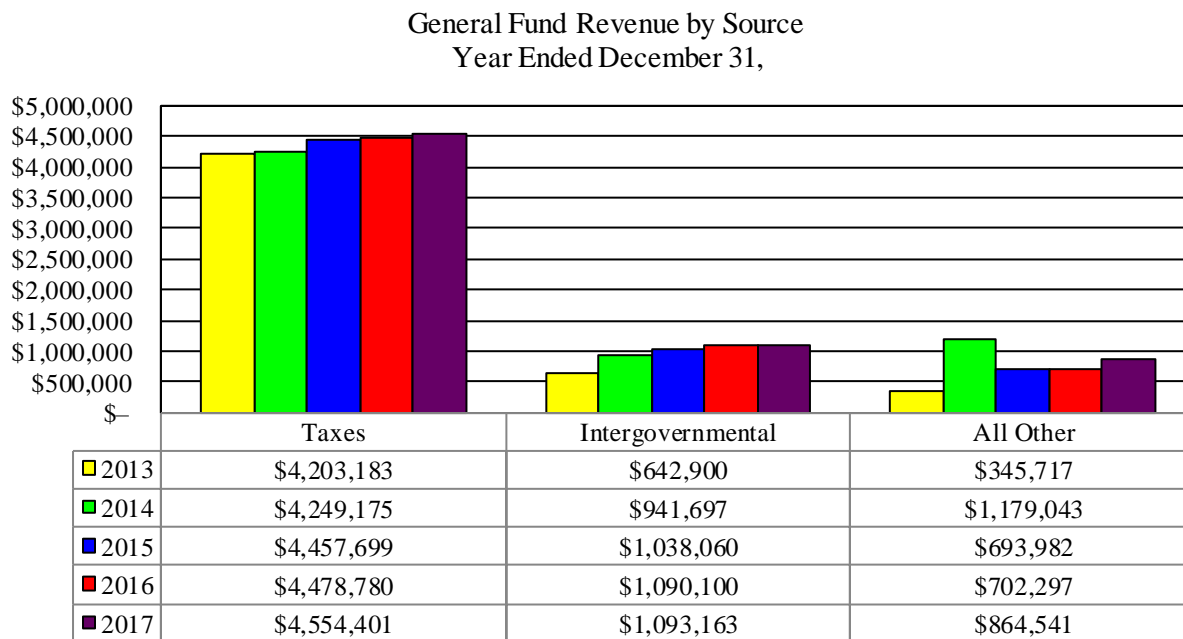
The City's unassigned General Fund balance at the end of the 2017 fiscal year represents approximately 62.0 percent of annual expenditures based on 2017 levels.

The following graph reflects the City’s General Fund revenue sources for 2017 compared to budget:



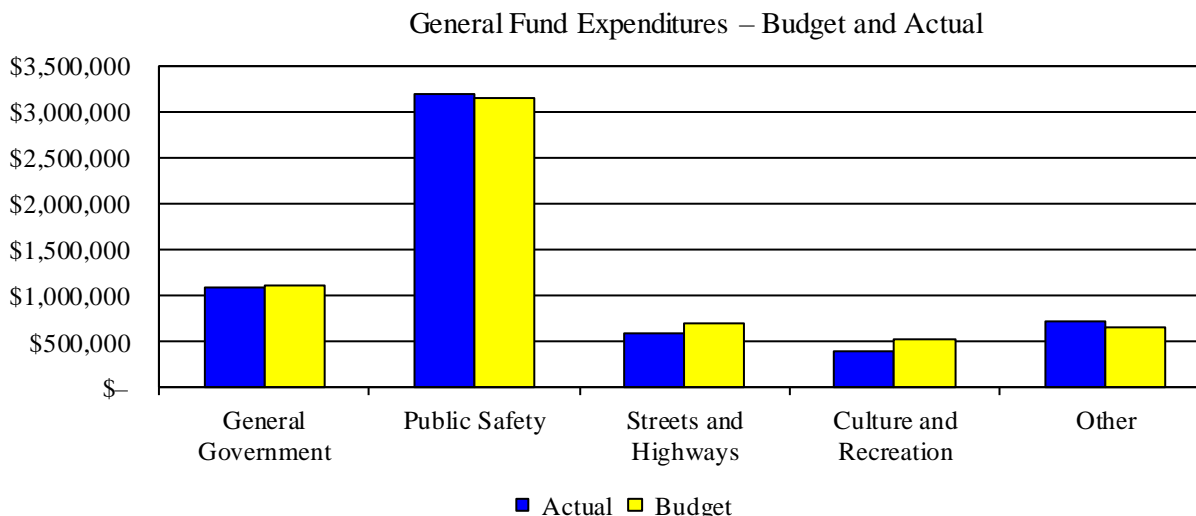
General Fund revenue for 2017 was \$6,512,105, which was \$345,849 (5.6 percent) more than budget. Tax revenue was \$11,454 over budget due to conservative budgeting for franchise and lodging tax receipts. Intergovernmental revenues exceeded projected amounts by \$116,527, due to the City conservatively budgeting for local government aid (LGA). Remaining sources were over budget by \$217,868, primarily due to conservative budgeting for these less predictable revenues.

The following graph presents the City’s General Fund revenues by source for the last five years. The graph reflects the City’s reliance on property and other taxes, which represented 69.9 percent of General Fund revenues in 2017.



