

Management Report  
for  
City of North St. Paul, Minnesota  
December 31, 2017

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PRINCIPALS

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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, 2017. We have organized this report into the following sections:

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

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

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

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

Minneapolis, Minnesota  
April 18, 2018

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## AUDIT SUMMARY

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

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

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

### PLANNED SCOPE AND TIMING OF THE AUDIT

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

### AUDIT OPINION AND FINDINGS

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

- We have issued an unmodified opinion on the City's basic financial statements.
- We reported no deficiencies in the City's internal control over financial reporting that we considered to be material weaknesses.
  - It should be understood that internal controls are never perfected, and those controls which protect the City's funds from such things as fraud and accounting errors need to be continually reviewed and modified as necessary.
- The results of our testing disclosed no instances of noncompliance that are required to be reported under *Government Auditing Standards*.
- We reported two 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. Payroll Declaration
  2. 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, 2017, 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:

- Minnesota Statutes require cities to pay each vendor obligation according to the terms of each contract or within 35 days after the receipt of the goods or service or the invoice for the goods or services. If such obligations are not paid within the appropriate time period, the City must pay interest on the unpaid obligations at the rate of 1.5 percent per month or part of a month. For two disbursements selected for testing in the prior year, the City did not pay the obligation within the required time period and did not pay interest on the unpaid obligation. We are pleased to report this is not a finding in the current year.

## 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 as of December 31, 2017, the City has one special revenue fund that has a deficit fund equity totaling \$5,662, one capital projects fund deficit totaling \$1,292, one enterprise fund deficit totaling \$790,855, and one internal service fund deficit totaling \$159,786. 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, 2017, the Fiber Optic Fund's unrestricted component of net position has a deficit of \$2,609,169. 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, 2017, however, the City implemented the following governmental accounting standards during the fiscal year:

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

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

## ACCOUNTING ESTIMATES AND MANAGEMENT JUDGMENTS

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

- **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 GASB 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, 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 18, 2018.

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

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

## **OTHER AUDIT FINDINGS OR ISSUES**

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

## **OTHER MATTERS**

We applied certain limited procedures to the management's discussion and analysis and the pension 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

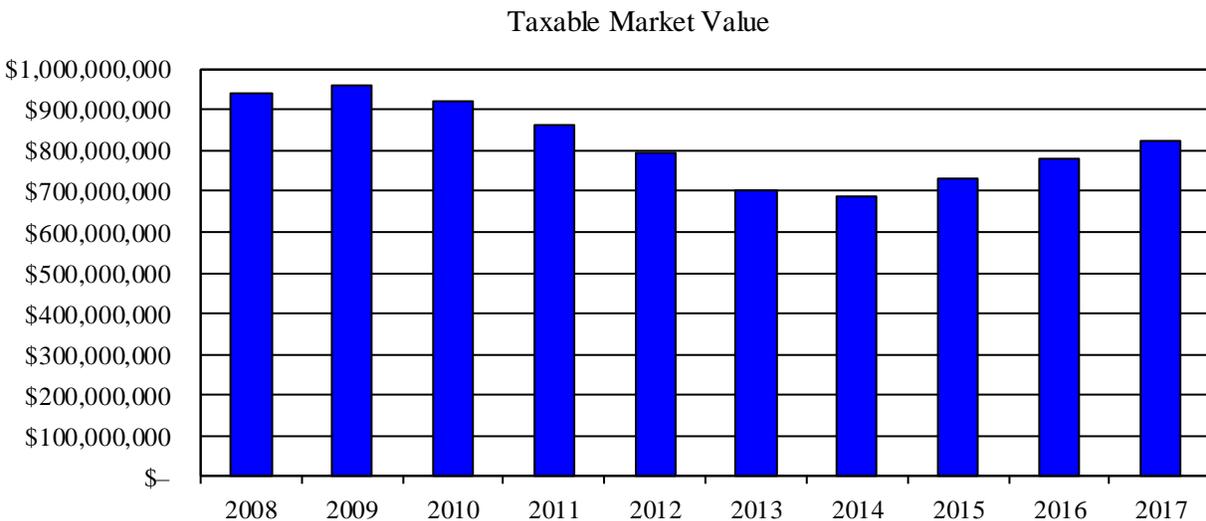
This section of the report provides you with an overview of the financial trends and activities of the City's governmental funds, which includes the General, special revenue, debt service, and capital project funds. These funds are used to account for the basic services the City provides to all of its 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 2016 fiscal year, local ad valorem property tax levies provided 39.8 percent of the total governmental fund revenues for cities over 2,500 in population, and 36.4 percent for cities under 2,500 in population.

