Management Report

for

City of North St. Paul, Minnesota

December 31, 2016

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MMKR
CERTIFIED PUBLIC ACCOUNTANTS

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To the City Council and Management
City of North St. Paul, Minnesota

We have prepared this management report in conjunction with our audit of the City of North St. Paul, Minnesota's (the City) financial statements for the year ended December 31, 2016. 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 17, 2017

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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, the discretely presented component unit, each major fund, and the aggregate remaining fund information of the City as of and for the year ended December 31, 2016, 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, 2016:

- We have issued an unmodified opinion on the City's basic financial statements.

- We reported no deficiencies in the City's internal control over financial reporting that we considered to be material weaknesses.

- The results of our testing disclosed no instances of noncompliance that are required to be reported under *Government Auditing Standards.*

- We reported three findings based on our testing of the City's compliance with Minnesota laws and regulations. These findings, as further detailed in the City's Special Purpose Audit Reports, include the following:

    1. Claims and Disbursements
    2. Payroll Declaration
    3. Solid Waste Management Billing

FOLLOW-UP ON PRIOR YEAR FINDINGS AND RECOMMENDATIONS

As a part of our audit of the City's financial statements for the year ended December 31, 2016, we performed procedures to follow-up on the findings and recommendations that resulted from our prior year audit. We reported the following finding that was corrected by the City in the current year:

- In the prior year audit, we reported a significant deficiency in the internal controls over financial reporting related to the City's segregation of duties in a number of areas due to the limited size and turnover of the City's finance department staff. Considering the mitigating controls implemented during the year and the City's finance department being fully staffed, we no longer considered this a significant deficiency in the City's internal controls over financial reporting.

AUDIT COMMENTS

- **Fund Balance Policy Recommendation** – With the implementation of a new fund balance standard in prior years, we recommend that the City review and update the current policy to be consistent with the fund balance components as established in this new standard.

- **Housing Improvement Interfund Loan and Land Held for Resale** – The Housing Improvement Fund is used to administer the resources for the rehabilitation of blighted properties within the City. The City holds a significant amount of assets held for resale, which management reports at the lower of cost or fair value. Cash resources have been made available primarily through the use of interfund loans and transfers, allowing this fund to purchase various properties as they became available. With interfund borrowing experiencing minimal activity in the current year, a significant balance still remains. Therefore, we continue to recommend that the City adopt a plan that would create a more formal arrangement on the related interfund loans. This plan would include the establishment of the terms of the interfund loans, including interest rates and length of borrowing. We recognize the City is working on an ongoing basis to utilize these assets in the best interest of the City. We also recommend that the City continue to review these property values to ensure a proper reporting of city assets and financial activity between funds for accurate presentation.

- **Individual Fund Deficits** – As reported in the City's Comprehensive Annual Financial Report (CAFR) as of December 31, 2016, the City has two special revenue funds that have deficit fund equity totaling $81,167, one debt service fund totaling $167, one capital projects fund totaling $32,037, one enterprise fund totaling $749,097, and one internal service fund totaling $112,208. There are several reasons that may cause individual funds to end a given period in a deficit position. For instance, the timing of related funding resources (future levy authority) may lag behind related expenditures made. While we understand that the City approves all disbursements and reviews the cash and equity positions of all funds, we recommend that the City match the timing of related resources with related expenditures as much as possible to limit the deficit balances at any given moment.

- **Fiber Optic Fund** – The Fiber Optic Fund has generated a significant deficit unrestricted net position balance due to cash borrowings from the Surface Water and Waste Water Funds used to finance required debt payments and capital asset purchases. As of December 31, 2016, the Fiber Optic Fund's unrestricted component of net position has a deficit of $2,611,851. It is important that the City review potential revenue streams for future years to ensure that this fund will be self-sustaining and not put any additional burden on other funds of the City.

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 basic financial statements.

No new accounting policies were adopted and the application of existing policies was not changed during the year ended December 31, 2016. 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:

- **Net Other Post-Employment Benefit (OPEB) and Pension Liabilities** – The City has recorded liabilities and activity for other post-employment benefits (OPEB) and pension benefits. These obligations are calculated using actuarial methodologies described in the Government Accounting Standards Board Statement Nos. 45 and 68. These actuarial calculations include significant assumptions, including projected changes, healthcare insurance costs, investment returns, retirement ages, proportionate share, and employee turnover.

- **Depreciation** – Management's estimates of depreciation expense are based on the estimated useful lives of the assets.

- **Compensated Absences** – Management's estimate is based on current rates of pay and unused compensated absence balances.

- **Value of Land Held for Resale** – Management's estimates of these assets are based on net realizable value (lower of cost or fair value).

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, professional standards define a disagreement with management as 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 17, 2017.

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

We were engaged to report on the supplementary 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

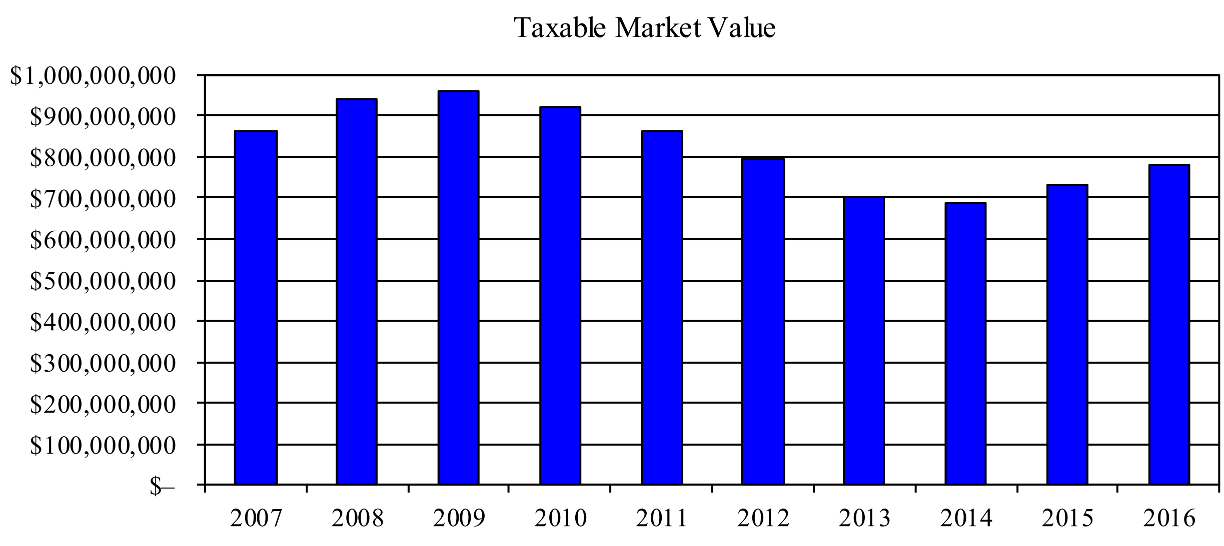
This section of the report provides you with an overview of the financial trends and activities of the City's governmental funds, which includes the General, special revenue, debt service, and capital project funds. These funds are used to account for the basic services the City provides to all of its 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 2015 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 35.6 percent for cities under 2,500 in population. Property tax levies certified by Minnesota cities for 2016 increased about 4.8 percent over 2015, compared to an increase of 4.0 percent the prior year.