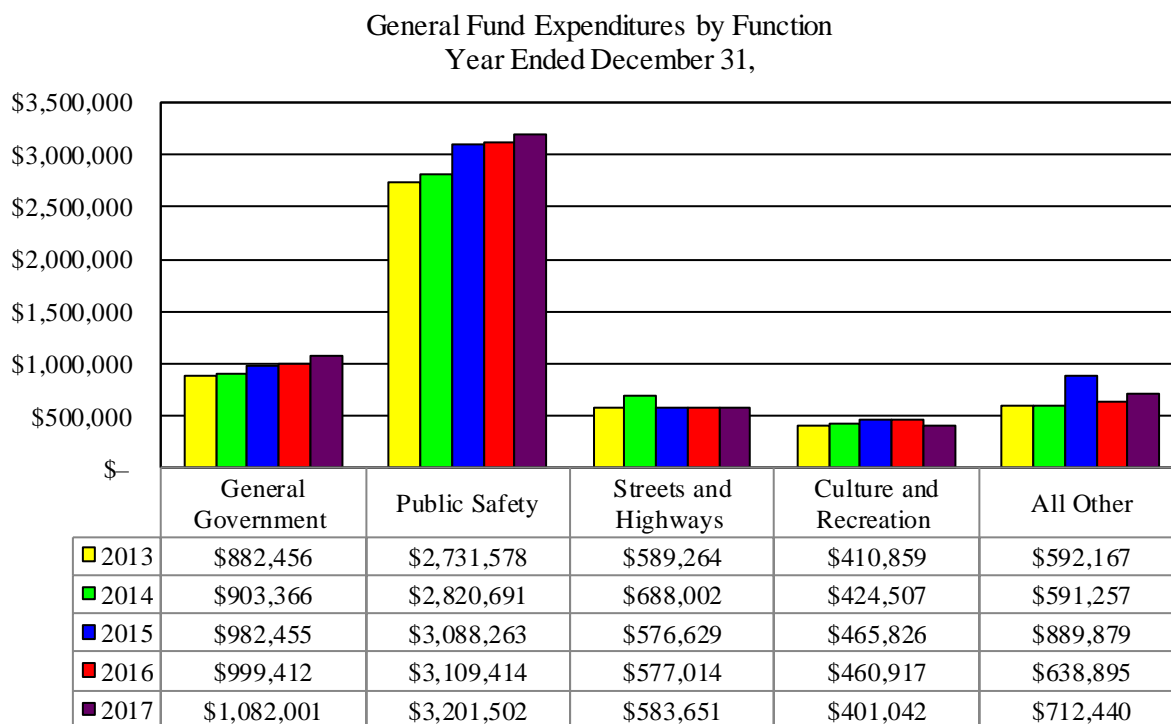
Total General Fund revenue for 2017 was \$240,928 (3.8 percent) more than last year. Taxes increased by \$75,621, due to an increase in the approved tax levy. Intergovernmental revenue was \$3,063 more than last year. Remaining revenue sources of the General Fund were \$162,244 more than 2016, due to more licenses and permits received in the current year.

The following graph illustrates the components of General Fund spending for 2017 compared to budget:



General Fund expenditures for 2017 were \$5,980,636, which was \$150,128 (2.4 percent) less than budget. The City’s efforts to maintain fiscal responsibility and spend within approved appropriations contributed to the expenditure variance. Staff turnover during the year also contributed to the favorable expenditure variance.

The following graph presents the City’s General Fund expenditures by function for the last five years:



Total General Fund expenditures for 2017 were \$194,984 (3.4 percent) more than the previous year. The largest change occurred in public safety, which increased \$92,088, due to more personnel costs compared to the prior year.

## ENTERPRISE FUNDS OVERVIEW

The City maintains several enterprise funds to account for services the City provides that are financed primarily through fees charged to those utilizing the service. This section of the report provides you with an overview of the financial trends and activities of the City's enterprise funds, which includes the Water, Sanitary Sewer, Storm Water, and Street Light Funds.

The utility funds comprise a considerable portion of the City's activities. These funds help to defray overhead and administrative costs and provide additional support to general government operations by way of annual transfers. We understand that the City is proactive in reviewing these activities on an ongoing basis and we want to reiterate the importance of continually monitoring these operations. Over the years, we have emphasized to our city clients the importance of these utility operations being self-sustaining, preventing additional burdens on general government funds. This would include the accumulation of net position for future capital improvements and to provide a cushion in the event of a negative trend in operations.

### ENTERPRISE FUNDS FINANCIAL POSITION

The following table summarizes the changes in the financial position of the City's enterprise funds during the year ended December 31, 2017, presented both by classification and by fund:

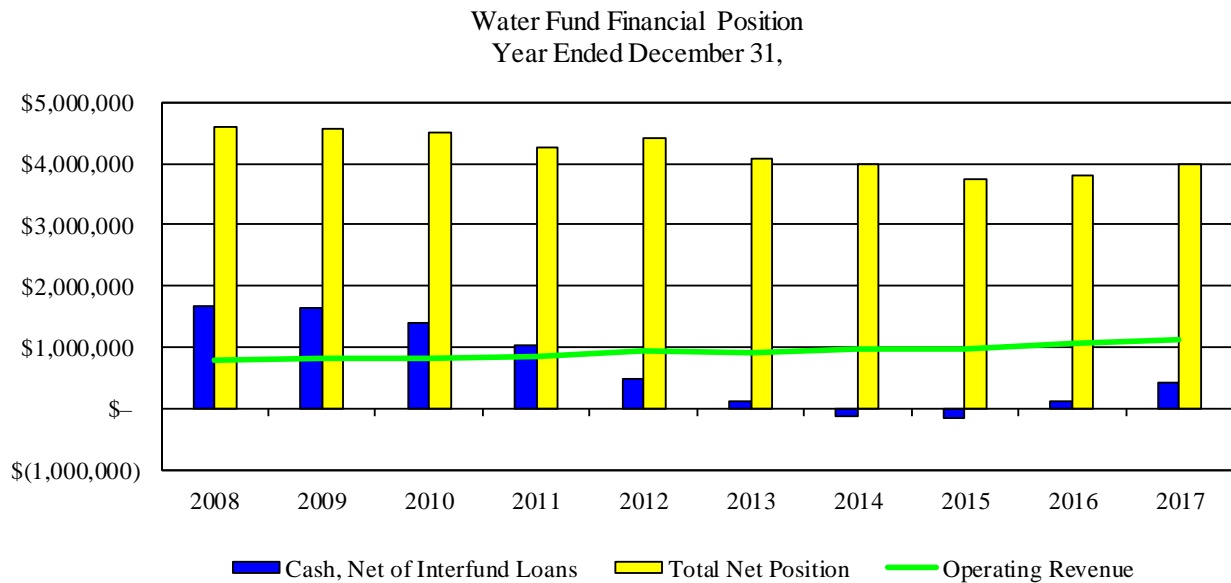
<b>Enterprise Funds Change in Financial Position</b>			
	Net Position as of December 31,		Increase (Decrease)
	<u>2017</u>	<u>2016</u>	
Net position of enterprise funds			
Total by classification			
Investment in capital assets	\$ 6,702,181	\$ 6,714,995	\$ (12,814)
Unrestricted	<u>4,455,356</u>	<u>4,075,782</u>	<u>379,574</u>
Total – enterprise funds	<u><u>\$ 11,157,537</u></u>	<u><u>\$ 10,790,777</u></u>	<u><u>\$ 366,760</u></u>
Total by fund			
Water	\$ 3,985,566	\$ 3,805,187	\$ 180,379
Sanitary Sewer	3,915,386	3,785,323	130,063
Storm Water	3,182,828	3,141,720	41,108
Street Light	<u>73,757</u>	<u>58,547</u>	<u>15,210</u>
Total – enterprise funds	<u><u>\$ 11,157,537</u></u>	<u><u>\$ 10,790,777</u></u>	<u><u>\$ 366,760</u></u>

In total, the net position of the City's enterprise funds increased by \$366,760 during the year ended December 31, 2017. The increase in net position is primarily related to positive operating results and improved investment earnings in the current year.