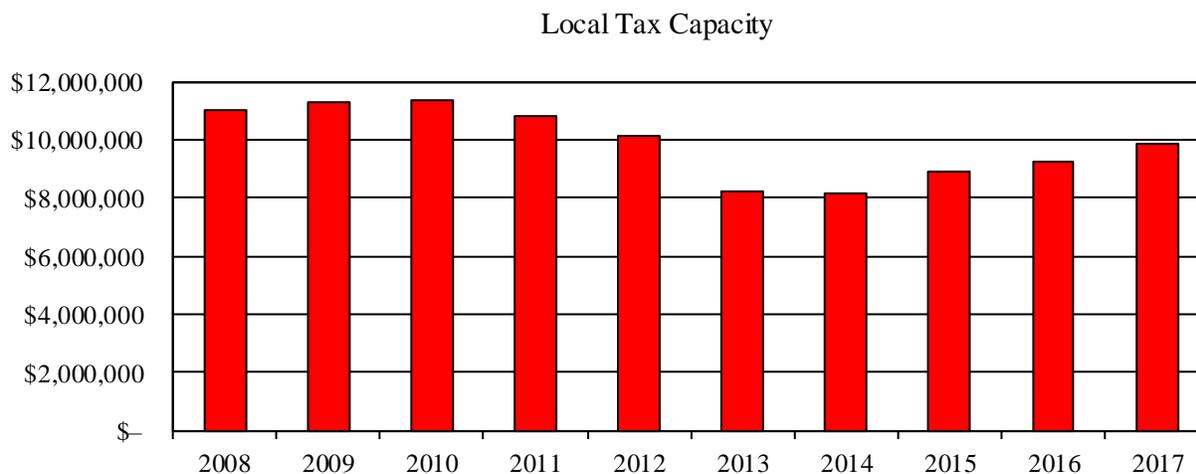
The total market value of property in Minnesota cities increased about 5.6 percent for the 2017 levy year, which followed an increase of 5.7 percent for the levy year 2016. The market values used for levying property taxes are based on the previous fiscal year (e.g., market values for taxes levied in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

The City's taxable market value increased 6.5 percent for taxes payable in 2016 and 5.7 percent for taxes payable in 2017. The following graph shows the City's changes in taxable market value over the past 10 years:



Tax capacity is considered the actual base available for taxation. It is calculated by applying the state's property classification system to each property's market value. Each property classification, such as commercial or residential, has a different calculation and uses different rates. Consequently, a city's total tax capacity will change at a different rate than its total market value, as tax capacity is affected by the proportion of its 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 4.1 percent for 2016 and 6.5 percent for 2017.

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



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

<b>Rates Expressed as a Percentage of Net Tax Capacity</b>							
	All Cities State-Wide		Seven-County Metro Area		City of North St. Paul		
	2015	2016	2015	2016	2015	2016	2017
<b>Average tax rate</b>							
City	46.9	46.5	43.4	43.0	35.2	38.7	41.9
County	44.7	44.1	42.9	42.3	58.9	58.9	55.9
School	27.1	27.5	28.3	28.6	35.9	35.6	33.6
Special taxing	<u>6.9</u>	<u>6.9</u>	<u>8.8</u>	<u>8.7</u>	<u>13.8</u>	<u>12.6</u>	<u>12.0</u>
Total	<u>125.6</u>	<u>125.0</u>	<u>123.4</u>	<u>122.6</u>	<u>143.8</u>	<u>145.8</u>	<u>143.4</u>

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

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, 2017, presented both by fund balance classification and by fund:

<b>Governmental Funds Change in Fund Balance</b>			
	Fund Balance as of December 31,		Increase (Decrease)
	<u>2017</u>	<u>2016</u>	
Fund balances of governmental funds			
Total by classification			
Nonspendable	\$ 26,016	\$ 23,492	\$ 2,524
Restricted	7,114,605	6,554,769	559,836
Committed	3,196,670	2,369,282	827,388
Assigned	1,019,565	1,191,708	(172,143)
Unassigned	<u>1,701,518</u>	<u>1,599,781</u>	<u>101,737</u>
Total governmental funds	<u>\$ 13,058,374</u>	<u>\$ 11,739,032</u>	<u>\$ 1,319,342</u>
Total by fund			
General	\$ 1,757,749	\$ 1,761,874	\$ (4,125)
G.O. Capital Improvement Plan Bonds of 2008A/G.O. Capital Improvement Plan Refunding Bonds of 2016B	3,108,427	3,106,956	1,471
Street Improvement	702,456	915,658	(213,202)
Nonmajor	<u>7,489,742</u>	<u>5,954,544</u>	<u>1,535,198</u>
Total governmental funds	<u>\$ 13,058,374</u>	<u>\$ 11,739,032</u>	<u>\$ 1,319,342</u>

In total, the fund balances of the City's governmental funds increased by \$1,319,342 during the year ended December 31, 2017. The increase is due largely to the increase in committed funds in the Street Maintenance Special Revenue Fund. This increase was the result of increased municipal street aid received in the current year. The increase in restricted funds is due in part to the issuance of the 2017A General Obligation Bonds, increased special assessments, and an increase in the debt service levy.

## 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 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 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.

