

Management Report  
for  
City of Mounds View, Minnesota  
December 31, 2018

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PRINCIPALS

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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, 2018. 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  
April 2, 2019

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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, 2018, 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, 2018:

- 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 one finding based on our testing of the City's compliance with Minnesota laws and regulations. We noted that 1 of 25 disbursements tested were not paid within the 35-day period as required by Minnesota Statutes § 471.425, Subd. 2.

### **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, 2018; however, the City implemented the following governmental accounting standards during the fiscal year:

- Governmental Accounting Standards Board (GASB) Statement No. 75, *Accounting and Financial Reporting for Postemployment Benefits Other Than Pensions*, which established new accounting and financial reporting requirements for governments whose employees are provided with other post-employment benefits.

- GASB Statement No. 85, *Omnibus 2017*, which addressed issues that have been identified during implementation and application of certain GASB statements.
- GASB Statement No. 86, *Certain Debt Extinguishment Issues*, which improves consistency in accounting and financial reporting for in-substance defeasances of debt.

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 acquisition 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 April 2, 2019.

## **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 (MD&A) 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

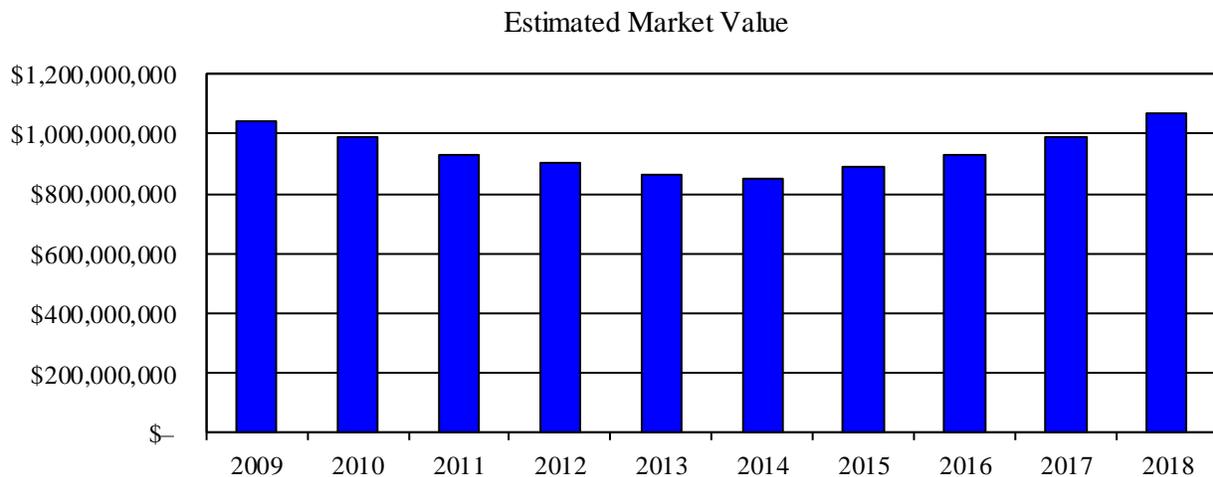
This section of the report provides you with an overview of the financial trends and activities of the City's governmental funds, which includes the General, special revenue, debt service, and capital project funds. These funds are used to account for the basic services the City provides to all of its 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 2017 fiscal year, local ad valorem property tax levies provided 41.1 percent of the total governmental fund revenues for cities over 2,500 in population, and 37.4 percent for cities under 2,500 in population. Total property taxes levied by all Minnesota cities for taxes payable in 2018 increased 6.2 percent from the prior year, and total certified levies payable in 2019 are projected to increase by 5.6 percent.

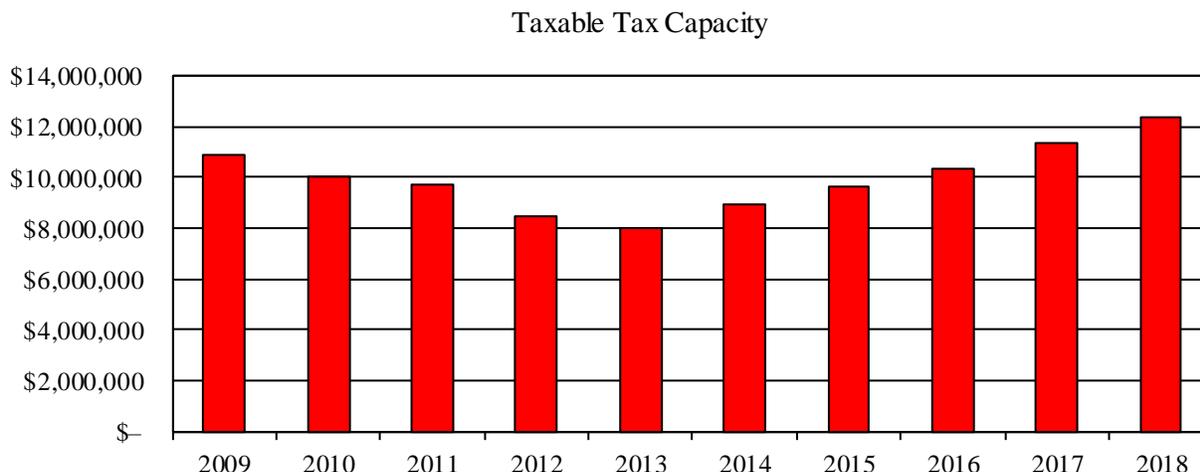
The total market value of property in Minnesota cities increased about 5.6 percent for the 2017 levy year (state-wide market value information for the 2018 levy year was not available at the time this report was issued). The market values used for levying property taxes are based on the previous fiscal year (e.g., market values for taxes levied in 2018 were based on assessed values as of January 1, 2017), so the trend of change in these market values lags somewhat behind the housing market and economy in general.

The City's estimated market value increased 6.7 percent for taxes payable in 2017 and increased 7.9 percent for taxes payable in 2018. The following graph shows the City's changes in estimated 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 a 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 10.0 percent for 2017 and increased 9.0 percent for 2018.

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:

Rates expressed as a percentage of net tax capacity			
	City of Mounds View		
	<u>2016</u>	<u>2017</u>	<u>2018</u>
Average tax rate			
City	40.1	38.0	37.7
County	58.9	55.8	54.0
School	26.3	25.3	28.5
Special taxing	<u>10.7</u>	<u>9.0</u>	<u>8.2</u>
Total	<u><u>136.0</u></u>	<u><u>128.1</u></u>	<u><u>128.4</u></u>

The total average tax rate remained similar to the prior year. An increase in the school portion was partially offset by decreases in the remaining taxing authority rates.