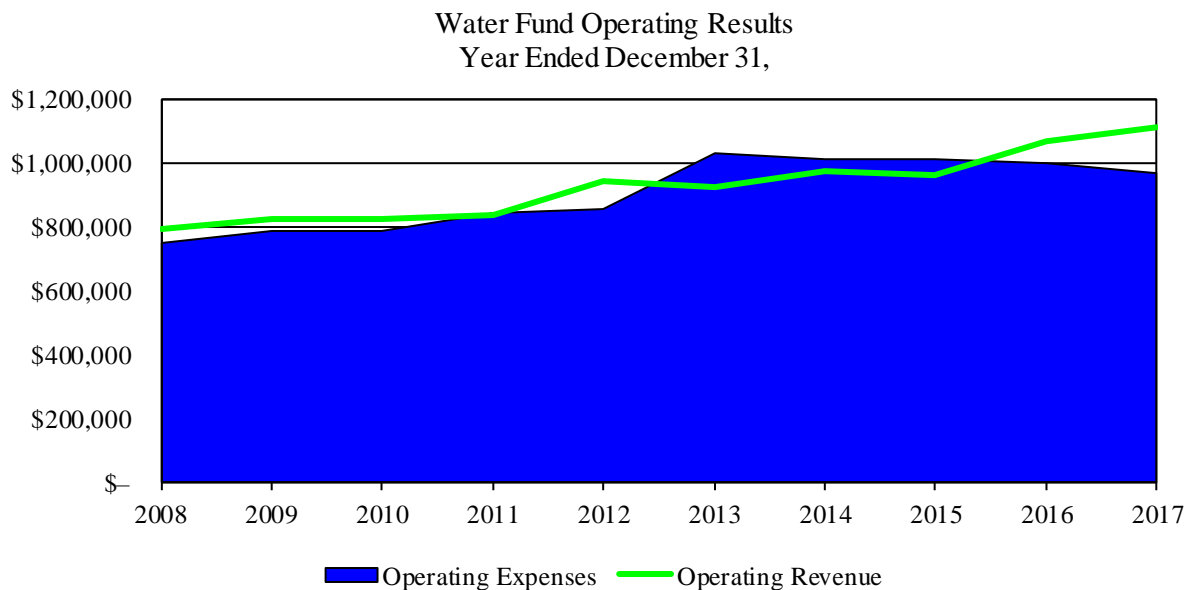


## WATER FUND

At December 31, 2017, the Water Fund had a cash balance of \$423,231 and total net position of \$3,985,566. Of this net position total, \$3,568,635 is the investment in capital assets, while \$416,931 is unrestricted. The following graph shows the financial position of the Water Fund over the past 10 years:



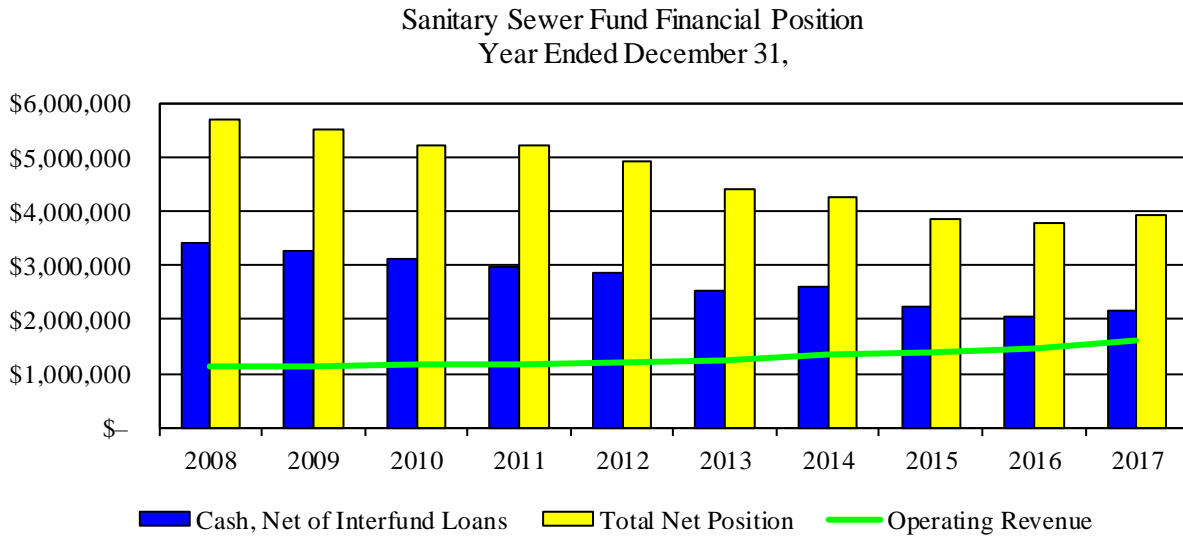
The following graph shows the operating results of the Water Fund over the last 10 years:



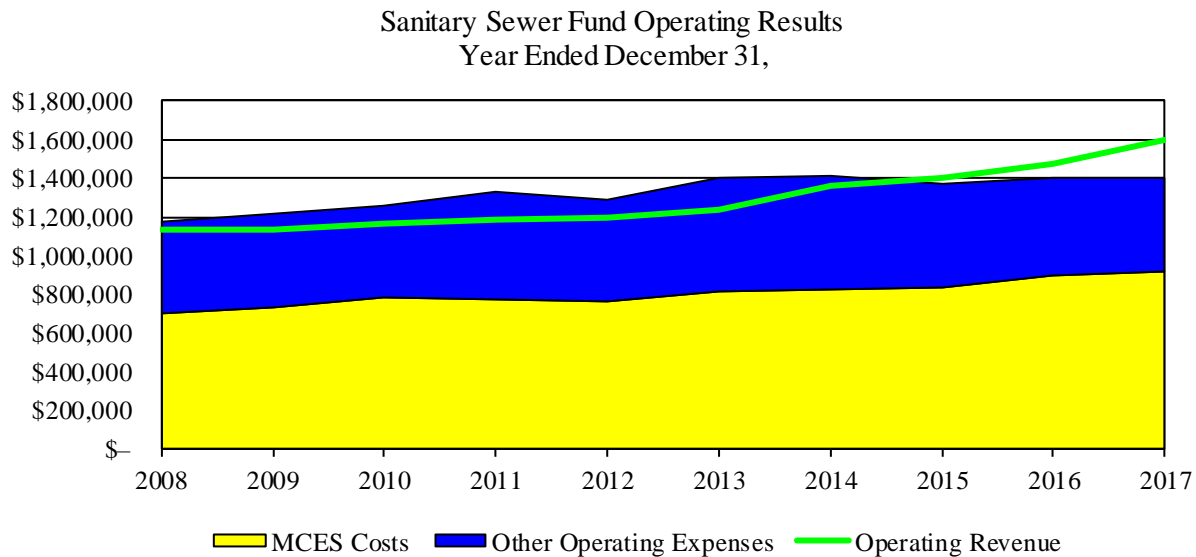
During fiscal 2017, the Water Fund experienced an operating income of \$143,784 compared to an operating income of \$63,893 in fiscal 2016. Increased sales and a decrease in operating expenses contributed to the change in current year operations. Consumption will fluctuate from year-to-year based on many factors, including weather patterns and number of utility customers. The City should continue to review utility rates during its annual budget process to make sure an adequate, yet fair rate is charged for the services provided.

## SANITARY SEWER FUND

At December 31, 2017, the Sanitary Sewer Fund had a cash balance of \$2,172,237 and total net position of \$3,915,386. Of this net position total, \$1,737,164 is the investment in capital assets, while \$2,178,222 is unrestricted. The following graph shows the financial position of the Sanitary Sewer Fund over the past 10 years:



The following graph shows the operating results of the Sanitary Sewer Fund for the last 10 years:

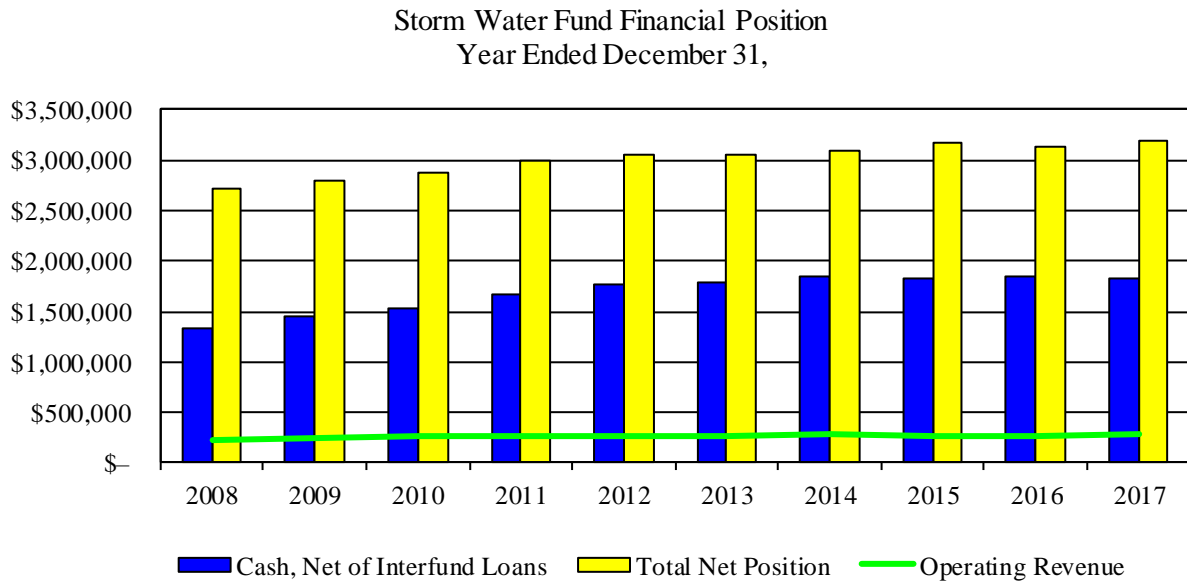


The major expense of the sanitary sewer operation is the charge from the Metropolitan Council Environmental Services (MCES). The main cause of the expense fluctuations from year-to-year, shown on the graph above, are generally changes made to the charges from MCES reflecting the results of their sewer treatment operations.

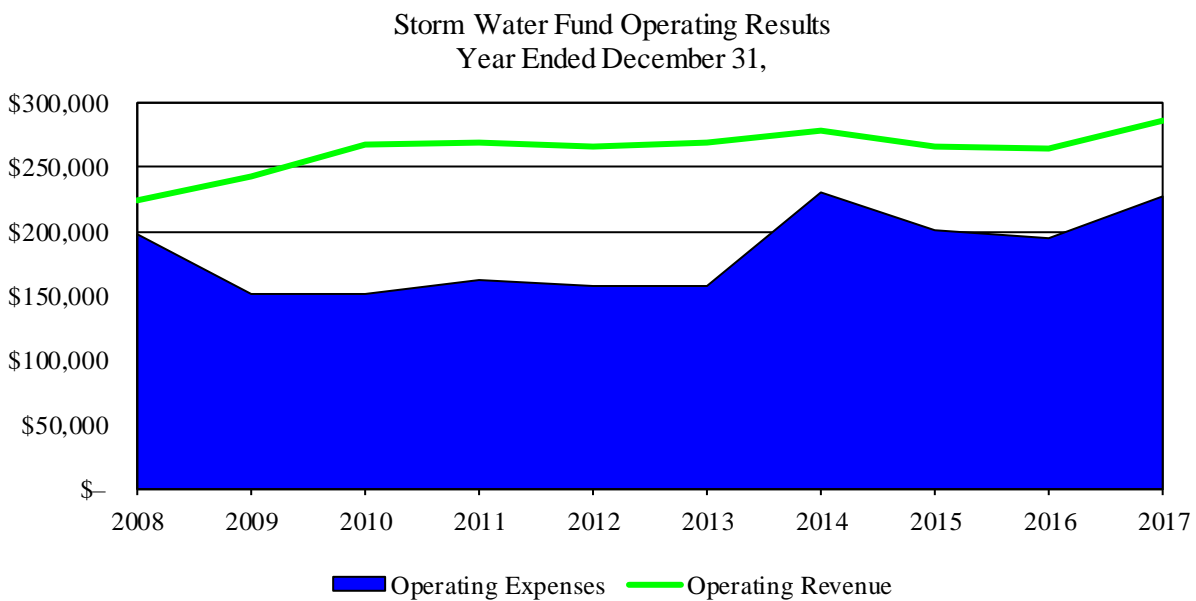
The Sanitary Sewer Fund maintains a healthy financial position. During fiscal 2017, the Sanitary Sewer Fund experienced operating income of \$203,048 compared to an operating income of \$71,327 in fiscal 2016. Increased sales and user fees contributed to the change in current year operations as expenses were similar to prior year levels. The City should continue to review utility rates during its annual budget process to make sure an adequate, yet fair rate is charged for the services provided.