<b>Governmental Funds Revenue per Capita</b>						
With State-Wide Averages by Population Class						
Year	State-Wide			City of North St. Paul		
	December 31, 2016			2015	2016	2017
Population	2,500–10,000	10,000–20,000	20,000–100,000	12,006	12,104	12,069
Property taxes	\$ 460	\$ 432	\$ 455	\$ 309	\$ 343	\$ 387
Tax increments	26	26	42	15	32	37
Franchise and other taxes	35	43	45	47	45	44
Special assessments	59	44	59	10	25	26
Licenses and permits	35	33	42	20	23	25
Intergovernmental revenues	313	275	152	185	195	219
Charges for services	110	92	103	18	16	17
Other	91	57	54	31	35	46
Total revenue	<u>\$ 1,129</u>	<u>\$ 1,002</u>	<u>\$ 952</u>	<u>\$ 635</u>	<u>\$ 714</u>	<u>\$ 801</u>

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 \$9,666,134 of total revenue in its governmental funds in 2017, an increase of \$1,027,326 (11.9 percent) from the prior year. The City's per capita governmental funds revenue for 2017 was \$801, an increase of \$87, from the prior year, including the effect of a change in estimated population. The largest changes occurred with increases in property taxes and intergovernmental revenues. The increase in property taxes was mainly due to the increased general property tax levy. Intergovernmental revenues increased due to the increased municipal street aid received in the current 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:

<b>Governmental Funds Expenditures per Capita</b> With State-Wide Averages by Population Class							
Year Population	State-Wide			City of North St. Paul			
	December 31, 2016			2015	2016	2017	
	2,500–10,000	10,000–20,000	20,000–100,000	12,006	12,104	12,069	
<b>Current</b>							
General government	\$ 145	\$ 114	\$ 97	\$ 174	\$ 174	\$ 178	
Public safety	263	250	273	261	285	297	
Streets and highways	126	123	95	66	75	73	
Parks and recreation	93	109	95	47	29	31	
All other	74	77	91	7	14	37	
	<u>701</u>	<u>673</u>	<u>651</u>	<u>555</u>	<u>577</u>	<u>616</u>	
Capital outlay and construction	381	370	301	86	304	125	
<b>Debt service</b>							
Principal	196	163	115	65	83	85	
Interest and fiscal	48	38	34	32	30	36	
	<u>244</u>	<u>201</u>	<u>149</u>	<u>97</u>	<u>113</u>	<u>121</u>	
Total expenditures	<u>\$ 1,326</u>	<u>\$ 1,244</u>	<u>\$ 1,101</u>	<u>\$ 738</u>	<u>\$ 994</u>	<u>\$ 862</u>	

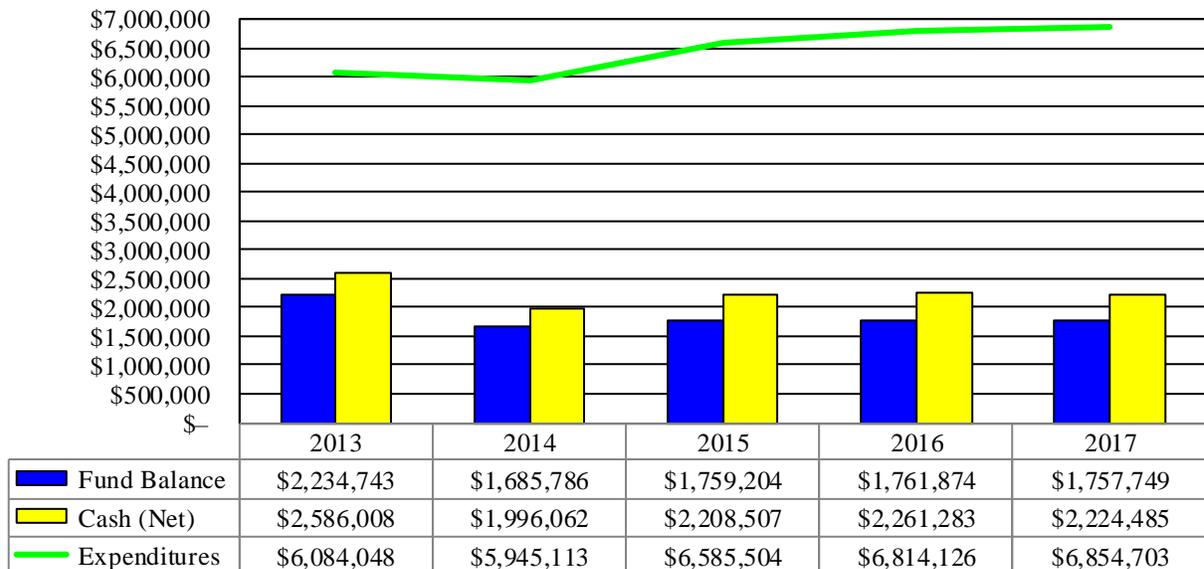
As the above table reflects, the City's expenditures per capita have also been below the state-wide averages in recent years. A significant reason for this difference is in capital outlay and debt service, which is reasonable for a city that is not in the middle of a major development or redevelopment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

Total expenditures in the City's governmental funds for 2017 were \$10,389,714, a decrease of \$1,652,171 (13.7 percent). The City's per capita governmental funds total expenditures decreased \$132, or 13.3 percent. This decrease was mainly in capital outlay and construction related to street improvement projects and the Casey Lake Project completed in the prior 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 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,