## 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, 2018, 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>2018</u>	<u>2017</u>	
Fund balances of governmental funds			
Total by classification			
Restricted	\$ 3,367,273	\$ 3,147,858	\$ 219,415
Assigned	10,073,511	10,796,442	(722,931)
Unassigned	<u>3,952,927</u>	<u>3,710,891</u>	<u>242,036</u>
Total – governmental funds	<u>\$ 17,393,711</u>	<u>\$ 17,655,191</u>	<u>\$ (261,480)</u>
Total by fund			
General	\$ 9,540,534	\$ 9,476,539	\$ 63,995
TIF District No. 5 Special Revenue	849,234	830,026	19,208
Park Dedication Capital Projects	145,650	337,739	(192,089)
Street Improvement Capital Projects	1,742,890	1,903,752	(160,862)
Nonmajor funds	<u>5,115,403</u>	<u>5,107,135</u>	<u>8,268</u>
Total – governmental funds	<u>\$ 17,393,711</u>	<u>\$ 17,655,191</u>	<u>\$ (261,480)</u>

In total, the fund balances of the City's governmental funds decreased by \$261,480. Restricted fund balance increased by \$219,415, primarily in amounts restricted for debt service. Assigned fund balances decreased \$722,931, primarily in amounts assigned for levy reduction, street reconstruction, and other capital projects. Favorable operations in the General Fund contributed to the unassigned fund balance increase of \$242,036.

## 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 a 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 in 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 MD&A. 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 Population	State-Wide			City of Mounds View			
	December 31, 2017			2016	2017	2018	
	2,500–10,000	10,000–20,000	20,000–100,000	13,007	13,161	13,327	
Property taxes	\$ 474	\$ 451	\$ 475	\$ 333	\$ 346	\$ 371	
Tax increments	26	27	38	120	124	125	
Franchise and other taxes	38	43	48	61	63	66	
Special assessments	57	48	59	3	2	2	
Licenses and permits	39	34	49	14	24	23	
Intergovernmental revenues	322	276	147	125	115	126	
Charges for services	108	103	103	23	24	27	
Other	68	53	48	43	48	53	
<b>Total revenue</b>	<b>\$ 1,132</b>	<b>\$ 1,035</b>	<b>\$ 967</b>	<b>\$ 722</b>	<b>\$ 746</b>	<b>\$ 793</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 2018 were \$10,582,299, an increase of \$777,256 from the prior year. On a per capita basis, the City received \$793 in governmental fund revenue for 2018, an increase of \$47 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 \$25 per capita from the prior year, with an increase in the certified levy. Intergovernmental revenues increased by \$11 per capita, due to receiving more aid from the state for local government aid and municipal state aid construction funding.

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:

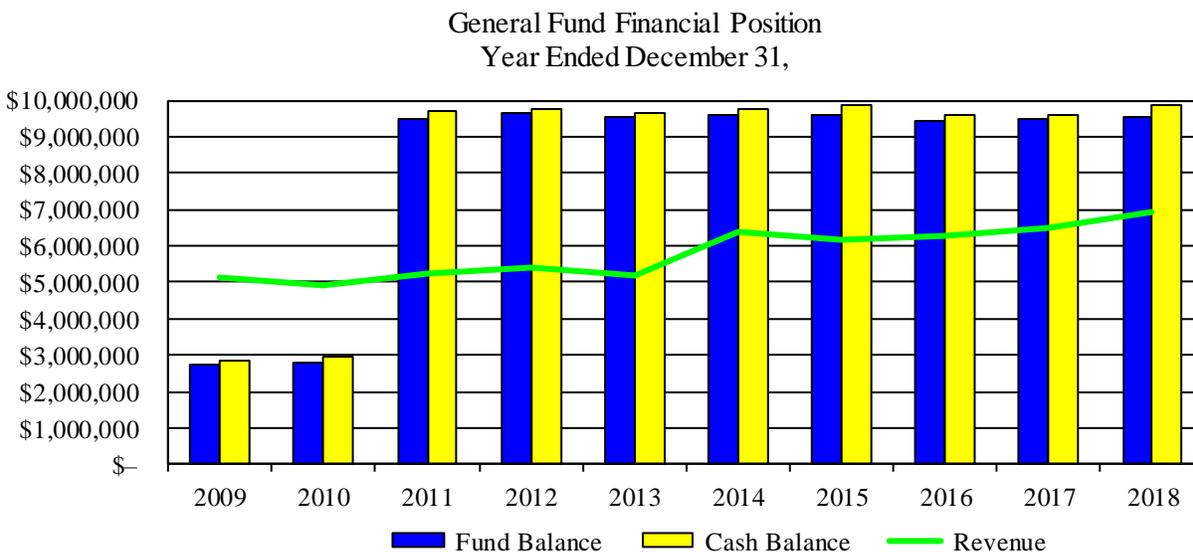
<b>Governmental Funds Expenditures per Capita</b> With State-Wide Averages by Population Class						
Year	State-Wide			City of Mounds View		
	December 31, 2017			2016	2017	2018
Population	2,500–10,000	10,000–20,000	20,000–100,000	13,007	13,161	13,327
<b>Current</b>						
General government	\$ 147	\$ 120	\$ 101	\$ 77	\$ 83	\$ 83
Public safety	270	259	287	241	246	260
Streets and highways	128	127	101	46	66	53
Culture and recreation	96	112	99	83	70	77
All other	76	64	77	149	158	168
Total current	717	682	665	596	623	641
Capital outlay and construction	403	319	263	365	588	176
<b>Debt service</b>						
Principal	228	147	121	14	11	11
Interest and fiscal	44	35	32	3	8	20
Total debt service	272	182	153	17	19	31
Total expenditures	<u>\$ 1,392</u>	<u>\$ 1,183</u>	<u>\$ 1,081</u>	<u>\$ 978</u>	<u>\$ 1,230</u>	<u>\$ 848</u>

Total expenditures in the City’s governmental funds for 2018 were \$11,315,771, a decrease of \$4,878,897 from the prior year. On a per capita basis, the City expended a total of \$848 in 2018, a decrease of \$382 from the previous year.

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

## 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, 2018 was \$9,870,313, an increase of \$244,384 from the previous year. Total fund balance at year-end was \$9,540,534, an increase of \$63,995 from the prior year, as compared to the final budget that projected a \$296,600 decrease in fund balance.

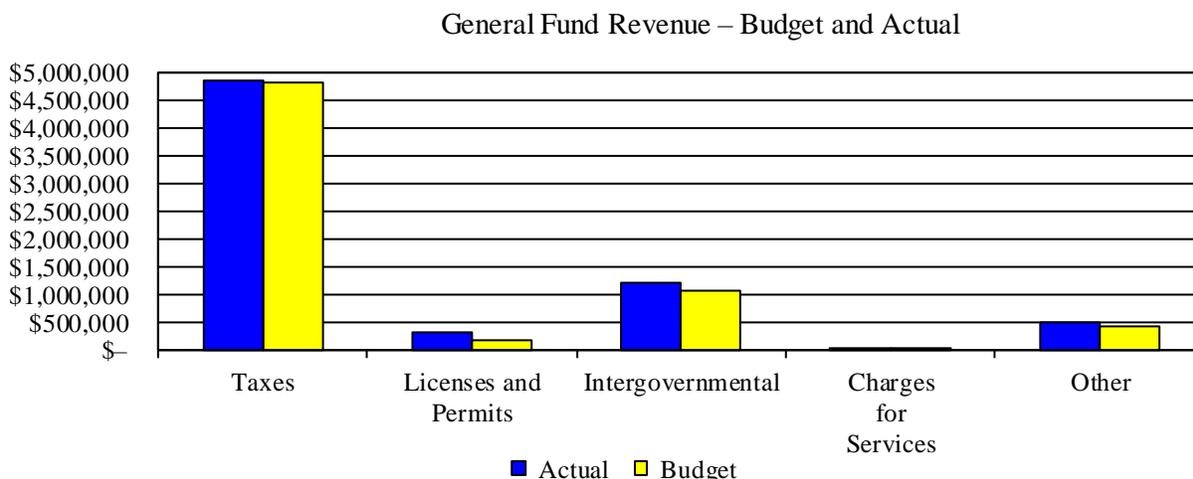
The significant change in fiscal 2011 in the General Fund cash and fund balance was the result of the City transferring the balance of the Levy Reduction Special Revenue Fund to the General Fund. The Levy Reduction Special Revenue Fund was closed with the City's implementation of the reporting requirements 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.