## STORM WATER FUND

At December 31, 2017, the Storm Water Fund had a cash balance of \$1,835,108 and total net position of \$3,182,828. Of this net position total, \$1,396,382 is the investment in capital assets, while \$1,786,446 is unrestricted. The following graph shows the financial position of the Storm Water Fund over the past 10 years:



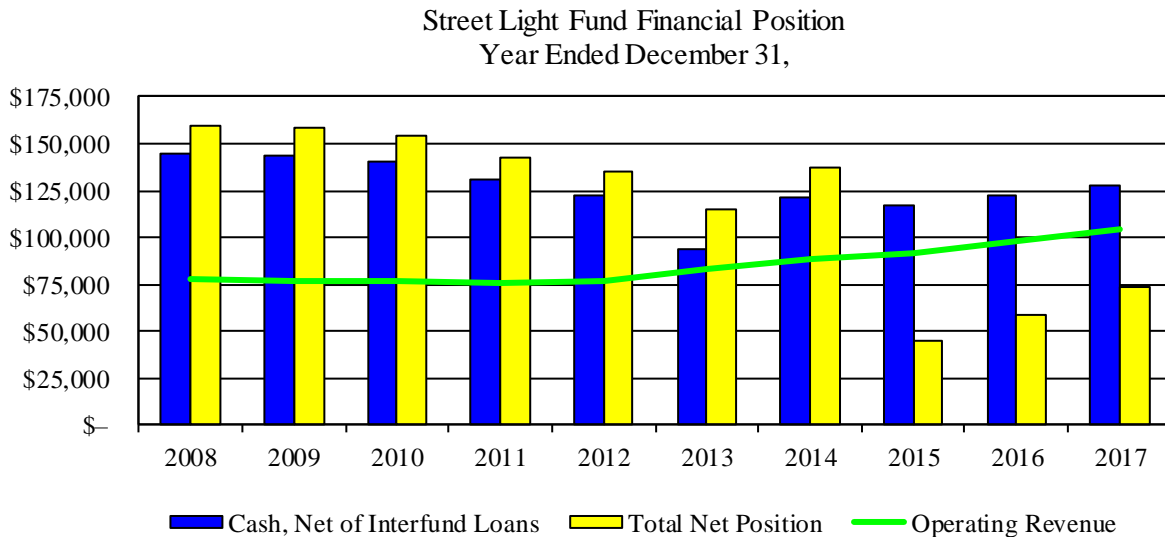
The following graph shows the operating results of Storm Water Fund for the last 10 years:



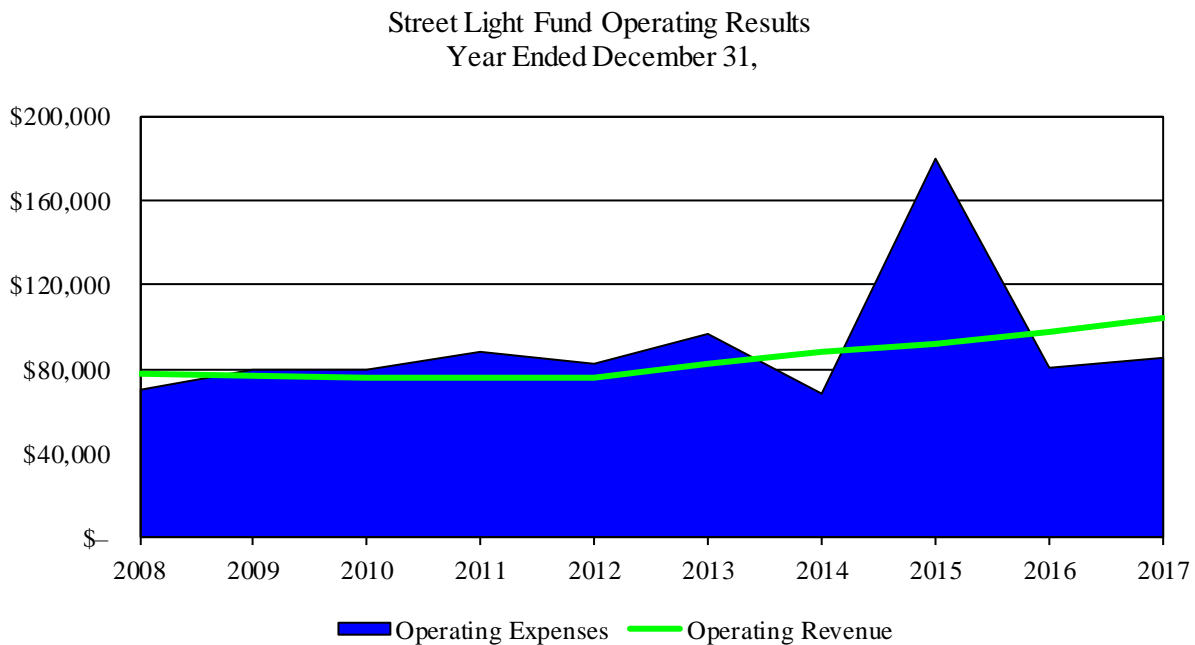
The Storm Water Fund has been able to report positive operating results each of the past 10 years, as presented in the table above. The Storm Water Fund maintains a healthy financial position. During fiscal 2017, the Storm Water Fund experienced operating income of \$58,732 compared to operating income of \$70,336 in fiscal 2016. An increase in current year expenses contributed to the change in current year operations.