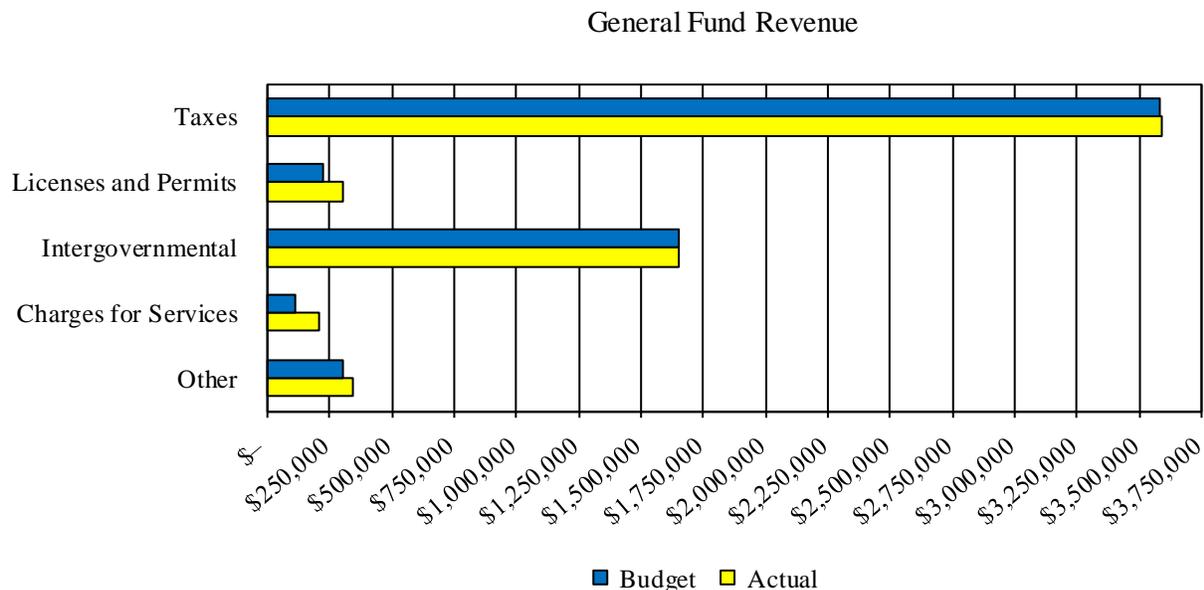
The City's General Fund cash and investment balance (net of borrowing) at December 31, 2017 was \$2,224,485, a decrease of \$36,798 from the previous year. Total fund balance at December 31, 2017 was \$1,757,749, a decrease of \$4,125 from the prior year. The unassigned portion of this fund balance level represents approximately 25 percent of the City's 2018 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.

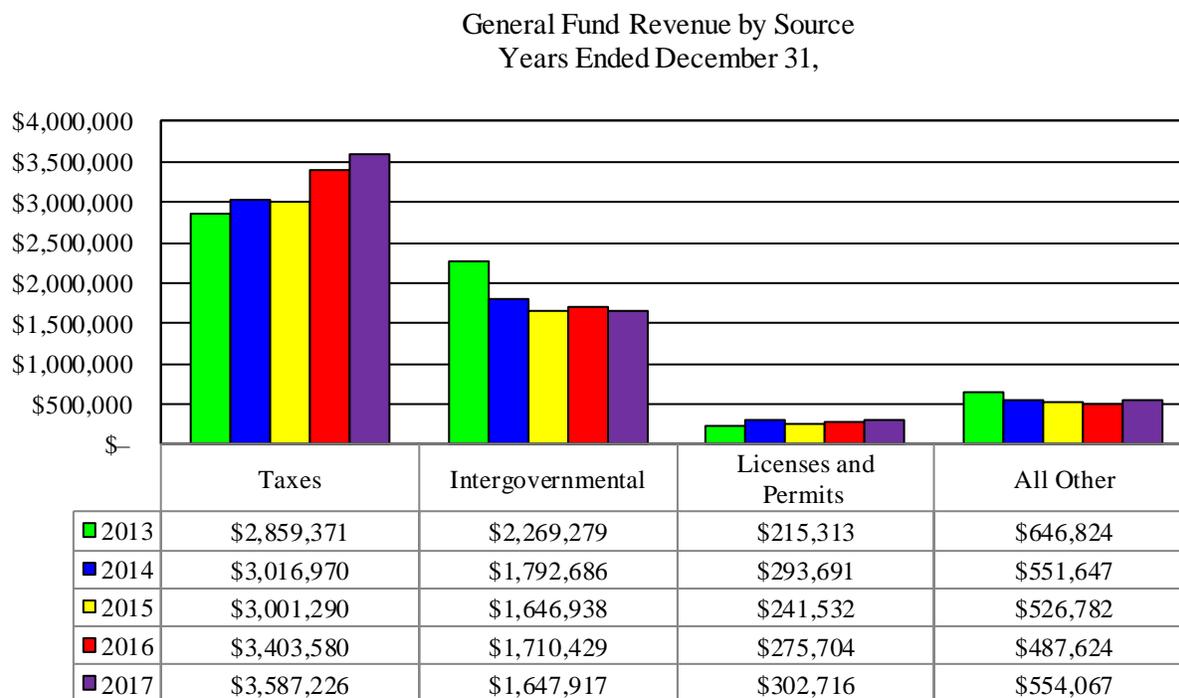
Current city policy allows fund balance in the General Fund to grow to 25 percent of the subsequent year's budgeted expenditures, while the State Auditor recommends that cities maintain an unrestricted fund balance that is between 35 percent and 50 percent of total current expenditures. The City should 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 2017:



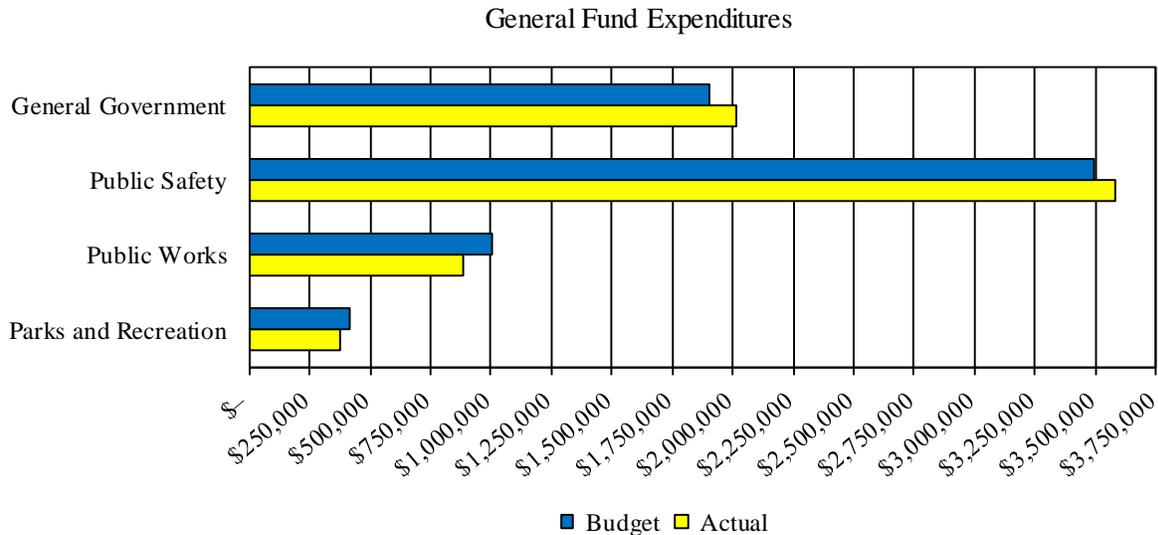
Total General Fund revenues for 2017 were \$6,091,926, an increase of \$214,589 from the previous year, and were \$227,196 (3.9 percent) over budget. Revenues were more than projected in each category as presented above, except for intergovernmental revenue, with the largest variances in charges for services and licenses and permits, which were \$98,099 and \$81,216, 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:



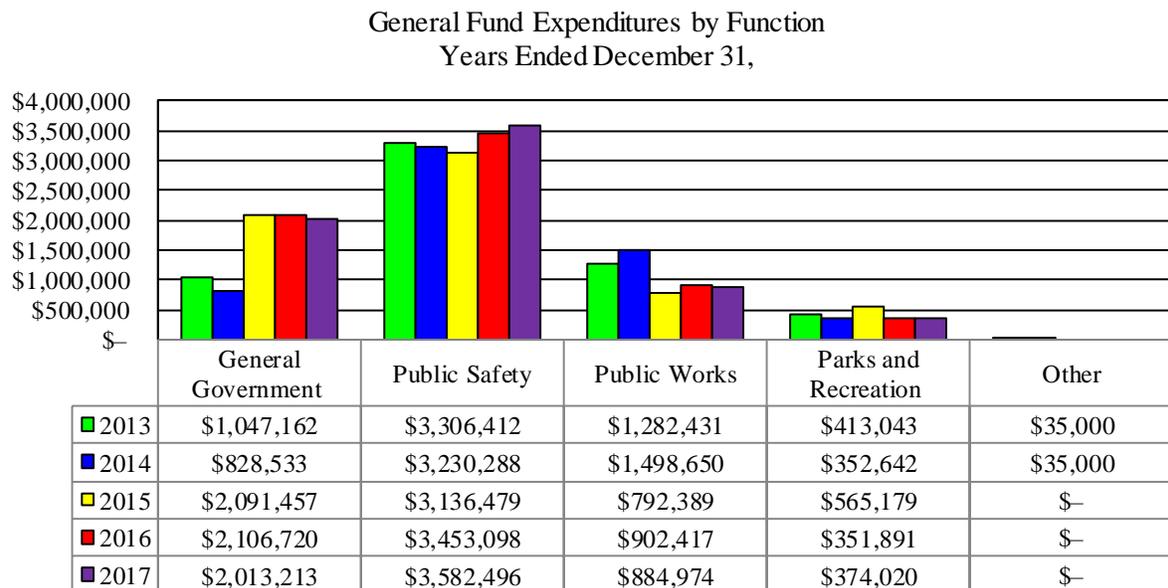
The General Fund is primarily financed by property and other taxes, along with local government aid, to operate activities in this fund. The largest change occurred in tax sources, which increased by \$183,646 from the prior year as a result of an increase in the general property tax levy approved by the City Council for 2017.

The following graph reflects the City's General Fund expenditures compared to budget for 2017:



Total General Fund expenditures for 2017 were \$6,854,703, an increase of \$40,577, or 0.6 percent, from the previous year, and \$39,673, or 0.6 percent, over budget. The largest variances occurred in the general government and public works functions. Public works expenditures were \$119,751 less than anticipated, while general government spending was over budget by \$108,672. The underspending in public works was largely caused by anticipating more spending for certain projects than actually occurred in the current year. The general government function was over budget mainly in the central services and legal services departments.