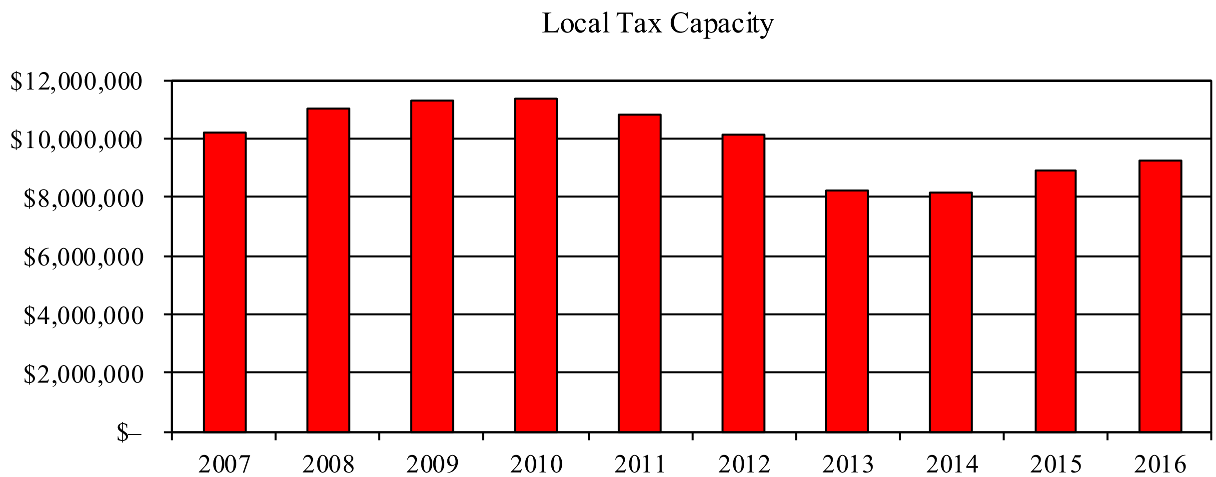
The total market value of property in Minnesota cities increased about 5.7 percent for the 2016 levy year. While the percentage of market value growth was less than the 8.5 percent increase for levy year 2015, it was considerably larger than the 1.1 percent growth experienced in levy year 2014. Market values increased across all property categories for 2016, with gains in the market values of non-homestead residential properties (9.1 percent) and other properties (7.3 percent) outpacing the market value gain of residential homestead properties (5.0 percent), commercial/industrial properties (4.9 percent), and farms (0.1 percent). The market values used for levying property taxes are based on the previous fiscal year (e.g., market values for taxes levied in 2016 were based on assessed values as of January 1, 2015), 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 6.1 percent for taxes payable in 2015 and 6.5 percent for taxes payable in 2016. 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 9.3 percent for 2015 and 4.1 percent for 2016.

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



The city portion of the average state-wide and metro area tax rates for 2016 both showed small decreases from the prior year, as levy increases were offset by improvements in property tax capacities. The following table presents the average tax rates applied to city residents for each of the last two levy years, along with comparative state-wide and metro area rates.

Rates expressed as a percentage of net tax capacity

	All Cities State-Wide		Seven-County Metro Area		City of North St. Paul	
	2015	2016	2015	2016	2015	2016
Average tax rate						
City	46.9	46.5	43.4	43.0	35.2	38.7
County	44.7	44.1	42.9	42.3	58.9	58.9
School	27.1	27.5	28.3	28.6	35.9	35.6
Special taxing	6.9	6.9	8.8	8.7	13.8	12.6
Total	125.6	125.0	123.4	122.6	143.8	145.8

There are a number of reasons contributing to the change in the average total tax rate. The City's portion of the total tax capacity rate for the City's residents has historically been well below the average for Minnesota cities state-wide and for cities in the seven-county metro area. Higher than average tax rates of other taxing authorities resulted in a total average tax rate exceeding both averages provided in the table above.

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, 2016, presented both by fund balance classification and by fund:

Governmental Funds Change in Fund Balance

	Fund Balance as of December 31, 2016	Fund Balance as of December 31, 2015	Increase (Decrease)
Fund balances of governmental funds			
Total by classification			
Nonspendable	$ 23,492	$ 1,800	$ 21,692
Restricted	6,554,769	3,089,182	3,465,587
Committed	2,369,282	2,042,917	326,365
Assigned	1,191,708	638,601	553,107
Unassigned	1,599,781	1,622,043	(22,262)
Total governmental funds	$ 11,739,032	$ 7,394,543	$ 4,344,489
Total by fund			
General	$ 1,761,874	$ 1,759,204	$ 2,670
G.O. Capital Improvement Plan Bonds of 2008A/G.O. Capital Improvement Plan Refunding Bonds of 2016B	$ 3,106,956	$ 577,786	2,529,170
Street Improvement	915,658	70,300	845,358
Casey Lake Project	(32,037)	–	(32,037)
Nonmajor	5,986,581	4,987,253	999,328
Total governmental funds	$ 11,739,032	$ 7,394,543	$ 4,344,489

In total, the fund balances of the City's governmental funds increased by $4,344,489 during the year ended December 31, 2016. The increase is due largely to the increase in restricted funds in the G.O. Capital Improvement Plan Bonds of 2008A/G.O. Capital Improvement Plan Refunding Bonds of 2016B Debt Service Fund and Street Improvement Capital Projects Fund. The increase in the Debt Service Fund was due to refunding bonds issued in the current year that will be used to call bonds in a future period in advance of their originally scheduled maturity dates. The increase in the Capital Project Fund was from bond proceeds exceeding current year spending on street projects. Any unspent proceeds will be expended next year with the completion of project costs.

GOVERNMENTAL FUND REVENUES

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 the City's operation. Also, certain data on 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.

Governmental Funds Revenue per Capita
With State-Wide Averages by Population Class

	State-Wide			City of North St. Paul		
Year	December 31, 2015			2014	2015	2016
Population	2,500–10,000	10,000–20,000	20,000–100,000	11,951	12,006	12,104
Property taxes	$ 443	$ 414	$ 443	$ 305	$ 309	$ 343
Tax increments	26	33	37	16	15	32
Franchise and other taxes	33	42	39	44	47	45
Special assessments	59	52	59	22	10	25
Licenses and permits	31	31	43	25	20	23
Intergovernmental revenues	285	322	156	192	185	195
Charges for services	110	85	94	17	18	16
Other	69	62	58	44	31	35
Total revenue	$ 1,056	$ 1,041	$ 929	$ 665	$ 635	$ 714

The City's governmental funds have generated significantly less revenue per capita in total than other Minnesota cities in its population class. 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 generated $8,638,808 of total revenue in its governmental funds in 2016, an increase of $1,012,945 (13.3 percent) from the prior year. The City's per capita governmental funds revenue for 2016 was $714, an increase of $79, from the prior year including the effect of a change in estimated population. The largest changes occurred with increases in property taxes, tax increments, and special assessments. The increase in property taxes was mainly due to the increased general property tax levy and the increase in tax increments was due to the first year of tax increment collections on the Helen Street Senior Housing Tax Increment Financing District. Special assessment revenue increased with the collection of about $210,000 in prepayments for street improvement projects in the current year compared to just $16,000 in the prior year.