## STREET LIGHT FUND

At December 31, 2017, the Street Light Fund had a cash balance of \$128,092 and total net position of \$73,757, all of which is unrestricted. The following graph shows the financial position of the Street Light Fund over the past 10 years:



The following graph shows the operating results of the Street Light Fund for the last 10 years:



During fiscal 2017, the Street Light Fund experienced an operating income of \$18,748 compared to operating income of \$17,391 in fiscal 2016. The revenue increase slightly exceeded the expense growth in current year operations.

## GOVERNMENT-WIDE FINANCIAL STATEMENTS

In addition to fund-based information, the current reporting model for governmental entities also requires the inclusion of two government-wide financial statements designed to present a clear picture of the City as a single, unified entity. These government-wide statements provide information on the total cost of delivering services, including capital assets and long-term liabilities.

### STATEMENT OF NET POSITION

The Statement of Net Position essentially tells you what the City owns and owes at a given point in time, the last day of the fiscal year. Theoretically, net position represents the resources the City has leftover to use for providing services after its debts are settled. However, those resources are not always in spendable form, or there may be restrictions on how some of those resources can be used. Therefore, net position is divided into three components: net investment in capital assets, restricted, and unrestricted.

The following table presents the components of the City's net position as of December 31, 2017 and 2016, for governmental activities and business-type activities:

	As of December 31,		Increase (Decrease)
	2017	2016	
Net position			
Governmental activities			
Net investment in capital assets	\$ 36,784,587	\$ 37,087,585	\$ (302,998)
Restricted	3,148,142	2,965,913	182,229
Unrestricted	9,248,882	9,943,649	(694,767)
Total governmental activities	<u>49,181,611</u>	<u>49,997,147</u>	<u>(815,536)</u>
Business-type activities			
Net investment in capital assets	6,702,181	6,714,995	(12,814)
Unrestricted	4,455,356	4,075,782	379,574
Total business-type activities	<u>11,157,537</u>	<u>10,790,777</u>	<u>366,760</u>
Total net position	<u>\$ 60,339,148</u>	<u>\$ 60,787,924</u>	<u>\$ (448,776)</u>

The City's total net position at December 31, 2017 was \$448,776 lower than the previous year. As presented above, the decrease in governmental activities net position was partially offset by an increase in business-type activities net position.

The change in components of governmental activity net position reflects the City's continued investment in street reconstruction in the current year along with increased depreciation on completed assets in recent years.

The increase in business-type activities net position reflects the Enterprise Fund operating activity previously discussed, along with transfers out of the business-type activities into the governmental activities.

At the end of the current fiscal year, the City is able to present positive balances in all categories of net position, both for the government as a whole, as well as for its separate governmental and business-type activities. The same situation held true for the prior fiscal year.

## STATEMENT OF ACTIVITIES

The Statement of Activities tracks the City's yearly revenues and expenses, as well as any other transactions that increase or reduce total net positions. These amounts represent the full cost of providing services. The Statement of Activities provides a more comprehensive measure than just the amount of cash that changed hands, as reflected in the fund-based financial statements. This statement includes the cost of supplies used, depreciation of long-lived capital assets, and other accrual-based expenses.

The following table presents the change in the net position of the City for the years ended December 31, 2017 and 2016:

	2017		2016	
	Expenses	Program Revenues	Net Change	Net Change
Net (expense) revenue				
Governmental activities				
General government	\$ 1,298,436	\$ 271,318	\$ (1,027,118)	\$ (884,813)
Public safety	3,653,742	331,242	(3,322,500)	(3,750,464)
Streets and highways	2,268,318	558,498	(1,709,820)	(1,029,231)
Sanitation	20,019	33,345	13,326	(7,658)
Culture and recreation	1,341,654	370,545	(971,109)	(1,229,195)
Economic development	2,078,756	326,132	(1,752,624)	(2,214,206)
Interest on long-term debt	100,802	–	(100,802)	(36,180)
Business-type activities				
Water	968,475	1,112,259	143,784	63,893
Sanitary sewer	1,396,463	1,599,511	203,048	71,327
Storm water	227,621	286,353	58,732	70,336
Street light	87,804	104,224	16,420	14,859
Total net (expense) revenue	<u>\$ 13,442,090</u>	<u>\$ 4,993,427</u>	(8,448,663)	(8,931,332)
General revenues				
Taxes			7,011,017	6,672,885
Grants and contributions not restricted to specific programs			682,022	677,284
Gain on sale or trade of capital assets			48,001	–
Unrestricted investment earnings			258,847	211,943
Total general revenues			<u>7,999,887</u>	<u>7,562,112</u>
Change in net position			(448,776)	(1,369,220)
Net position – beginning			<u>60,787,924</u>	<u>62,157,144</u>
Net position – ending			<u>\$ 60,339,148</u>	<u>\$ 60,787,924</u>

One of the goals of this statement is to provide a side-by-side comparison to illustrate the difference in the way the City's governmental and business-type operations are financed. The table clearly illustrates the dependence of the City's governmental operations on general revenues, such as property taxes and unrestricted grants. In contrast, the City's business-type activities tend to rely more heavily on program revenues like charges for services (sales) and program specific grants to cover expenses. This is critical given the current downward pressures on the general revenue sources.

## LEGISLATIVE UPDATES

The 2017 legislative session began with a full agenda, which included adopting a fiscal year 2018–2019 biennial state budget. The February 2017, state budget forecast projected that the state General Fund would end the 2016–2017 biennium with a surplus of \$743 million, eliminating the need for budget cuts or transfers to balance the fund. However, the Legislature was expected to address several significant spending areas for which successful funding appropriations had not been passed in recent legislative sessions. The 2017 regular legislative session ended with four omnibus budget bills being vetoed, potentially leaving a number of these same areas without appropriations. After a three-day special session, the Governor and Legislature were able to agree on budget and appropriation bills addressing most of the state budgetary needs for the upcoming biennium, albeit not without several line item vetoes invoked by the Governor, including striking the appropriations for operating the House and Senate from the bills.

The following is a summary of recent legislation affecting Minnesota cities:

**Omnibus Bonding Bill** – The omnibus bonding bill authorizes financing for approximately \$1.1 billion in capital improvements. Included in the approved funding was \$255 million for transportation infrastructure, \$83 million for economic development, \$116 million for Public Financing Agency water infrastructure loans and grants to municipalities, and \$4 million for Metropolitan Council inflow and infiltration improvement grants to metro area cities.