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



Typical to other cities we audit, public safety costs comprise the largest portion of General Fund spending. The largest changes occurred in public safety, which increased by \$129,398, and general government, which decreased by \$93,507, in the current year. The increase in the public safety function was mainly due to increased contractual services in police protection and increased personal services in fire. The decrease in the general government function was mainly due to staff turnover in the community development department.

## 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, 2017, presented both by classification and by fund:

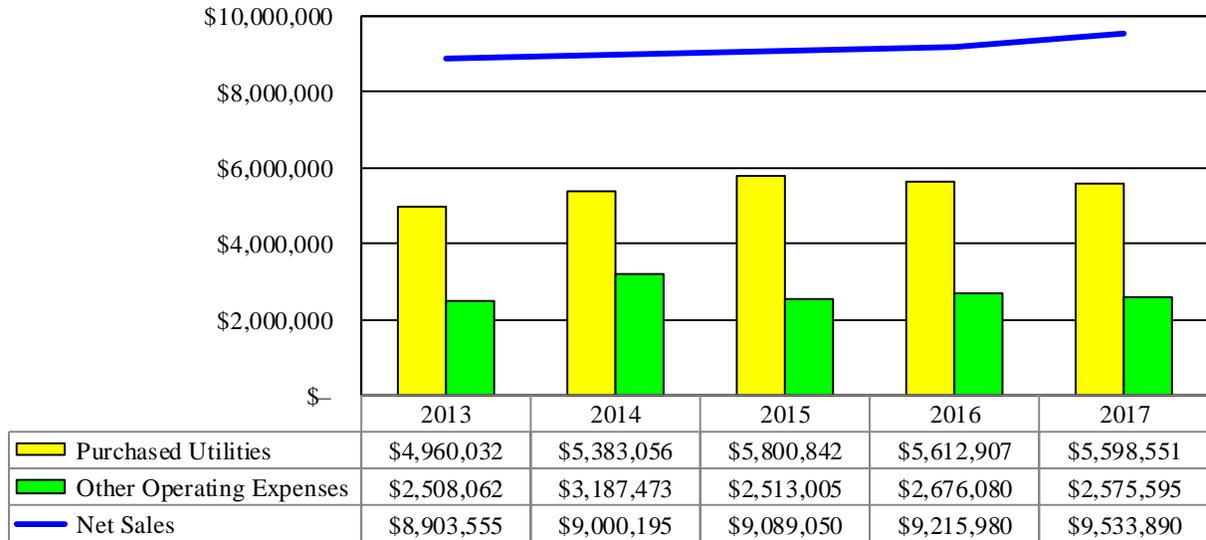
<b>Enterprise Funds Change in Financial Position</b>			
	Net Position as of December 31,		Increase (Decrease)
	<u>2017</u>	<u>2016</u>	
Net position of enterprise funds			
Total by classification			
Net investment in capital assets	\$ 5,125,174	\$ 5,361,800	\$ (236,626)
Unrestricted	<u>7,378,119</u>	<u>4,936,728</u>	<u>2,441,391</u>
Total enterprise funds	<u>\$ 12,503,293</u>	<u>\$ 10,298,528</u>	<u>\$ 2,204,765</u>
Total by fund			
Electric	\$ 5,101,257	\$ 4,363,732	\$ 737,525
Water	3,450,075	2,609,535	840,540
Surface Water	2,213,845	2,098,470	115,375
Waste Water	1,862,732	1,398,128	464,604
Fiber Optic	(790,855)	(749,097)	(41,758)
Solid Waste	<u>666,239</u>	<u>577,760</u>	<u>88,479</u>
Total enterprise funds	<u>\$ 12,503,293</u>	<u>\$ 10,298,528</u>	<u>\$ 2,204,765</u>

In total, the net position of the City's enterprise funds increased by \$2,204,765 during the year ended December 31, 2017. This increase was mainly in unrestricted net position, which increased \$2,441,391 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,