GOVERNMENTAL FUND EXPENDITURES

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 comparative state-wide averages, are presented in the following table:

Governmental Funds Expenditures per Capita
With State-Wide Averages by Population Class

	State-Wide			City of North St. Paul		
Year	December 31, 2015			2014	2015	2016
Population	2,500–10,000	10,000–20,000	20,000–100,000	11,951	12,006	12,104
Current						
General government	$ 134	$ 109	$ 89	$ 69	$ 174	$ 174
Public safety	255	244	261	271	261	285
Streets and highways	119	117	99	125	66	75
Parks and recreation	88	108	94	30	47	29
All other	64	70	89	33	7	14
	660	648	632	528	555	577
Capital outlay and construction	372	389	286	187	86	304
Debt service						
Principal	181	178	117	64	65	83
Interest and fiscal	51	40	33	27	32	30
	232	218	150	91	97	113
Total expenditures	$ 1,264	$ 1,255	$ 1,068	$ 806	$ 738	$ 994

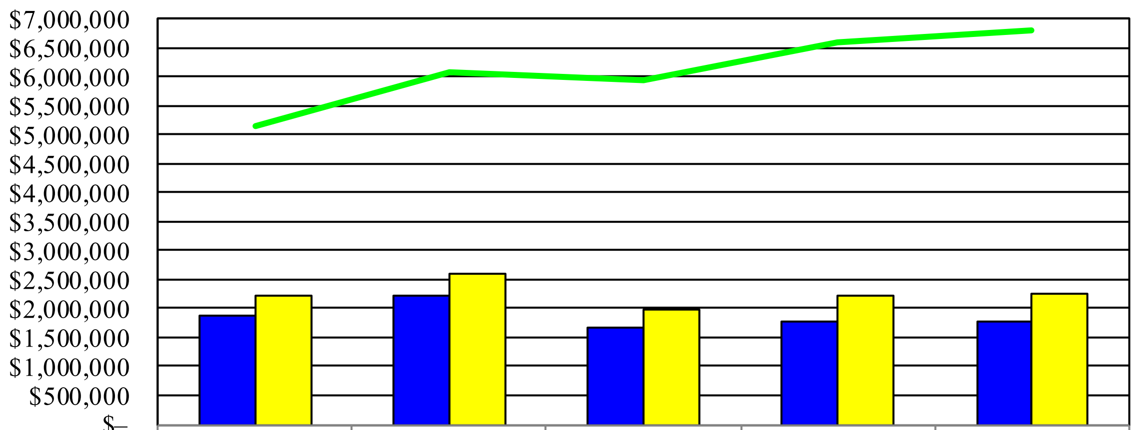
As the above table reflects, the City's expenditures per capita have also been below the state-wide averages in recent years. A significant reason for this difference is in capital outlay and debt service, which is reasonable for a city that is not in the middle of a major development or redevelopment period.

Total expenditures in the City's governmental funds for 2016 were $12,041,885, an increase of $3,171,645 (35.8 percent). The City's per capita governmental funds total expenditures increased $256, or 34.7 percent. This increase was mainly in capital outlay and construction related to increased costs from street improvement projects.

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 parks and recreation. The graph below illustrates the change in the General Fund financial position over the last five years. We have also included a line representing annual expenditures to reflect the change in the size of the General Fund operation over the same period.

General Fund Financial Position
Years Ended December 31,



	2012	2013	2014	2015	2016
Fund Balance	$1,864,823	$2,234,743	$1,685,786	$1,759,204	$1,761,874
Cash (Net)	$2,220,403	$2,586,008	$1,996,062	$2,208,507	$2,261,283
Expenditures	$5,151,656	$6,084,048	$5,945,113	$6,585,504	$6,814,126

The City's General Fund cash and investment balance (net of borrowing) at December 31, 2016 was $2,261,283, an increase of $52,776 from the previous year. Total fund balance at December 31, 2016 was $1,761,874, an increase of $2,670 from the prior year. The unassigned portion of this fund balance level represents approximately 25 percent of the City's 2017 budgeted General Fund expenditure levels.

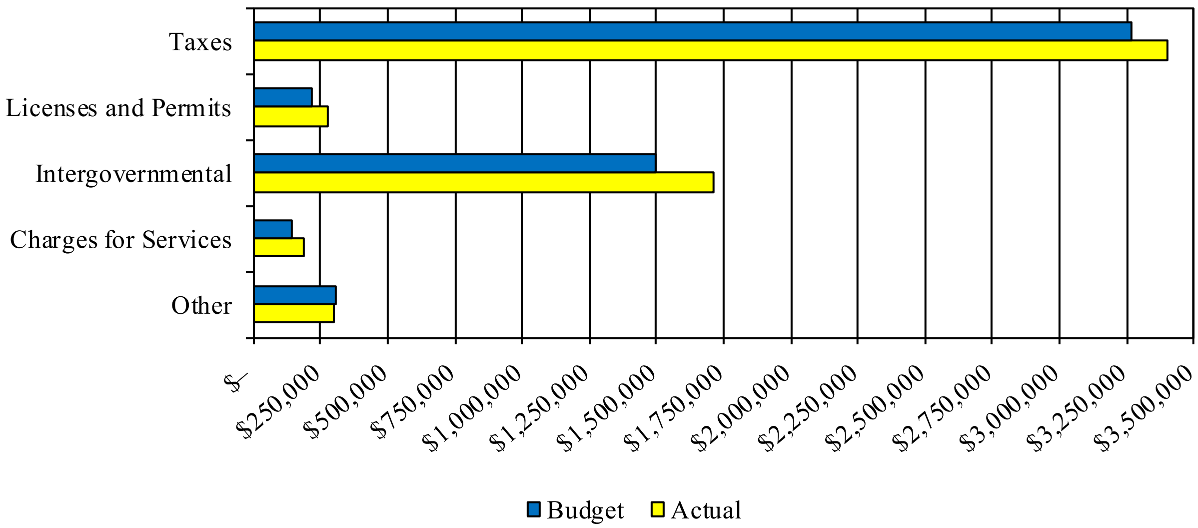
The level of General Fund balance is greatly attributed to the City's fund balance policies as well as the general budgeting policies. These policies have allowed the City to provide funding for the General Fund operations as well as equipment replacement and street improvement programs without disrupting the General Fund's financial position or having to issue debt for these types of projects.

As the graph illustrates, the City has generally been able to maintain stable 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.