**Omnibus Transportation Bill** – The omnibus transportation bill appropriates \$2.95 billion in fiscal 2018 and \$2.87 billion in fiscal 2019, for a wide variety of transportation related projects. Included in the appropriations are approximately \$191 million and \$198 million for municipal state aid street fund purposes in fiscal 2018 and fiscal 2019, respectively.

**Property Tax Relief** – The omnibus tax bill contained a number of property tax relief measures, including:

- Elimination of the implicit price deflator annual increase for the state general property tax levy, effectively freezing it at the payable 2018 level for many property classes;
- Exempting the first \$100,000 of each commercial-industrial parcel's tax capacity from the state general property tax levy;
- Expanding eligibility for homestead or agricultural property classification exemptions for certain types of resort and conservation property for general property taxes; and
- Increasing the minimum value for a storage shed, deck, or similar structure on a leased mobile home to be considered taxable from \$1,000 to \$10,000.

**Local Government Aid** – The annual appropriation for Local Government Aid (LGA) for cities was increased \$15.0 million to \$534.4 million for aid payable in 2018 and thereafter, and the LGA payment schedule was accelerated for fiscal 2019 only. Several corrections were also made to the city LGA formula calculation, and a sparsity adjustment was incorporated for certain medium and small cities beginning in 2018.

**Minnesota Investment Fund** – The omnibus jobs and economic growth bill appropriates \$12.5 million for each year of the biennium for the Minnesota Investment Fund, which is available for municipalities to provide loans to assist with the expansion of local businesses.

**Electronic Funds Transfers** – Effective August 1, 2017, home rule charter cities of the second, third, or fourth class are added to the list of local government entities allowed to pay certain claims using electronic funds transfers. To be eligible, local governments must enact specified policy controls governing the initiation, authorization, and documentation of electronic funds transfers.

**Claims Declaration** – The requirement to obtain a specific form of written claim declaration was also repealed based on the understanding that by making the claim, the party making the claim is declaring that the claim is just and correct and has not been paid previously.

**City Email Address Required to Receive State Aid** – Effective for state aids payable in 2018 and thereafter, cities will be required to register an official email address with the Commissioner of the state Department of Revenue in order to receive state aid payments.

**Workforce Housing Tax Increment Financing** – The omnibus tax bill created a new authorized use of tax increment financing (TIF) for workforce housing in cities located outside of the statutorily defined metropolitan area that meet certain criteria.

**Tax Increment Financing Interfund Loans** – Interfund loan provisions for TIF were amended to make it easier for cities and development authorities to make and document interfund loans. Loans may now be made or documented up to 60 days after the actual transfer or expenditure occurs. Interfund loan resolutions may now be passed prior to the final approval of the related TIF plan. Loan terms may be amended after the loan has been made if the TIF district has not been decertified.

**Public Debt** – The Legislature passed several amendments to statutes governing public debt that took effect on July 1, 2017, including:

- Allowing both home rule charter and statutory cities to issue 20-year capital notes for projects to eliminate R-22 Freon-based refrigerant;
- Increasing the maximum dollar limit on Housing and Redevelopment Authority general obligation bond issues from \$3 million to \$5 million; and
- Modifying the requirements for street reconstruction bonds to be approved by a two-thirds majority of the governing body rather than requiring unanimous approval.

**Local Housing Trust Funds** – The omnibus jobs and economic growth appropriations bill established authority for cities to create a local housing trust fund by ordinance, or to participate in a joint powers agreement to establish a regional housing trust fund. The funds, which may be financed from sources such as local government appropriations or housing and redevelopment authority levies, may be used for grants or loans for development, rehabilitation, financing of housing to match federal or state or private funds for housing, down payment assistance, rental assistance, or homebuyer counseling.

**Long-Term Equity Investment Authority** – Effective July 1, 2017, cities with a population of more than 100,000 or those that had their most recently issued general obligation bonds rated in the highest category, are authorized to invest in an expanded list of authorized investments that includes certain equity-based investments. The amount invested in equity-based investments cannot exceed 15 percent of the sum of the city's unassigned cash, cash equivalents, deposits, and investments. Before investing in the expanded list of authorized investments, the governing body of the municipality must adopt a resolution acknowledging the risks assumed.

**Border-to-Border Broadband Grants** – The Legislature appropriated \$20 million in fiscal 2018 for the Border-to-Border Broadband Grant Program. The grants, available through the Office of Broadband Development in the Department of Employment and Economic Development, provide funding to help communities meet state goals for the development of state-wide, high-speed broadband access, focusing on areas currently considered to be underserved or with a high concentration of low-income households.

**Elections** – An omnibus elections law was passed making several modifications to election administration, including: requiring special elections conducted by local governments be held on one of five uniform election dates, clarifying the timeline for municipalities to change from odd to even-year election cycles or vice-versa, allowing municipalities to canvass the results of a primary election on the second or third day after the primary, and appropriating \$7 million for grants to replace aging election equipment or purchase electronic poll books.



**Workers' Compensation and PERA Retirement Benefits** – A statutory change was adopted based on the results of recent court rulings that Public Employees Retirement Association (PERA) retirement benefits should not be offset against workers' compensation permanent total disability benefits. Under the new law, claimants would receive all past and future permanent and total disability benefits without a PERA retirement offset.

**Notice of Proposed Ordinances** – A new statute was created requiring cities to provide a 10-day notice prior to a scheduled final vote on most new proposed ordinances or amendments to ordinances, and specifying the various acceptable means of providing the required notification.

**State Building Code Applicability** – Construction, additions, and alterations to places of public accommodation; defined as publicly or privately-owned facilities designed for occupancy by 200 or more people as a sports or entertainment arena, stadium, theater, community or convention hall, special event center, indoor amusement facility or water park, or indoor swimming pool; must comply with the state building code.

**Sunday Liquor Sales** – Minnesota Statutes were amended to allow for the sale of intoxicating liquor on Sundays between the hours of 11:00 a.m. and 6:00 p.m. by off-sale licensees, effective July 1, 2017.

**REAL ID Act** – Minnesota Statutes were amended to make the state compliant with federal REAL ID Act requirements, which will change identity verification and security related to state issued identification cards and driver's licenses.

## ACCOUNTING AND AUDITING UPDATES

### **GASB STATEMENT NO. 75, *ACCOUNTING AND FINANCIAL REPORTING FOR POSTEMPLOYMENT BENEFITS OTHER THAN PENSIONS***

GASB Statement No. 75, *Accounting and Financial Reporting for Postemployment Benefits Other Than Pensions*, establishes new accounting and financial reporting requirements for governments whose employees are provided with other post-employment benefits (OPEB), as well as for certain nonemployer governments that have a legal obligation to provide financial support for OPEB provided to the employees of other entities. This statement replaces the requirements of GASB Statement Nos. 45 and 57.