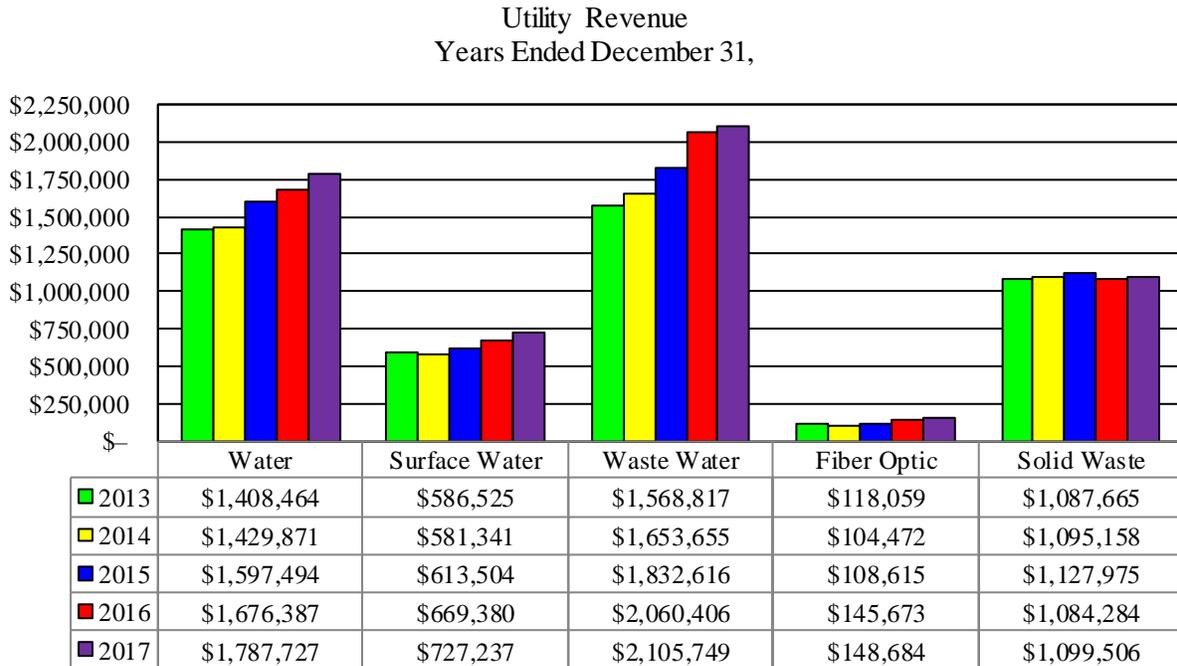
	2013	2014	2015	2016	2017
Total operating revenue	\$ 8,903,555	\$ 9,000,195	\$ 9,089,050	\$ 9,215,980	\$ 9,533,890
Purchased utilities	4,960,032	5,383,056	5,800,842	5,612,907	5,598,551
Gross profit	3,943,523	3,617,139	3,288,208	3,603,073	3,935,339
Other operating expenses	(2,508,062)	(3,187,473)	(2,513,005)	(2,676,080)	(2,575,595)
Depreciation	(155,852)	(56,960)	(65,916)	(71,606)	(73,602)
Interest expense	(85,625)	(81,524)	(76,546)	(74,761)	(66,894)
Other income (loss)	(27,751)	75,482	73,904	69,321	75,077
Income (loss) before transfers	1,166,233	366,664	706,645	849,947	1,294,325
Net transfers in (out)	(343,175)	(600,000)	(1,146,021)	(959,000)	(556,800)
Change in net position	\$ 823,058	\$ (233,336)	\$ (439,376)	\$ (109,053)	\$ 737,525
Income (loss) before transfers as a percentage of net sales	13.1 %	4.1 %	7.8 %	9.2 %	13.6 %

Gross profit results for the City’s Electric Fund increased by \$332,266 from the prior year. This increase was mainly due to increased rates in the current year as approved by City Council.

The Electric Fund ended fiscal 2017 with a total net position of \$5,101,257, of which \$4,040,876 was unrestricted, with the remaining balance being classified as net investment in capital assets. At December 31, 2017, unrestricted cash and investments totaled \$4,994,155.

## OTHER ENTERPRISE UTILITY FUNDS

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



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 2009C, 2014A, 2015A, 2016A, and 2017A.

## WATER FUND

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

	2013	2014	2015	2016	2017
Operating revenue	\$ 1,408,464	\$ 1,429,871	\$ 1,597,494	\$ 1,676,387	\$ 1,787,727
Operating expenses	(962,340)	(905,104)	(934,400)	(825,720)	(532,654)
Depreciation	(212,357)	(160,457)	(162,240)	(162,915)	(167,070)
Operating income	233,767	364,310	500,854	687,752	1,088,003
Nonoperating revenue (expenses)	(76,817)	(73,485)	(80,462)	(111,442)	(42,463)
Income before transfers	156,950	290,825	420,392	576,310	1,045,540
Net transfers in (out)	(46,000)	(185,000)	(142,201)	(205,000)	(205,000)
Change in net position	<u>\$ 110,950</u>	<u>\$ 105,825</u>	<u>\$ 278,191</u>	<u>\$ 371,310</u>	<u>\$ 840,540</u>
Income before transfers as a percentage of operating revenue	<u>11.1 %</u>	<u>20.3 %</u>	<u>26.3 %</u>	<u>34.4 %</u>	<u>58.5 %</u>

The Water Fund ended 2017 with a net position of \$3,450,075, an increase of \$840,540 from the prior year. Of this, \$1,167,120 represents the net investment in capital assets, while \$2,282,955 is considered unrestricted.

Operating revenue increased \$111,340 from the previous year, or about 6.6 percent. Increased rates and consumption resulted in this overall increase in operating revenue. Operating expenses decreased \$293,066, or about 35.5 percent, from the prior year primarily in professional services and materials and supplies due to the installation of water meters in the prior year.