Current city policy allows fund balance in the General Fund to grow to 25 percent of the subsequent year's budgeted expenditures, while the State Auditor recommends that cities maintain an unrestricted fund balance that is between 35 percent and 50 percent of total current expenditures. The City should review the level of fund balance on an ongoing basis to determine the optimal level for efficient operations.

The following graph reflects the City's General Fund revenue sources compared to budget for 2016:

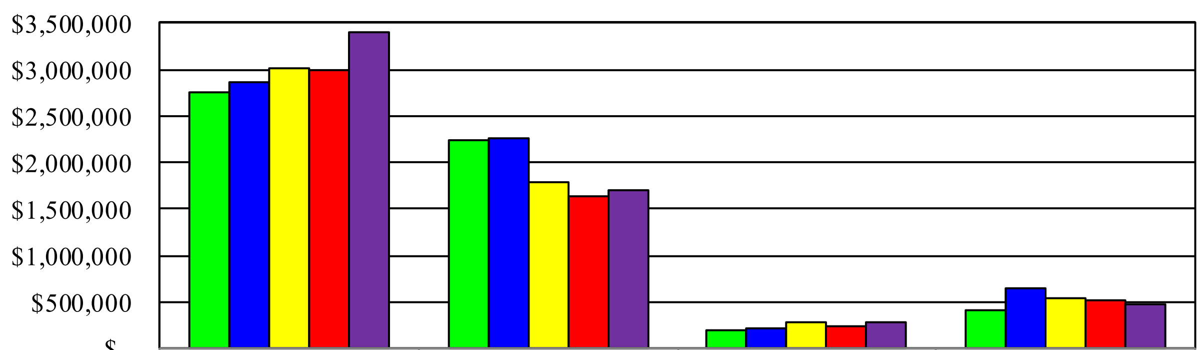
General Fund Revenue



Total General Fund revenues for 2016 were $5,877,337, an increase of $460,795 from the previous year, and were $447,185 (8.2 percent) over budget. Revenues were more than projected in each category as presented above except for the other revenue category, with the largest variances in intergovernmental and taxes, which were $214,436 and $136,424, respectively above anticipated levels due in part to conservative budgeting.

The following graph presents the City's General Fund revenue by source for the last five years:

General Fund Revenue by Source
Years Ended December 31,

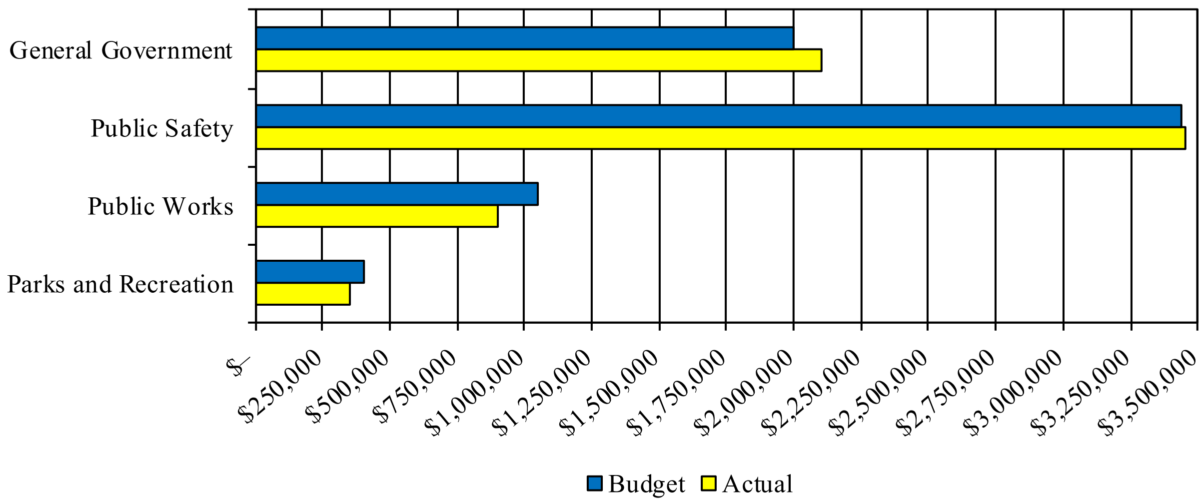


	Taxes	Intergovernmental	Licenses and Permits	All Other
2012	$2,747,440	$2,250,123	$197,529	$419,877
2013	$2,859,371	$2,269,279	$215,313	$646,824
2014	$3,016,970	$1,792,686	$293,691	$551,647
2015	$3,001,290	$1,646,938	$241,532	$526,782
2016	$3,403,580	$1,710,429	$275,704	$487,624

The General Fund is primarily financed by property and other taxes, along with local government aid, to operate activities in this fund. The largest change occurred in tax sources, which increased by $402,290 from the prior year as a result of an increase in the general property levy approved by City Council for 2016.

The following graph reflects the City's General Fund expenditures compared to budget for 2016:

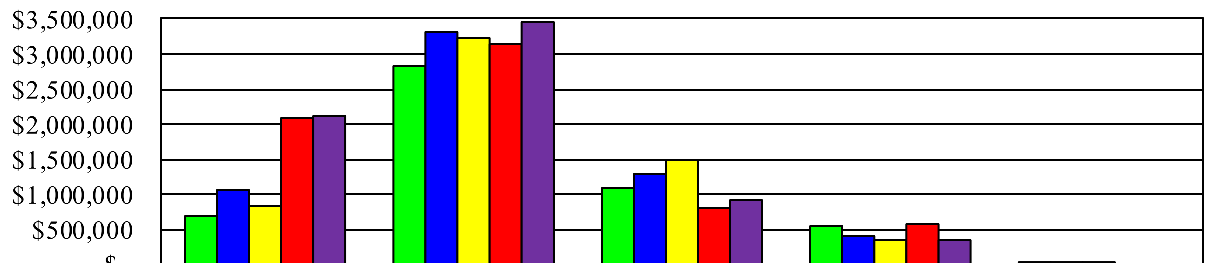
General Fund Expenditures



Total General Fund expenditures for 2016 were $6,814,126, an increase of $228,622, or 3.5 percent, from the previous year, and $74,261, or 1.1 percent, under budget. The largest variances occurred in the general government and public works functions. Public works expenditures were $143,555 less than anticipated, while general government spending was over budget by $108,494. The underspending in public works was largely caused by anticipating more spending for street improvement projects than actually occurred in the current year. The general government function was over budget mainly in the elections and central services departments.

The following graph provides you with the components of the City's General Fund spending for the past five years:

General Fund Expenditures by Function
Years Ended December 31,



	General Government	Public Safety	Public Works	Parks and Recreation	Other
2012	$680,556	$2,817,773	$1,085,088	$533,239	$35,000
2013	$1,047,162	$3,306,412	$1,282,431	$413,043	$35,000
2014	$828,533	$3,230,288	$1,498,650	$352,642	$35,000
2015	$2,091,457	$3,136,479	$792,389	$565,179	$–
2016	$2,106,720	$3,453,098	$902,417	$351,891	$–

Typical to other cities we audit, public safety costs comprise the largest portion of General Fund spending. The largest changes occurred in public safety and public works, which increased $316,619 and $110,028, respectively in the current year. The increase in the public safety function was mainly due to increased personal services in police protection and fire. The increase in the public works function was mainly due to increased street maintenance.