This statement establishes standards for recognizing and measuring liabilities, deferred outflows of resources, deferred inflows of resources, and expense/expenditures. Similar to changes implemented for pensions, this statement requires the liability of employers and nonemployer contributing entities to employees for defined benefit OPEB (net OPEB liability) to be measured as the portion of the present value of projected benefit payments to be provided to current active and inactive employees that is attributed to those employees' past periods of service (total OPEB liability), less the amount of the OPEB plan's fiduciary net position. Note disclosure and RSI requirements about defined benefit OPEB also are addressed.

This statement is effective for fiscal years beginning after June 15, 2017. Earlier application is encouraged.

### **GASB STATEMENT NO. 83, *CERTAIN ASSET RETIREMENT OBLIGATIONS***

This statement addresses accounting and financial reporting for certain asset retirement obligations (ARO), which are legally enforceable liabilities associated with the retirement of a tangible capital asset.

This statement establishes criteria for determining the timing and pattern of recognition of a liability and a corresponding deferred outflow of resources for ARO. A government that has legal obligations to perform future asset retirement activities related to its tangible capital assets should recognize a liability when it is both incurred and reasonably estimable. The measurement of an ARO is required to be based on the best estimate of the current value of outlays expected to be incurred, and a deferred outflow of resources associated with an ARO is required to be measured at the amount of the corresponding liability upon initial measurement.

This statement requires the current value of a government's AROs to be adjusted for the effects of general inflation or deflation at least annually, and a government to evaluate all relevant factors at least annually to determine whether the effects of one or more of the factors are expected to significantly change the estimated asset retirement outlays. A government should remeasure an ARO only when the result of the evaluation indicates there is a significant change in the estimated outlays. Deferred outflows of resources should be reduced and recognized as outflows of resources in a systematic and rational manner over the estimated useful life of the tangible capital asset.

If a government owns a minority interest in a jointly owned tangible asset where a nongovernmental entity is the majority owner or has operational responsibility for the jointly owned asset, the government's minority share of an ARO should be reported using the measurement produced by the nongovernmental majority owner or the nongovernmental minority owner that has operational responsibility, without adjustment to conform to the liability measurement and recognition requirements of this statement.

The statement also requires disclosures of any funding or financial assurance requirements a government has related to the performance of asset retirement activities, along with any assets restricted for the payment of the government's AROs. This statement also requires disclosure of information about the nature of a government's AROs, the methods and assumptions used for the estimates of the liabilities, and the estimated remaining useful life of the associated tangible capital assets. If an ARO (or portions thereof) has been incurred by a government but is not yet recognized because it is not reasonably estimable, the government is required to disclose that fact and the reasons therefor. This statement requires similar disclosures for a government's minority shares of AROs.

The requirements of this statement are effective for reporting periods beginning after June 15, 2018. Earlier application is encouraged.

#### **GASB STATEMENT NO. 84, *FIDUCIARY ACTIVITIES***

This statement establishes criteria for identifying fiduciary activities of all state and local governments. The focus of the criteria generally is on (1) whether a government is controlling the assets of the fiduciary activity and (2) the beneficiaries with whom a fiduciary relationship exists. Separate criteria are included to identify fiduciary component units and postemployment benefit arrangements that are fiduciary activities.

An activity meeting the criteria should be reported in a fiduciary fund in the basic financial statements, which should present a statement of fiduciary net position and a statement of changes in fiduciary net position. This statement describes four fiduciary funds that should be reported, if applicable: (1) pension (and other employee benefit) trust funds, (2) investment trust funds, (3) private-purpose trust funds, and (4) custodial funds. Custodial funds generally should report fiduciary activities that are not held in a trust or equivalent arrangement that meets specific criteria.

A fiduciary component unit, when reported in the fiduciary fund financial statements of a primary government, should combine its information with its component units that are fiduciary component units and aggregate that combined information with the primary government's fiduciary funds.

This statement also provides for recognition of a liability to the beneficiaries in a fiduciary fund when an event has occurred that compels the government to disburse fiduciary resources, defined as when a demand for the resources has been made or when no further action, approval, or condition is required to be taken or met by the beneficiary to release the assets.

The requirements of this statement are effective for reporting periods beginning after December 15, 2018. Earlier application is encouraged.

#### **GASB STATEMENT NO. 85, *OMNIBUS 2017***

The objective of this statement is to address issues that have been identified during implementation and application of certain GASB statements. The statement addresses a variety of topics, including issues related to blending component units, goodwill, fair value measurement and application, and post-employment benefits (pensions and OPEB). The statement is meant to enhance consistency in the application of recent accounting and financial reporting standards. The requirements of this statement are effective for reporting periods beginning after June 15, 2017.

## **GASB STATEMENT NO. 86, *CERTAIN DEBT EXTINGUISHMENT ISSUES***

Current GASB guidance requires that debt be considered defeased in substance when the debtor irrevocably places cash or other monetary assets acquired with refunding debt proceeds in a trust to be used solely for satisfying scheduled payments of both principal and interest of the defeased debt. This new standard establishes essentially the same requirements for when a government places cash and other monetary assets acquired with only existing resources in an irrevocable trust to extinguish the debt.

The primary objective of this statement is to improve consistency in accounting and financial reporting for in-substance defeasance of debt by providing guidance for transactions in which cash and other monetary assets acquired with only existing resources—resources other than the proceeds of refunding debt—are placed in an irrevocable trust for the sole purpose of extinguishing debt. This statement also improves accounting and financial reporting for prepaid insurance on debt that is extinguished and notes to financial statements for debt that is defeased in substance. The requirements of this statement are effective for reporting periods beginning after June 15, 2017.

## **GASB STATEMENT NO. 87, *LEASES***

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

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

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

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

To reduce the cost of implementation, this statement includes an exception for short-term leases, defined as a lease that, at the commencement of the lease term, has a maximum possible term under the lease contract of 12 months (or less), including any options to extend, regardless of their probability of being exercised. Lessees and lessors should recognize short-term lease payments as outflows of resources or inflows of resources, respectively, based on the payment provisions of the lease contract. The requirements of this statement are effective for reporting periods beginning after December 15, 2019.

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