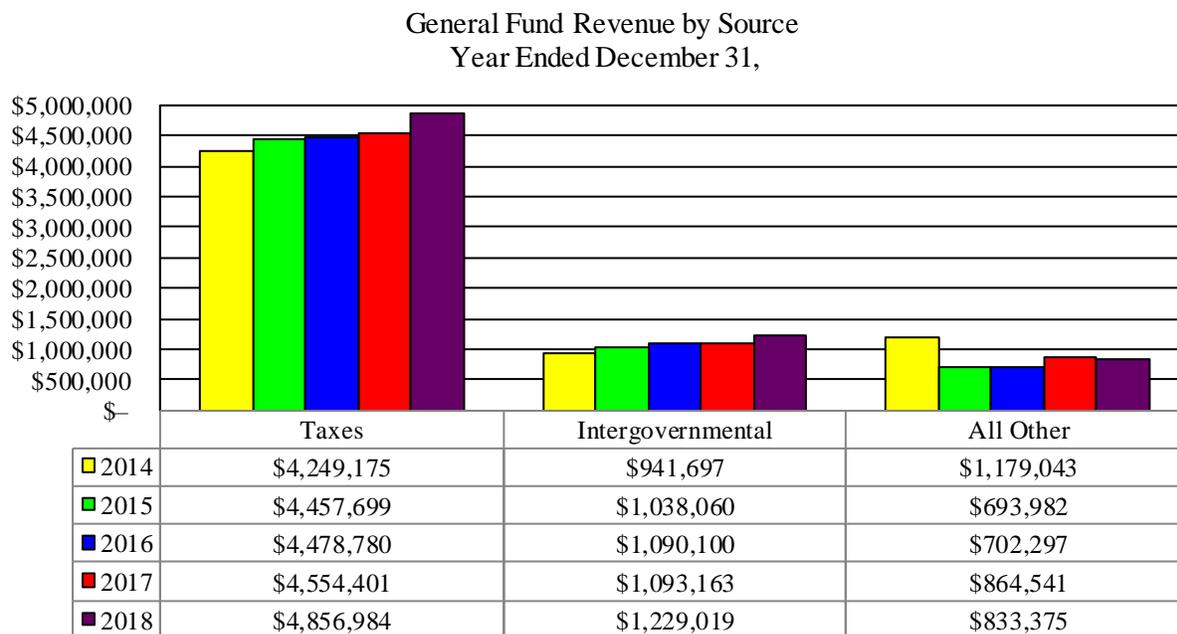
The City's unassigned General Fund balance at the end of the 2018 fiscal year represents approximately 60.4 percent of annual expenditures based on 2018 levels.

The following graph reflects the City's General Fund revenue sources for 2018 compared to budget:



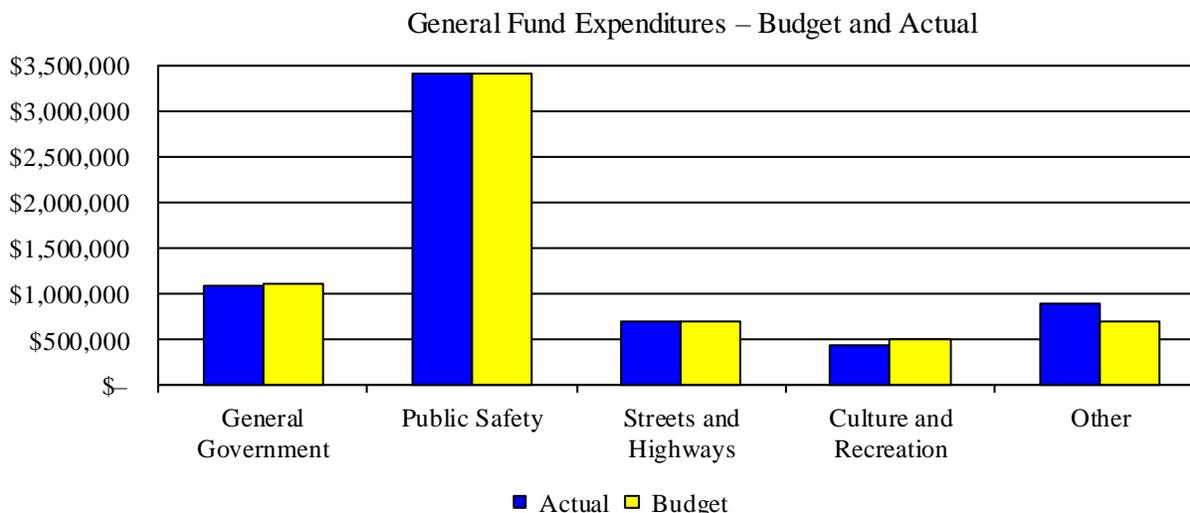
General Fund revenues totaled \$6,919,378 for 2018, which was \$387,380 (5.9 percent) more than budget. Intergovernmental revenues exceeded projected amounts by \$174,265, due to the City conservatively budgeting for local government aid (LGA). Licenses and permits and other sources were over budget by \$128,875 and \$63,296 respectively, 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 70.2 percent of General Fund revenues in 2018.