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 include the Electric, Water, Surface Water, Waste Water, Fiber Optic, and Solid Waste 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, 2016, presented both by classification and by fund:

Enterprise Funds Change in Financial Position

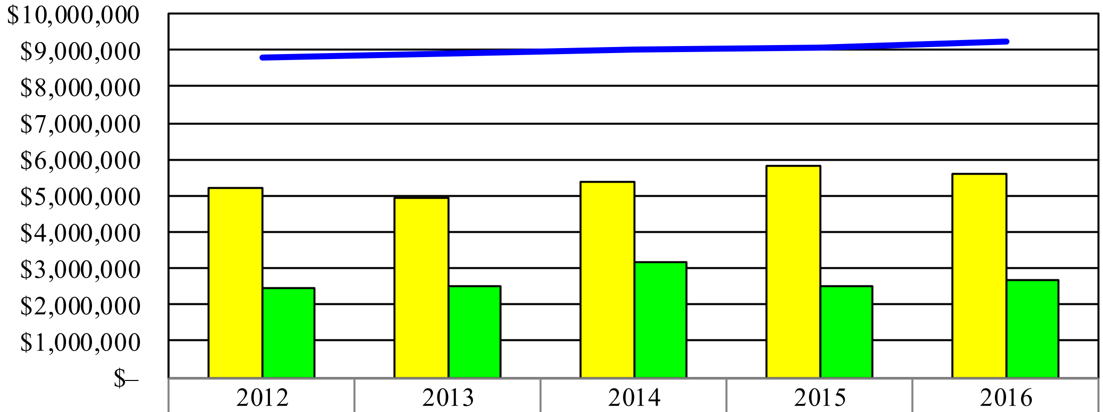
	Net Position as of December 31, 2016	Net Position as of December 31, 2015	Increase (Decrease)
Net position of enterprise funds			
Total by classification			
Net investment in capital assets	$ 5,361,800	$ 5,230,857	$ 130,943
Unrestricted	4,936,728	4,045,686	891,042
Total enterprise funds	$ 10,298,528	$ 9,276,543	$ 1,021,985
Total by fund			
Electric	$ 4,363,732	$ 4,472,785	$ (109,053)
Water	2,609,535	2,238,225	371,310
Surface Water	2,098,470	1,933,952	164,518
Waste Water	1,398,128	984,341	413,787
Fiber Optic	(749,097)	(704,966)	(44,131)
Solid Waste	577,760	352,206	225,554
Total enterprise funds	$ 10,298,528	$ 9,276,543	$ 1,021,985

In total, the net position of the City's enterprise funds increased by $1,021,985 during the year ended December 31, 2016. This increase was mainly in unrestricted net position, which increased $891,042 due to positive operating results in the enterprise funds.

ELECTRIC FUND

The following graph and table presents comparative data for Electric Fund operations:

Electric Fund Operations
Years Ended December 31,



	2012	2013	2014	2015	2016
Purchased Utilities	$5,216,641	$4,960,032	$5,383,056	$5,800,842	$5,612,907
Other Operating Expenses	$2,457,377	$2,508,062	$3,187,473	$2,513,005	$2,676,080
Net Sales	$8,796,555	$8,903,555	$9,000,195	$9,089,050	$9,215,980

	2012	2013	2014	2015	2016
Total operating revenue	$ 8,796,555	$ 8,903,555	$ 9,000,195	$ 9,089,050	$ 9,215,980
Purchased utilities	5,216,641	4,960,032	5,383,056	5,800,842	5,612,907
Gross profit	3,579,914	3,943,523	3,617,139	3,288,208	3,603,073
Other operating expenses	(2,457,377)	(2,508,062)	(3,187,473)	(2,513,005)	(2,676,080)
Depreciation	(201,450)	(155,852)	(56,960)	(65,916)	(71,606)
Interest expense	(89,799)	(85,625)	(81,524)	(76,546)	(74,761)
Other income (loss)	(10,523)	(27,751)	75,482	73,904	69,321
Income (loss) before transfers	820,765	1,166,233	366,664	706,645	849,947
Net transfers in (out)	(42,910)	(343,175)	(600,000)	(1,146,021)	(959,000)
Change in net position	$ 777,855	$ 823,058	$ (233,336)	$ (439,376)	$ (109,053)
Income (loss) before transfers as a percentage of net sales	9.3 %	13.1 %	4.1 %	7.8 %	9.2 %

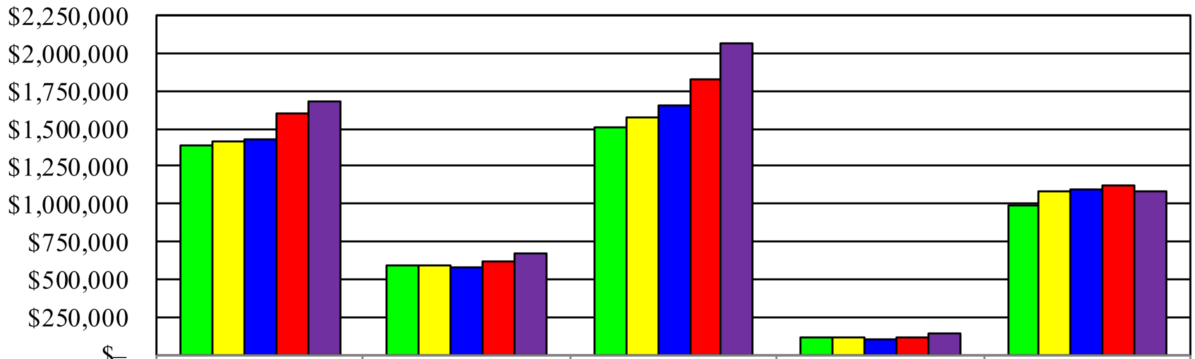
Gross profit results for the City's Electric Fund increased by $314,865 from the prior year. This increase was due in part to a decrease in purchased utilities charges paid to the Minnesota Municipal Power Agency in the current year.

The Electric Fund ended fiscal 2016 with a total net position of $4,363,732, of which $3,360,979 was unrestricted, with the remaining balance being classified as net investment in capital assets. At December 31, 2016, unrestricted cash and investments totaled $4,742,219.

OTHER ENTERPRISE UTILITY FUNDS

The graph below shows operating revenue of the other enterprise utility funds over the last five years:

Utility Revenue
Years Ended December 31,



	Water	Surface Water	Waste Water	Fiber Optic	Solid Waste
2012	$1,384,986	$588,515	$1,508,674	$117,651	$992,495
2013	$1,408,464	$586,525	$1,568,817	$118,059	$1,087,665
2014	$1,429,871	$581,341	$1,653,655	$104,472	$1,095,158
2015	$1,597,494	$613,504	$1,832,616	$108,615	$1,127,975
2016	$1,676,387	$669,380	$2,060,406	$145,673	$1,084,284

As the graph displays, utility revenue will fluctuate from year-to-year, which is common as a result of changes for rate adjustments as well as external factors, such as the weather, which may impact usage levels.