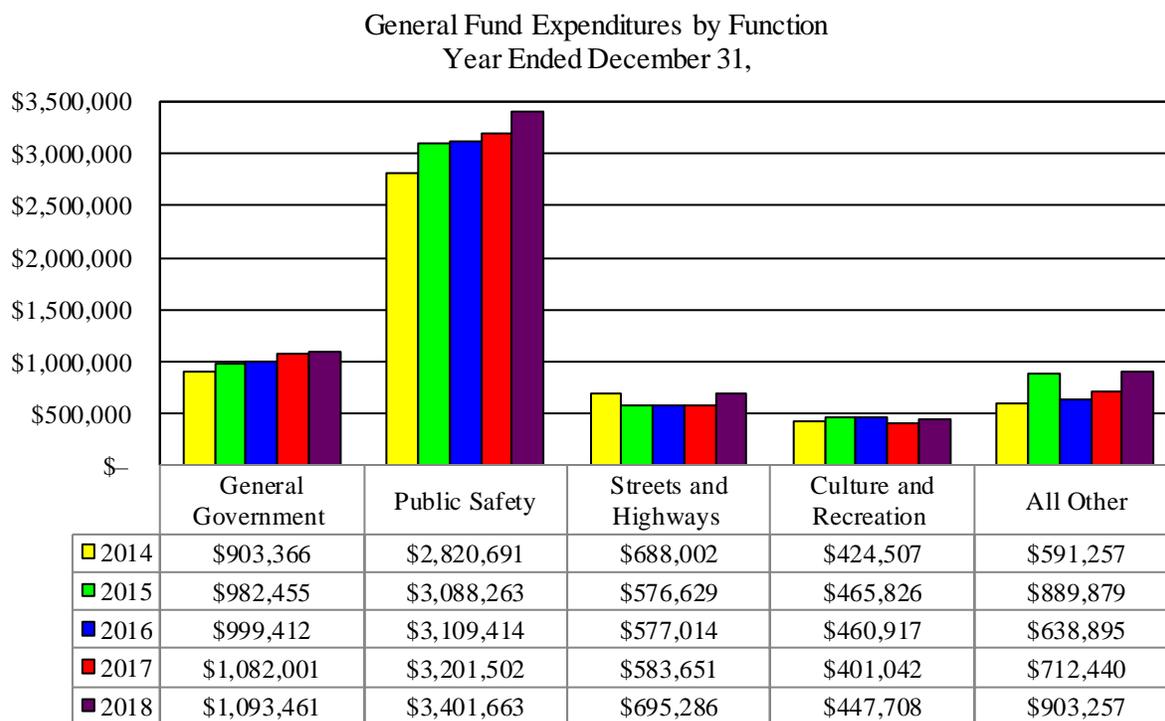
Total General Fund revenue for 2018 was \$407,273 (6.3 percent) more than last year. Taxes increased by \$302,583, due to an increase in the approved tax levy. Intergovernmental revenue was \$135,856 more than last year, with more LGA funding and reimbursement for school resource officer services recognized in the current year. Remaining revenue sources of the General Fund were \$31,166 less than 2017.

The following graph illustrates the components of General Fund spending for 2018 compared to budget:



General Fund expenditures for 2018 were \$6,541,375, which was \$104,976 (1.6 percent) more than budget. The variance was in the other category in the table above, which includes capital outlay that was over budget by \$175,190. Capital outlay spending exceeded appropriations due to public safety fire suppression equipment expenditures financed by equipment certificates in the current year.

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



Total General Fund expenditures for 2018 were \$560,739 (9.4 percent) more than the previous year. The expenditure increase was spread across all functions presented in the graph above. The largest change occurred in public safety, which increased \$200,161, 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

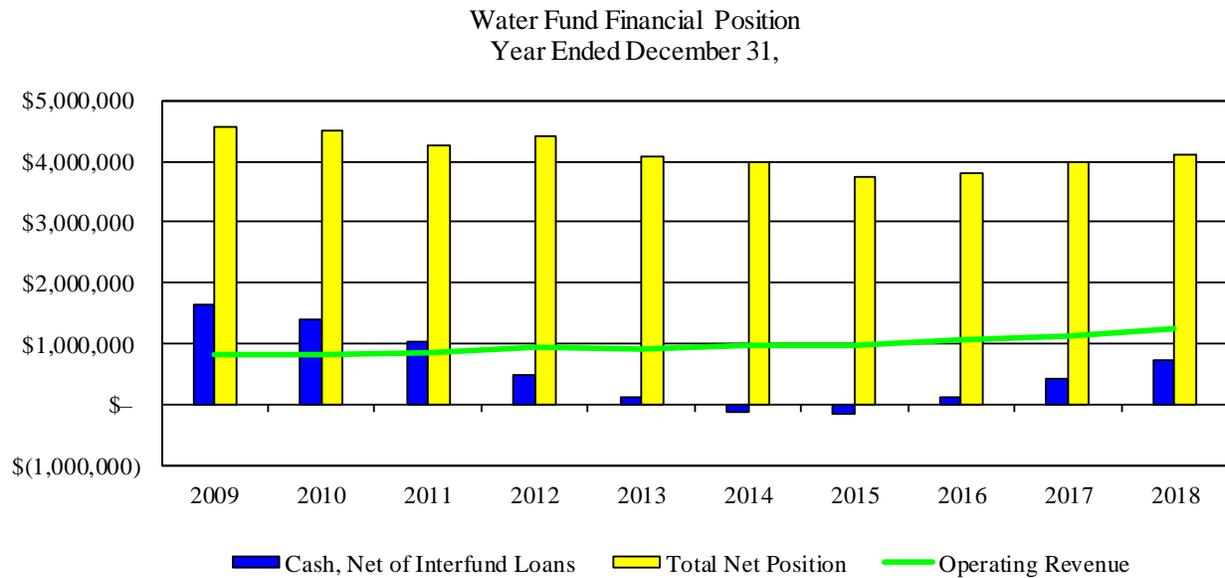
The following table summarizes the changes in the financial position of the City’s enterprise funds during the year ended December 31, 2018, presented both by classification and by fund:

<b>Enterprise Funds Change in Financial Position</b>			
	Net Position as of December 31,		Increase (Decrease)
	<u>2018</u>	<u>2017</u>	
Net position of enterprise funds			
Total by classification			
Investment in capital assets	\$ 6,329,151	\$ 6,702,181	\$ (373,030)
Unrestricted	<u>5,122,447</u>	<u>4,455,356</u>	<u>667,091</u>
Total – enterprise funds	<u><u>\$ 11,451,598</u></u>	<u><u>\$ 11,157,537</u></u>	<u><u>\$ 294,061</u></u>
Total by fund			
Water	\$ 4,109,247	\$ 3,985,566	\$ 123,681
Sanitary Sewer	4,023,265	3,915,386	107,879
Storm Water	3,229,022	3,182,828	46,194
Street Light	<u>90,064</u>	<u>73,757</u>	<u>16,307</u>
Total – enterprise funds	<u><u>\$ 11,451,598</u></u>	<u><u>\$ 11,157,537</u></u>	<u><u>\$ 294,061</u></u>

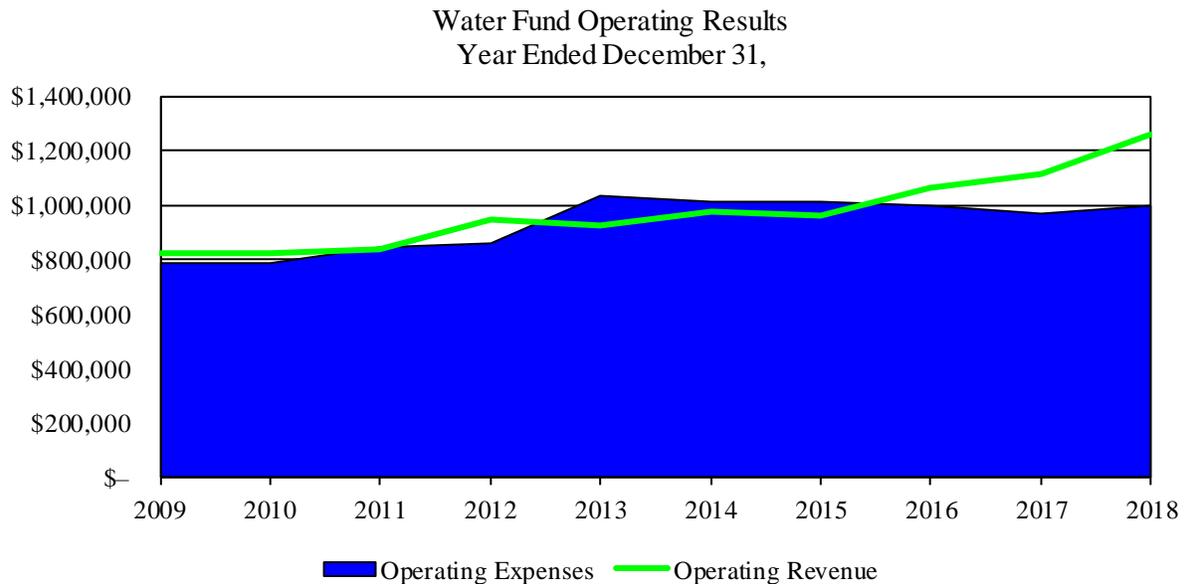
In total, the net position of the City’s enterprise funds increased by \$294,061 during the year ended December 31, 2018. The increase in net position is primarily related to positive operating results and improved investment earnings in the current year.

## WATER FUND

At December 31, 2018, the Water Fund had a cash balance of \$715,913 and total net position of \$4,109,247. Of this net position total, \$3,332,068 is the investment in capital assets, while \$777,179 is unrestricted. The following graph shows the financial position of the Water Fund over the past 10 years:



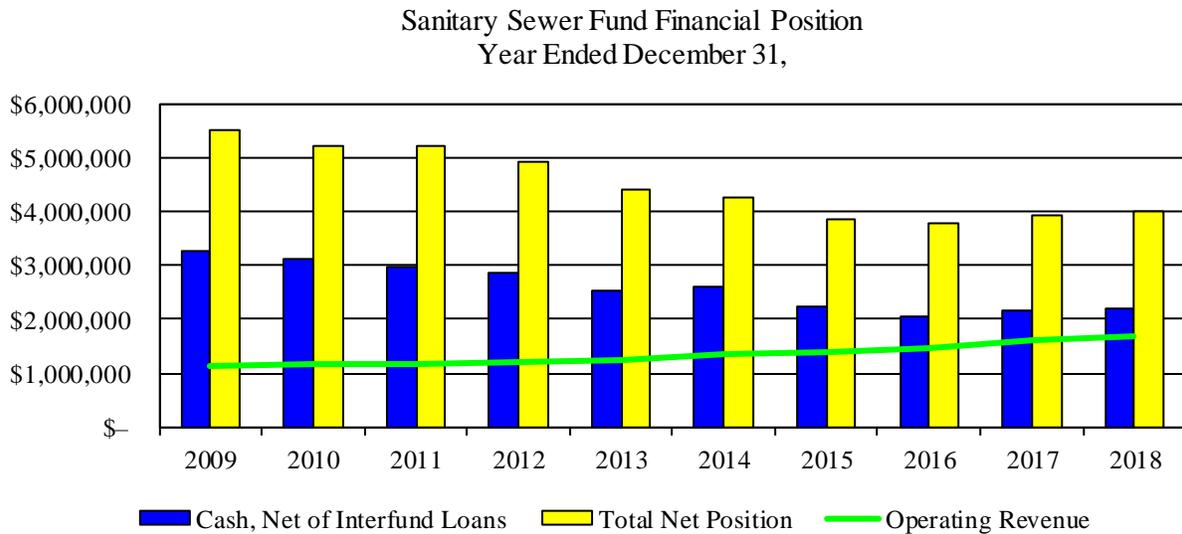
The following graph shows the operating results of the Water Fund over the last 10 years:



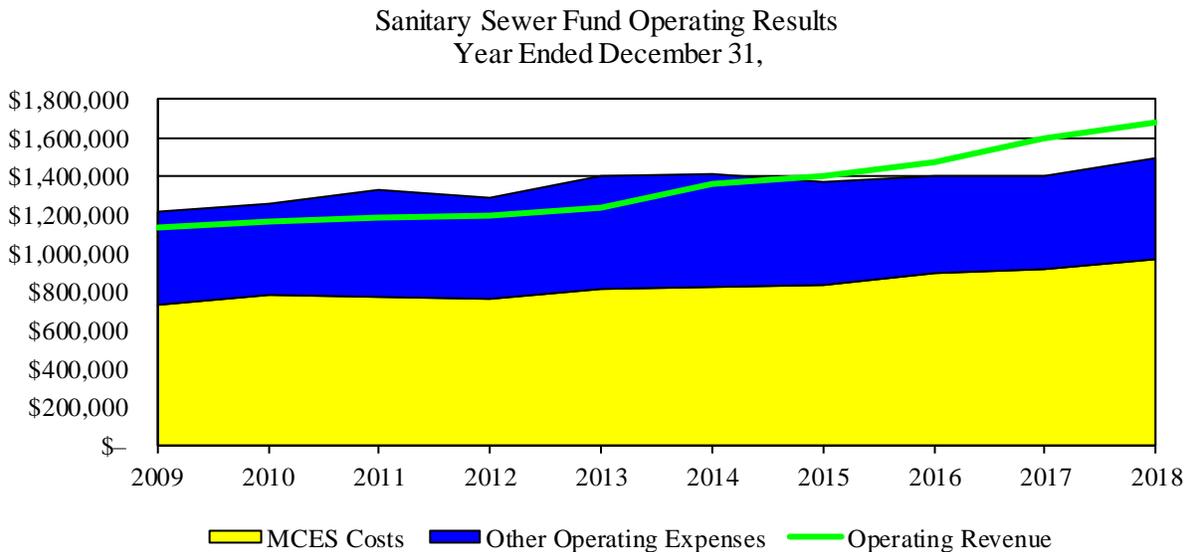
During fiscal 2018, the Water Fund experienced an operating income of \$260,414, compared to an operating income of \$143,784 in fiscal 2017. Increased sales contributed to the change in current year operations. Consumption will fluctuate from year-to-year based on many factors, including weather patterns 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, 2018, the Sanitary Sewer Fund had a cash balance of \$2,189,722 and total net position of \$4,023,265. Of this net position total, \$1,639,717 is the investment in capital assets, while \$2,383,548 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:

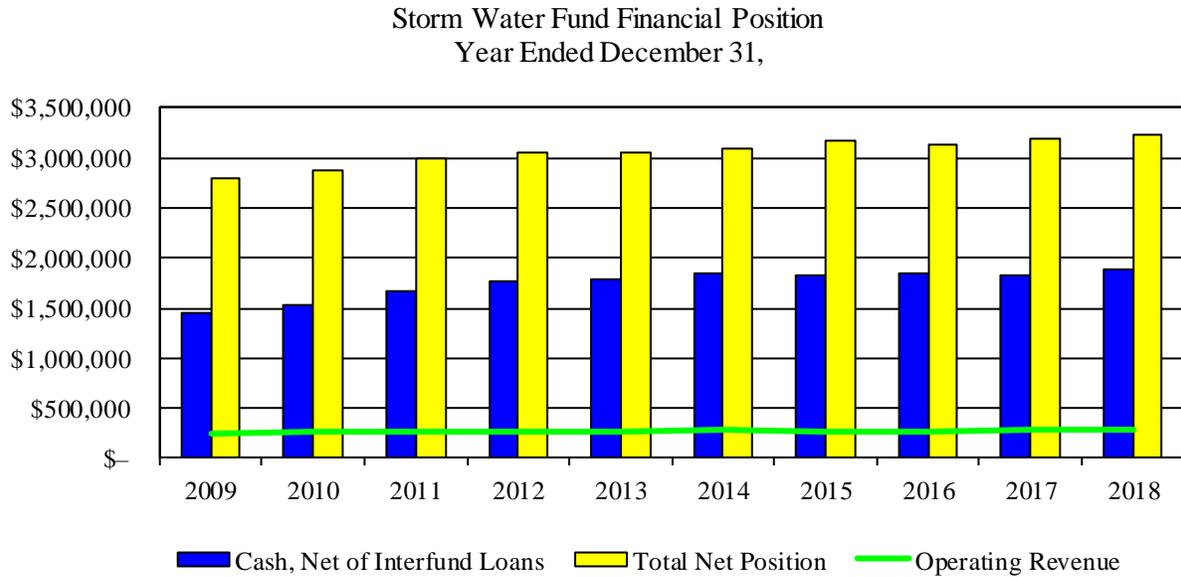


The major expense of the sanitary sewer operation is the charge from the Metropolitan Council Environmental Services (MCES). The main cause of the expense fluctuations from year-to-year, shown on the graph above, are generally changes made to the charges from the MCES reflecting the results of its sewer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

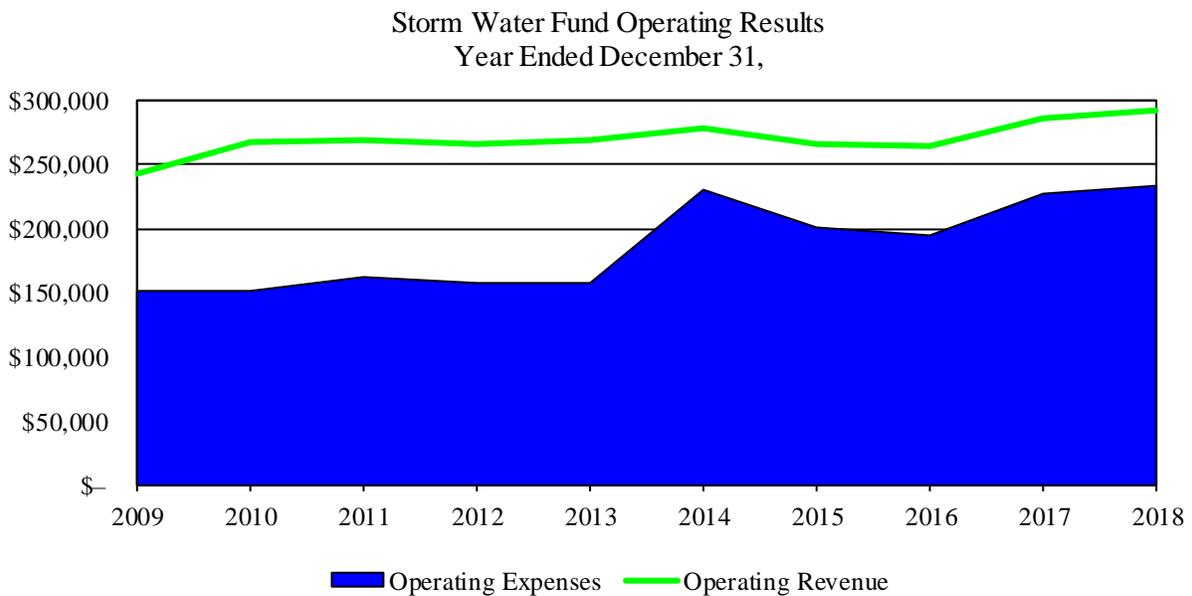
The Sanitary Sewer Fund maintains a healthy financial position. During fiscal 2018, the Sanitary Sewer Fund experienced operating income of \$186,662, compared to an operating income of \$203,048 in fiscal 2017. Increased sales and user fees, offset by a greater increase in operating expenses, contributed to the change in operating income compared to the prior year. 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, 2018, the Storm Water Fund had a cash balance of \$1,884,668 and total net position of \$3,229,022. Of this net position total, \$1,357,366 is the investment in capital assets, while \$1,871,656 is unrestricted. The following graph shows the financial position of the Storm Water Fund over the past 10 years:



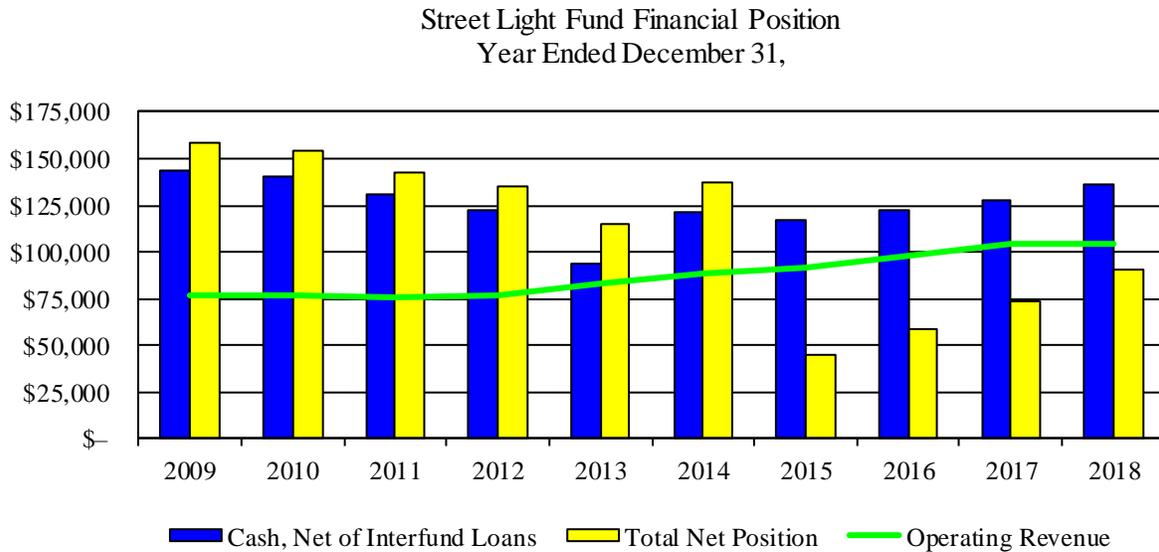
The following graph shows the operating results of Storm Water Fund for the last 10 years:



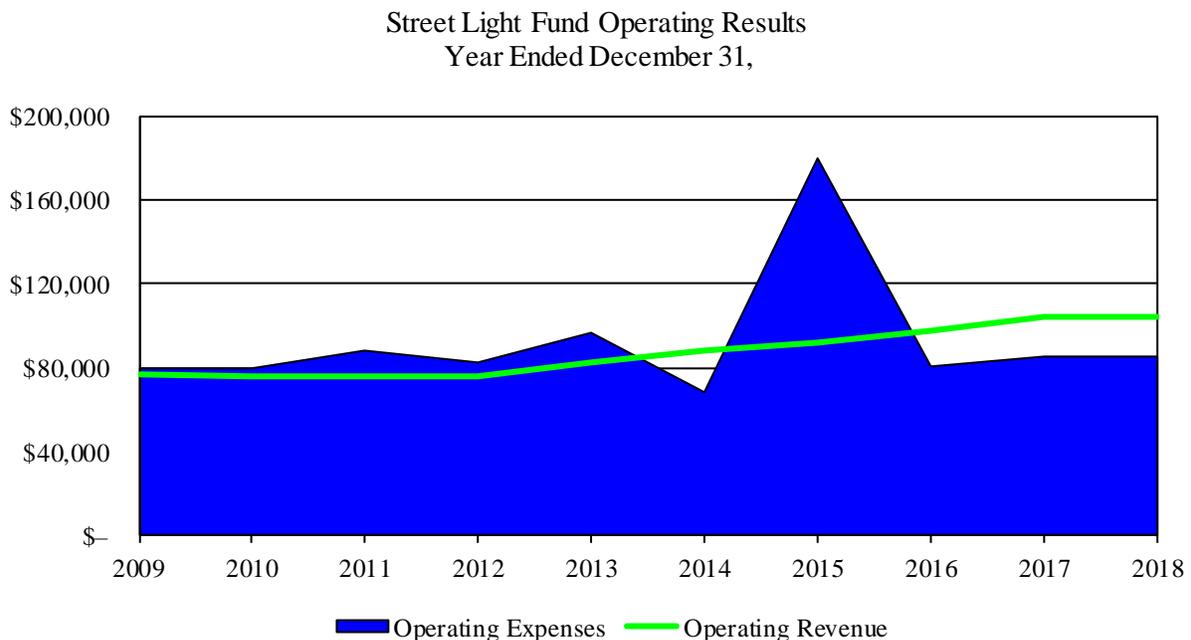
The Storm Water Fund has been able to report positive operating results each of the last 10 years, as presented in the table above. The Storm Water Fund maintains a healthy financial position. During fiscal 2018, the Storm Water Fund experienced operating income of \$58,909, compared to operating income of \$58,732 in fiscal 2017.

## STREET LIGHT FUND

At December 31, 2018, the Street Light Fund had a cash balance of \$136,169 and total net position of \$90,064, 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 2018, the Street Light Fund experienced an operating income of \$19,275 compared to an operating income of \$18,748 in fiscal 2017. A revenue increase and slight decrease in the current year expenses accounted for the change from the prior 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, 2018 and 2017, for governmental activities and business-type activities:

	As of December 31,		Increase (Decrease)
	2018	2017	
Net position			
Governmental activities			
Net investment in capital assets	\$ 36,010,512	\$ 36,784,587	\$ (774,075)
Restricted	3,298,426	3,148,142	150,284
Unrestricted	<u>9,792,777</u>	<u>9,248,882</u>	<u>543,895</u>
Total governmental activities	49,101,715	49,181,611	(79,896)
Business-type activities			
Net investment in capital assets	6,329,151	6,702,181	(373,030)
Unrestricted	<u>5,122,447</u>	<u>4,455,356</u>	<u>667,091</u>
Total business-type activities	<u>11,451,598</u>	<u>11,157,537</u>	<u>294,061</u>
Total net position	<u>\$ 60,553,313</u>	<u>\$ 60,339,148</u>	<u>\$ 214,165</u>

The City's total net position at December 31, 2018 was \$214,165 higher than the previous year. As presented above, the decrease in governmental activities net position was offset by an increase in business-type activities net position.

Positive operations improved unrestricted net position, while depreciation expense reduced the amount presented as net investment in capital assets.

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 position. 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, 2018 and 2017:

	2018		2017	
	Expenses	Program Revenues	Net Change	Net Change
Net (expense) revenue				
Governmental activities				
General government	\$ 1,327,997	\$ 255,379	\$ (1,072,618)	\$ (1,027,118)
Public safety	3,523,790	408,882	(3,114,908)	(3,322,500)
Streets and highways	2,103,663	599,481	(1,504,182)	(1,709,820)
Sanitation	27,330	21,885	(5,445)	13,326
Culture and recreation	1,467,715	436,551	(1,031,164)	(971,109)
Economic development	2,211,174	314,047	(1,897,127)	(1,752,624)
Interest on long-term debt	225,377	–	(225,377)	(100,802)
Business-type activities				
Water	996,602	1,257,016	260,414	143,784
Sanitary sewer	1,492,863	1,679,525	186,662	203,048
Storm water	233,995	292,904	58,909	58,732
Street light	87,165	104,322	17,157	16,420
Total	<u>\$ 13,697,671</u>	<u>\$ 5,369,992</u>	(8,327,679)	(8,448,663)
General revenues				
Taxes			7,498,163	7,011,017
Grants and contributions not restricted to specific programs			746,962	682,022
Gain on sale or trade of capital assets			–	48,001
Unrestricted investment earnings			296,719	258,847
Total general revenues			<u>8,541,844</u>	<u>7,999,887</u>
Change in net position			214,165	(448,776)
Net position – beginning			<u>60,339,148</u>	<u>60,787,924</u>
Net position – ending			<u>\$ 60,553,313</u>	<u>\$ 60,339,148</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 (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 2018 legislative session, falling in the second half of the state's fiscal biennium, was a short session in which only two major finance-related bills were passed, omnibus bonding bills related to bonding, and pensions. The following is a brief summary of specific legislative changes from the 2018 session or previous legislative sessions potentially impacting Minnesota cities.

**Omnibus Bonding Bill** – The omnibus bonding bill authorized financing for over \$1.5 billion in capital improvements. Included in the approved funding was \$542 million for various transportation infrastructure, \$99 million for local city-related economic development projects, and appropriations for a number of different utility (water, sewer, wastewater, etc.) infrastructure improvement programs.

**Wastewater Investment Protection** – Effective retroactively back to August 1, 2017, when a city builds a new wastewater treatment facility or upgrades one to meet current standards that exceed its previous performance, the investment in that facility would be considered adequate for a period of 16 years before a city could be required to upgrade the facility again to meet updated state wastewater facility standards.

**Competitive Bidding Threshold** – Effective for contracts awarded on or after August 1, 2018, the dollar threshold at which Minnesota Statutes require the use of a sealed bidding process was raised from \$100,000 to \$175,000. This extends the dollar range for which contracts may be awarded using direct negotiation (obtaining two quotations) to contracts between \$25,000 and \$175,000. By reference, this change also increased the dollar threshold at which public contractors' performance and payment bonds are required for contracts over \$175,000.

**Water Tank Maintenance Contracts** – Effective for contracts awarded on or after September 1, 2018, multi-year service contracts for water tank maintenance work that were previously allowed to be awarded through direct negotiation, are required to be awarded through a sealed bid or best value bid procurement process when the total cost of the contract for the services and supplies is expected to exceed the competitive bid threshold of \$175,000.