With the exception of the Fiber Optic Fund, these enterprise utility funds have typically experienced positive operating results. The positive operating results of these funds are important because the revenue is being used to pay debt service on the City's Utility Revenue Bonds of 2006A, 2009C, 2014A, 2015A, and 2016A.

WATER FUND

The following table presents five years of comparative operating results for the City's Water Fund:

	2012	2013	2014	2015	2016
Operating revenue	$ 1,384,986	$ 1,408,464	$ 1,429,871	$ 1,597,494	$ 1,676,387
Operating expenses	(748,680)	(962,340)	(905,104)	(934,400)	(825,720)
Depreciation	(196,666)	(212,357)	(160,457)	(162,240)	(162,915)
Operating income	439,640	233,767	364,310	500,854	687,752
Nonoperating revenue (expenses)	(79,602)	(76,817)	(73,485)	(80,462)	(111,442)
Income before transfers	360,038	156,950	290,825	420,392	576,310
Net transfers in (out)	(20,000)	(46,000)	(185,000)	(142,201)	(205,000)
Change in net position	$ 340,038	$ 110,950	$ 105,825	$ 278,191	$ 371,310
Income before transfers as a percentage of operating revenue	26.0 %	11.1 %	20.3 %	26.3 %	34.4 %

The Water Fund ended 2016 with a net position of $2,609,535, an increase of $371,310 from the prior year. Of this, $1,225,048 represents the net investment in capital assets, while $1,384,487 is considered unrestricted.

Operating revenue increased $78,893 from the previous year, or about 4.9 percent. Increased rates and charges resulted in this overall increase in operating revenue. Operating expenses decreased $108,680, or about 11.6 percent, from the prior year primarily in professional services and materials and supplies.

During the current year, this utility operation also made transfers to other funds totaling $205,000.

SURFACE WATER FUND

The following table presents five years of comparable operating results for the City's Surface Water Fund:

	2012	2013	2014	2015	2016
Operating revenue	$ 588,515	$ 586,525	$ 581,341	$ 613,504	$ 669,380
Operating expenses	(348,443)	(345,793)	(271,762)	(246,858)	(301,498)
Depreciation	(94,673)	(94,673)	(79,073)	(99,533)	(99,533)
Operating income	145,399	146,059	230,506	267,113	268,349
Nonoperating revenue (expense)	(50,609)	(56,278)	(16,802)	(33,472)	(23,831)
Income before transfers	94,790	89,781	213,704	233,641	244,518
Net transfers in (out)	–	–	(40,000)	164,599	(80,000)
Change in net position	$ 94,790	$ 89,781	$ 173,704	$ 398,240	$ 164,518
Income before transfers as a percentage of operating revenue	16.1 %	15.3 %	36.8 %	38.1 %	36.5 %

The Surface Water Fund ended 2016 with a net position of $2,098,470, an increase of $164,518 from the prior year. Of this, $868,906 represents the net investment in capital assets, while $1,229,564 is considered unrestricted.

Operating revenues increased $55,876 from the previous year, or about 9.1 percent, due to the increased rates. Operating expenses increased $54,640, or about 22.1 percent, from the previous year primarily in personal services.

During the current year, this utility operation also made transfers to other funds totaling $80,000.

WASTE WATER FUND

The following table presents five years of comparative operating results for the City's Waste Water Fund:

	2012	2013	2014	2015	2016
Operating revenue	$ 1,508,674	$ 1,568,817	$ 1,653,655	$ 1,832,616	$ 2,060,406
Operating expenses	(1,086,642)	(977,277)	(1,011,362)	(1,270,007)	(1,362,513)
Depreciation	(185,183)	(197,498)	(148,457)	(113,889)	(106,296)
Operating income	236,849	394,042	493,836	448,720	591,597
Nonoperating revenue (expenses)	(115,191)	(115,448)	(80,637)	(99,808)	(32,810)
Income before transfers	121,658	278,594	413,199	348,912	558,787
Net transfers in (out)	(69,967)	(44,000)	(125,000)	(61,966)	(145,000)
Change in net position	$ 51,691	$ 234,594	$ 288,199	$ 286,946	$ 413,787
Income before transfers as a percentage of operating revenue	8.1 %	17.8 %	25.0 %	19.0 %	27.1 %

The Waste Water Fund ended 2016 with a net position of $1,398,128, an increase of $413,787 from the prior year. Of this, $402,339 represents the net investment in capital assets, while the unrestricted portion has a balance of $995,789.

Operating revenue increased $227,790 from the previous year, or about 12.4 percent, largely due to the increase in rates applied in fiscal 2016. Operating expenses increased $92,506, or about 7.3 percent, due to increased spending in personal services and professional services related to the street improvements and lift station repairs.

During the current year, this utility operation also made transfers to other funds totaling $145,000.

FIBER OPTIC FUND

The following table presents five years of comparable operating results for the City's Fiber Optic Fund:

	2012	2013	2014	2015	2016
Operating revenue	$ 117,651	$ 118,059	$ 104,472	$ 108,615	$ 145,673
Operating expenses	(128,301)	(94,045)	(157,661)	(73,756)	(121,364)
Depreciation	(46,558)	(46,558)	(46,558)	(44,440)	(44,440)
Operating income (loss)	(57,208)	(22,544)	(99,747)	(9,581)	(20,131)
Nonoperating revenue (expenses)	(42,195)	(32,665)	(22,699)	(5,293)	(24,000)
Change in net position	(99,403)	(55,209)	(122,446)	(14,874)	(44,131)
Net position					
Beginning of year	(413,034)	(512,437)	(567,646)	(690,092)	(704,966)
End of year	$ (512,437)	$ (567,646)	$ (690,092)	$ (704,966)	$ (749,097)
Net position					
Net investment in capital assets	$ 1,330,977	$ 1,409,163	$ 1,590,340	$ 1,784,058	$ 1,862,754
Unrestricted	(1,843,414)	(1,976,809)	(2,280,432)	(2,489,024)	(2,611,851)
Total net position	$ (512,437)	$ (567,646)	$ (690,092)	$ (704,966)	$ (749,097)

The Fiber Optic Fund ended 2016 with a net position deficit of $749,097, down $44,131 from the prior year. Of this, $1,862,754 represents the net investment in capital assets, while the unrestricted portion has a deficit balance of $2,611,851.

As discussed earlier in this report, it is critical for the City to review the operations of this fund. This analysis would need to consider the City's plans to cover repair and replacement costs as the operating results include a charge for depreciation expense, which is a noncash expense. Cash flow management for this fund is also important for repayment on interfund borrowing.

SOLID WASTE FUND

The following table presents five years of comparable operating results for the City's Solid Waste Fund:

	2012	2013	2014	2015	2016
Operating revenue	$ 992,495	$ 1,087,665	$ 1,095,158	$ 1,127,975	$ 1,084,284
Operating expenses	(886,897)	(923,779)	(839,576)	(1,167,540)	(826,275)
Operating income	105,598	163,886	255,582	(39,565)	258,009
Nonoperating revenue (expenses)	(25,982)	(29,699)	25,694	23,069	27,545
Income (loss) before transfers	79,616	134,187	281,276	(16,496)	285,554
Net transfers in (out)	(20,000)	(20,000)	(20,000)	(20,000)	(60,000)
Change in net position	$ 59,616	$ 114,187	$ 261,276	$ (36,496)	$ 225,554
Income (loss) before transfers as a percentage of operating revenue	8.0 %	12.3 %	25.7 %	(1.5) %	26.3 %

The Solid Waste Fund ended 2016 with a net position of $577,760, an increase of $225,554 from the prior year, all of which is reported as unrestricted net position.

Operating revenue decreased $43,691 from the previous year, or about 3.9 percent, due to a decrease in rebates received in fiscal 2016. Operating expenses decreased $341,265, or about 29.2 percent, as a result of decreased hauling charges recognized in the current year.

During the current year, this utility operation also made transfers to other funds totaling $60,000.

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 financial 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.

- **Net Investment in Capital Assets** – The portion of net position reflecting equity in capital assets (i.e., capital assets minus related debt).
- **Restricted Net Position** – The portion of net position equal to resources whose use is legally restricted minus any noncapital-related liabilities payable from those same resources.
- **Unrestricted Net Position** – The residual balance of net position after the elimination of *net investment in capital assets* and *restricted net position*.

The following table presents the components of the City's net position as of December 31, 2016 and 2015 for governmental activities, business-type activities (utility fund operations), and the Economic Development Authority (EDA) component unit:

	As of December 31,		Increase
	2016	2015	(Decrease)
Net position			
Governmental activities			
Net investment in capital assets	$ 18,613,487	$ 18,732,114	$ (118,627)
Restricted	4,343,924	3,734,922	609,002
Unrestricted	1,535,730	1,113,925	421,805
Total governmental activities	24,493,141	23,580,961	912,180
Business-type activities			
Net investment in capital assets	5,361,800	5,230,857	130,943
Unrestricted	4,870,810	3,946,517	924,293
Total business-type activities	10,232,610	9,177,374	1,055,236
Economic Development Authority			
Restricted	72,894	60,108	12,786
Total net position	$ 34,798,645	$ 32,818,443	$ 1,980,202

The City (including the EDA) ended 2016 with combined total net position of $34,798,645, an increase of $1,980,202 from the prior year. At the end of the current fiscal year, the City is able to present positive balances in all three 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 and the EDA for the years ended December 31, 2016 and 2015:

	2016			2015
	Expenses	Program Revenues	Net Change	Net Change
Net (expense) revenue				
Governmental activities				
General government	$ 2,635,566	$ 298,971	$ (2,336,595)	$ (2,261,474)
Public safety	4,237,119	439,424	(3,797,695)	(2,329,105)
Public works	1,576,435	980,474	(595,961)	(1,255,371)
Parks and recreation	544,721	210,081	(334,640)	(242,718)
Economic development	184,357	200	(184,157)	(95,388)
Interest and fiscal charges	412,714	–	(412,714)	(356,642)
Business-type activities				
Electric	8,443,299	9,255,317	812,018	656,546
Water	1,110,248	1,680,594	570,346	432,659
Surface water	428,295	670,005	241,710	229,611
Waste water	1,620,631	2,175,789	555,158	359,856
Fiber optic	167,886	145,673	(22,213)	(14,874)
Solid waste	835,013	1,113,601	278,588	(23,082)
Economic Development Authority	122,849	–	(122,849)	(137,847)
Total net (expense) revenue	$ 22,319,133	$ 16,970,129	(5,349,004)	(5,037,829)
General revenues				
Property and franchise taxes			5,222,789	4,581,882
Grants and contributions not restricted to specific programs			1,919,280	1,828,503
Other general revenues			42,049	4,606
Investment earnings			145,088	184,947
Total general revenues			7,329,206	6,599,938
Change in net position			$ 1,980,202	$ 1,562,109

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. It also shows that, for the most part, the City's business-type activities are generating sufficient program revenues (service charges and program-specific grants) to cover expenses. This is critical given the current downward pressures on the general revenue sources.

LEGISLATIVE UPDATES

The 2016 legislative session, falling in the second half of the state's fiscal biennium, was scheduled to be a short session lasting only 11 weeks. Since biennial budgets are adopted in odd-year legislative sessions, less time is usually needed for the even-year sessions. However, because the 2015 Legislature adjourned without passing funding bills in several significant areas, it was anticipated that the 2016 legislative session would be considerably more active than the typical short session. In spite of this, only a few funding bills were brought forth to the Governor by the end of the 2016 regular legislative session, including a supplemental budget bill and an omnibus tax bill. The Governor chose not to sign the tax bill due to a drafting error that would have resulted in an unintended reduction of state revenues. When the framework for a special session could not be agreed upon, the fiscal year ended without the adoption of a new tax bill, capital bonding bill, or transportation funding package.

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

Border-to-Border Broadband Grants – The 2016 supplemental budget act appropriated $35 million in fiscal 2017 for a Border-to-Border Broadband Grant Program. The grants, available through the Office of Broadband Development in the Department of Employment and Economic Development (DEED), 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.

Equity-Related Programs and Grants – The 2016 supplemental budget act also appropriated $35 million in fiscal 2017 for the financing of equity-related programs through DEED, the majority of which was allocated for programs and grants for communities of color, people with disabilities, seniors, and youth.

Sales Tax Exemption – Effective January 1, 2017, the sales tax exemption on the purchase of goods or services enacted for cities in 2014 is expanded to include all special districts; city, county, or township instrumentalities; economic development authorities; housing and redevelopment authorities; and all joint power boards or organizations.

Taxes Covered Under Debt Management Services – Amendments were made to the statutes governing debt management and debt settlement services to clarify the status of delinquent taxes owed to Minnesota local governments and political subdivisions as debt with regard to those services, and include those entities as creditors for the purpose of debt management services.

Elections – An omnibus elections law was passed making several changes to elections administration requirements. In addition to establishing a presidential primary to take the place of the current caucus system beginning in 2020, the law modified election procedures in a number of areas, including: absentee balloting, voting station dimensions, election canvassing, candidate filing, the extension of polling hours to accommodate voters in line at closing, and emergency election plans.

Police-Worn Body Cameras – A number of new laws were enacted related to portable recording systems (police-worn body cameras) and the data derived from their use, addressing: data retention and destruction, permitted uses of the systems, audits of the data, and vendor practices. Among the changes are a requirement for gathering public input before purchasing or implementing the use of portable recording systems, and requirements for the adoption and dissemination of written policies over the use of portable recording systems.

Veteran Preference Act – New language was added to state statutes clarifying that Minnesota cities and towns may require a veteran to complete an initial probationary period when hired.

Charitable Gambling – Cities that require charitable gambling organizations to contribute 10 percent of their net profits to the city for charitable purposes are now required to acknowledge the source of the funds, either in communications about the receipt or distribution of the funds.