**Minnesota Licensing and Registration System (MNLARS)** – The Legislature established the MNLARS steering committee, and a one-time appropriation of \$9.65 million was approved for fiscal year 2018, to fund costs related to the continued development, improvement, operation, and deployment of the MNLARS. However, a bill to provide an additional proposed appropriation of \$9 million to partially compensate deputy registrars throughout the state for financial losses related to the flawed rollout of the MNLARS was vetoed by the Governor.

**Pension Benefit Reforms** – The 2018 pension bill included a number of reforms to the various defined benefit pension plans across the state, including the plans administered by the Public Employees Retirement Association (PERA).

- Reforms impacting the PERA General Employees Retirement Fund (GERF) plan included:
  - The actuarial assumption for investment rate of return was reduced from 8.0 percent to 7.5 percent.
  - Post-retirement cost of living adjustments (COLAs) will be equal to 50.0 percent of the annual increase for Social Security, but not less than 0.5 percent, and not more than 1.5 percent.
  - For early retirees that retire on or after January 1, 2024, COLAs are deferred until the retiree reaches the normal retirement age.
  - Phases in actuarial reduction factors over five years on early retirement benefits payable beginning July 1, 2019.
  - The rate of interest paid on refunds of employee contributions to former public employees was reduced from an annual rate of 4.0 percent to 3.0 percent.

- Reforms impacting the PERA Public Employees Police and Fire Fund plan included:
  - The actuarial assumption for investment rate of return was reduced from 8.00 percent to 7.50 percent.
  - Post-retirement COLAs were permanently set at 1.00 percent.
  - Employer contribution rates increase from the current 16.20 percent of covered salaries to 16.95 percent beginning January 1, 2019, and 17.70 percent beginning January 1, 2020.
  - Employee contribution rates increase from the current 10.80 percent of covered salaries to 11.30 percent beginning January 1, 2019, and 11.80 percent beginning January 1, 2020.
  - To reduce the need for additional contribution increases, the state will contribute an additional \$4.5 million to the plan annually for fiscal years 2019 and 2020, increasing to \$9.0 million annually thereafter through fiscal 2048, or until the plan is fully funded.
  - The rate of interest paid on refunds of employee contributions to former public employees was reduced from an annual rate of 4.00 percent to 3.00 percent.
  
- Reforms impacting the volunteer firefighter relief associations plan included:
  - Added a requirement that the fire chief annually certify each firefighter's service credit to the relief association and the related municipality effective January 1, 2019.

## ACCOUNTING AND AUDITING UPDATES

### **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 post-employment 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. 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 the four tests. In many cases, the previous guidance resulted in reporting lease transactions differently than similar nonlease financing transactions.

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

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

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

***GASB STATEMENT NO. 88, CERTAIN DISCLOSURES RELATED TO DEBT, INCLUDING DIRECT BORROWINGS AND DIRECT PLACEMENTS***

The primary objective of this statement is to improve the information that is disclosed in notes to government financial statements related to debt, including direct borrowings and direct placements. It also clarifies which liabilities governments should include when disclosing information related to debt.

The requirements of this statement will improve financial reporting by providing users of financial statements with essential information that currently is not consistently provided. In addition, information about resources to liquidate debt and the risks associated with changes in terms associated with debt will be disclosed. As a result, users will have better information to understand the effects of debt on a government's future resource flows.

This statement defines debt for purposes of disclosure in notes to financial statements as a liability that arises from a contractual obligation to pay cash (or other assets that may be used in lieu of cash) in one or more payments to settle an amount that is fixed at the date the contractual obligation is established. The statement requires that additional essential information related to debt be disclosed in notes to financial statements, including unused lines of credit; assets pledged as collateral for the debt; and terms specified in debt agreements related to significant events of default with finance-related consequences, significant termination events with finance-related consequences, and significant subjective acceleration clauses. It also requires that existing and additional information be provided for direct borrowings and direct placements of debt separately from other debt. The requirements of this statement are effective for reporting periods beginning after June 15, 2018.

***GASB STATEMENT NO. 89, ACCOUNTING FOR INTEREST COST INCURRED BEFORE THE END OF A CONSTRUCTION PERIOD***

The objectives of this statement are to enhance the relevance and comparability of information about capital assets and the cost of borrowing for a reporting period and to simplify accounting for interest cost incurred before the end of a construction period.

This statement requires that interest cost incurred before the end of a construction period be recognized as an expense in the period in which the cost is incurred for financial statements prepared using the economic resources measurement focus. As a result, interest cost incurred before the end of a construction period will no longer be included in the historical cost of a capital asset reported in a business-type activity or enterprise fund. This statement also reiterates that in financial statements prepared using the current financial resources measurement focus, interest cost incurred before the end of a construction period should continue to be recognized as an expenditure on a basis consistent with governmental fund accounting principles.

The requirements of this statement are effective for reporting periods beginning after December 15, 2019. Earlier application is encouraged. The requirements of this statement should be applied prospectively.

**GASB STATEMENT NO. 90, MAJORITY EQUITY INTEREST—AN AMENDMENT OF GASB STATEMENTS  
NO. 14 AND NO. 61**

The primary objectives of this statement are to improve the consistency and comparability of reporting a government's majority equity interest in a legally separate organization and to improve the relevance of financial statement information for certain component units.

It specifies that a majority equity interest in a legally separate organization should be reported as an investment if a government's holding of the equity interest meets the definition of an investment. It further specifies that such investments should generally be measured using the equity method, unless it is held by a special-purpose government engaged only in fiduciary activities, a fiduciary fund, or an endowment (including permanent and term endowments) or permanent fund, in which case the majority equity interest should be measured at fair value.

All other holdings of a majority equity interest in a legally separate organization that do not meet the definition of an investment result in the government being financially accountable for the legally separate organization and, therefore, the government should report that organization as a component unit, and should report an asset related to the majority equity interest using the equity method.

This statement also requires that a component unit in which a government has a 100 percent equity interest account for its assets, deferred outflows of resources, liabilities, and deferred inflows of resources at acquisition value at the date the government acquired a 100 percent equity interest in the component unit. Transactions presented in flows statements of the component unit in that circumstance should include only transactions that occurred subsequent to the acquisition.

The requirements of this statement are effective for reporting periods beginning after December 15, 2018. Earlier application is encouraged. The requirements should be applied retroactively, except for the provisions related to reporting a majority equity interest in a component unit and reporting a component unit if the government acquires a 100 percent equity interest, which should be applied prospectively.

**UNIFORM GUIDANCE, MICRO-PURCHASE THRESHOLD**

Under the Uniform Guidance for federal programs, a micro-purchase is one for goods or services that, due to its relatively low value, does not require the government to abide by many of its ordinary competitive procedures, including small business set-asides. Because the contract is theoretically such a low amount, the contracting officer can pick virtually whatever company and product he or she wants to satisfy the procurement, so long as the price is reasonable. The standard micro-purchase threshold has been amended to increase the threshold to \$10,000, effective June 20, 2018. Entities are not required to increase the micro-purchase and simplified acquisition thresholds but, if they wish to do so, they must update their procurement policies and procedures to reflect the change in thresholds. They cannot retroactively make these changes effective prior to June 20, 2018.