Donation of Surplus Equipment – Local governments are now permitted to donate surplus public works equipment, cell phones, or emergency medical and firefighting equipment to nonprofit organizations. The donation of surplus equipment was added to the list of exceptions to municipal tort liability. Prior to making any such donations, a city must adopt a policy on how it will determine what equipment is considered surplus and eligible for donation and how it will determine which nonprofit organizations will receive such donations. The policy must address the city's obligation to disclose that the donated equipment may be defective and cannot be relied upon for safety.

Temporary Family Health Care Housing Permits – A new special land use permit system was established for a specific type of mobile health care-related mobile housing, intended to provide transitional housing for seniors. Cities will be required to implement the new permit system unless they officially act to opt out of the program. The program sets forth requirements for structure and placement, the permit process and duration, applicants, inspections, and the process for opting out.

Partition Fence Viewing Exemption – Cities now have the authority to pass a resolution to exempt adjoining owners or occupants from the partition fence law when their land is considered to be less than 20 acres combined, thereby relieving the city of the responsibility of participating in a potentially costly "fence-viewing" process to mediate disputes between adjoining landowners required to share the costs of constructing fences.

ACCOUNTING AND AUDITING UPDATES

GASB STATEMENT NO. 73, *ACCOUNTING AND FINANCIAL REPORTING FOR PENSIONS AND RELATED ASSETS THAT ARE NOT WITHIN THE SCOPE OF GASB STATEMENT 68, AND AMENDMENTS TO CERTAIN PROVISIONS OF GASB STATEMENTS 67 AND 68*

This statement extends the approach to accounting and financial reporting established in GASB Statement No. 68 to all pensions, including those not administered through a trust. Governmental employers participating in such plans will be required to report the total of any unfunded pension liability related to the plan in their accrual basis financial statements, rather than the net pension liability. The requirements of this statement that address accounting and financial reporting by employers and governmental nonemployer contributing entities for pensions not within the scope of GASB Statement No. 68, are effective for financial statements for fiscal years beginning after June 15, 2016.

This statement also clarified the application of certain provisions of GASB Statement Nos. 67 and 68 regarding 10-year schedules of required supplementary information (RSI) and other recognition issues pertaining to employers and nonemployer contributing entities effective for financial statements for fiscal years beginning after June 15, 2015.

GASB STATEMENT NO. 74, *FINANCIAL REPORTING FOR POSTEMPLOYMENT BENEFIT PLANS OTHER THAN PENSION PLANS*

This statement establishes new accounting and financial reporting requirements for other post-employment benefits (OPEB) plans, replacing GASB Statement Nos. 43 and 57. It also includes requirements for defined contribution OPEB plans that replace the requirements for those OPEB plans in GASB Statement Nos. 25, 43, and 50.

This statement will improve financial reporting primarily through enhanced note disclosures and schedules of RSI that will be presented by OPEB plans administered through trusts meeting the specified criteria. The new information will enhance the decision-usefulness of the financial reports of those OPEB plans, their value for assessing accountability, and their transparency by providing information about measures of net OPEB liabilities and explanations of how and why those liabilities changed from year to year. The net OPEB liability information, including ratios, will offer an up-to-date indication of the extent to which the total OPEB liability is covered by the fiduciary net position of the OPEB plan. The comparability of the reported information for similar types of OPEB plans will be improved by the changes related to the attribution method used to determine the total OPEB liability. The contribution schedule will provide measures to evaluate decisions related to the assessment of contribution rates in comparison with actuarially determined rates, if such rates are determined. In addition, new information about rates of return on OPEB plan investments will inform financial report users about the effects of market conditions on the OPEB plan’s assets over time and provide information for users to assess the relative success of the OPEB plan’s investment strategy and the relative contribution that investment earnings provide to the OPEB plan’s ability to pay benefits to plan members when they come due.

This statement is effective for financial statements for fiscal years beginning after June 15, 2016. Earlier application is encouraged.

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 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. 80, *BLENDING REQUIREMENTS FOR CERTAIN COMPONENT UNITS—AN AMENDMENT OF GASB STATEMENT NO. 14*

The objective of this statement is to clarify the financial statement presentation requirements for certain component units. This statement amends the blending requirements for the financial statement presentation of component units of all state and local governments. The additional criterion requires blending of a component unit incorporated as a not-for-profit corporation in which the primary government is the sole corporate member. The additional criterion does not apply to component units included in the financial reporting entity pursuant to the provisions of GASB Statement No. 39, *Determining Whether Certain Organizations Are Component Units—an amendment of GASB Statement No. 14.*

The requirements of this statement are effective for reporting periods beginning after June 15, 2016. Earlier application is encouraged.

GASB STATEMENT NO. 81, *IRREVOCABLE SPLIT-INTEREST AGREEMENTS*

This statement provides recognition and measurement guidance for the accounting and financial reporting of irrevocable split-interest agreements by governments that are the beneficiary of such an agreement. Split-interest agreements are a type of giving agreement used by donors to provide resources to two or more beneficiaries, including governments.

This statement requires that a government that receives resources pursuant to an irrevocable split-interest agreement (1) recognize assets, liabilities, and deferred inflows of resources at the inception of the agreement, (2) recognize assets representing its beneficial interests in irrevocable split-interest agreements that are administered by a third party if the government controls the present service capacity of the beneficial interests, and (3) recognize revenue when the resources become applicable to the reporting period.

The requirements of this statement are effective for financial statements for periods beginning after December 15, 2016, and should be applied retroactively. Earlier application is encouraged.

GASB STATEMENT NO. 82, *PENSION ISSUES—AN AMENDMENT OF GASB STATEMENTS NO. 67, NO. 68, AND NO. 73*

The intent of this statement is to address certain issues raised with respect to GASB Statement Nos. 67, 68, and 73.

This statement amends GASB Statement Nos. 67 and 68, changing the definition of "covered payroll" utilized in schedules of RSI from the payroll of employees that are provided with pensions through the pension plan, to the payroll on which contributions to a pension plan are based. It clarifies that a deviation, as the term is used in Actuarial Standards of Practice, is not considered to be in conformity with the requirements of GASB Statement Nos. 67, 68, or 73 for the selection of assumptions used in determining the total pension liability and related measures. It also clarifies that payments made by an employer to satisfy contribution requirements that are identified by the pension plan terms as plan member contribution requirements should be classified as plan member contributions for purposes of Statement No. 67 and as employee contributions for purposes of Statement No. 68, and requires that an employer's expense and expenditures for those amounts be recognized in the period for which the contribution is assessed and classified in the same manner as the employer classifies similar compensation other than pensions.

The requirements of this statement are effective for reporting periods beginning after June 15, 2016, except for the requirements of this statement for the selection of assumptions in a circumstance in which an employer's pension liability is measured as of a date other than the employer's most recent fiscal year-end. In that circumstance, the requirements for the selection of assumptions are effective for that employer in the first reporting period in which the measurement date of the pension liability is on or 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.