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:

	<u>2013</u>	<u>2014</u>	<u>2015</u>	<u>2016</u>	<u>2017</u>
Operating revenue	\$ 586,525	\$ 581,341	\$ 613,504	\$ 669,380	\$ 727,237
Operating expenses	(345,793)	(271,762)	(246,858)	(301,498)	(413,569)
Depreciation	(94,673)	(79,073)	(99,533)	(99,533)	(106,553)
Operating income	146,059	230,506	267,113	268,349	207,115
Nonoperating revenue (expense)	(56,278)	(16,802)	(33,472)	(23,831)	(11,740)
Income before transfers	89,781	213,704	233,641	244,518	195,375
Net transfers in (out)	—	(40,000)	164,599	(80,000)	(80,000)
Change in net position	<u>\$ 89,781</u>	<u>\$ 173,704</u>	<u>\$ 398,240</u>	<u>\$ 164,518</u>	<u>\$ 115,375</u>
Income before transfers as a percentage of operating revenue	<u>15.3 %</u>	<u>36.8 %</u>	<u>38.1 %</u>	<u>36.5 %</u>	<u>26.9 %</u>

The Surface Water Fund ended 2017 with a net position of \$2,213,845, an increase of \$115,375 from the prior year. Of this, \$767,525 represents the net investment in capital assets, while \$1,446,320 is considered unrestricted.

Operating revenues increased \$57,857 from the previous year, or about 8.6 percent, due to the increased rates. Operating expenses increased \$112,071, or about 37.2 percent, from the previous year primarily in professional services and materials and supplies.

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:

	2013	2014	2015	2016	2017
Operating revenue	\$ 1,568,817	\$ 1,653,655	\$ 1,832,616	\$ 2,060,406	\$ 2,105,749
Operating expenses	(977,277)	(1,011,362)	(1,270,007)	(1,362,513)	(1,298,095)
Depreciation	(197,498)	(148,457)	(113,889)	(106,296)	(108,295)
Operating income	394,042	493,836	448,720	591,597	699,359
Nonoperating revenue (expenses)	(115,448)	(80,637)	(99,808)	(32,810)	(89,755)
Income before transfers	278,594	413,199	348,912	558,787	609,604
Net transfers in (out)	(44,000)	(125,000)	(61,966)	(145,000)	(145,000)
Change in net position	<u>\$ 234,594</u>	<u>\$ 288,199</u>	<u>\$ 286,946</u>	<u>\$ 413,787</u>	<u>\$ 464,604</u>
Income before transfers as a percentage of operating revenue	<u>17.8 %</u>	<u>25.0 %</u>	<u>19.0 %</u>	<u>27.1 %</u>	<u>29.0 %</u>

The Waste Water Fund ended 2017 with a net position of \$1,862,732, an increase of \$464,604 from the prior year. Of this, \$311,834 represents the net investment in capital assets, while the unrestricted portion has a balance of \$1,550,898.

Operating revenue increased \$45,343 from the previous year, or about 2.2 percent, largely due to the increase in rates applied in fiscal 2017. Operating expenses decreased \$64,418, or about 4.7 percent, due to decreased spending in professional services related to the street improvements and lift station repairs in the prior year.

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:

	2013	2014	2015	2016	2017
Operating revenue	\$ 118,059	\$ 104,472	\$ 108,615	\$ 145,673	\$ 148,684
Operating expenses	(94,045)	(157,661)	(73,756)	(121,364)	(109,781)
Depreciation	<u>(46,558)</u>	<u>(46,558)</u>	<u>(44,440)</u>	<u>(44,440)</u>	<u>(44,440)</u>
Operating income (loss)	<u>(22,544)</u>	<u>(99,747)</u>	<u>(9,581)</u>	<u>(20,131)</u>	<u>(5,537)</u>
Nonoperating revenue (expenses)	<u>(32,665)</u>	<u>(22,699)</u>	<u>(5,293)</u>	<u>(24,000)</u>	<u>(36,221)</u>
Change in net position	(55,209)	(122,446)	(14,874)	(44,131)	(41,758)
Net position					
Beginning of year	<u>(512,437)</u>	<u>(567,646)</u>	<u>(690,092)</u>	<u>(704,966)</u>	<u>(749,097)</u>
End of year	<u>\$ (567,646)</u>	<u>\$ (690,092)</u>	<u>\$ (704,966)</u>	<u>\$ (749,097)</u>	<u>\$ (790,855)</u>
Net position					
Net investment in capital assets	\$ 1,409,163	\$ 1,590,340	\$ 1,784,058	\$ 1,862,754	\$ 1,818,314
Unrestricted	<u>(1,976,809)</u>	<u>(2,280,432)</u>	<u>(2,489,024)</u>	<u>(2,611,851)</u>	<u>(2,609,169)</u>
Total net position	<u>\$ (567,646)</u>	<u>\$ (690,092)</u>	<u>\$ (704,966)</u>	<u>\$ (749,097)</u>	<u>\$ (790,855)</u>

The Fiber Optic Fund ended 2017 with a net position deficit of \$790,855, down \$41,758 from the prior year. Of this, \$1,818,314 represents the net investment in capital assets, while the unrestricted portion has a deficit balance of \$2,609,169.

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:

	<u>2013</u>	<u>2014</u>	<u>2015</u>	<u>2016</u>	<u>2017</u>
Operating revenue	\$ 1,087,665	\$ 1,095,158	\$ 1,127,975	\$ 1,084,284	\$ 1,099,506
Operating expenses	<u>(923,779)</u>	<u>(839,576)</u>	<u>(1,167,540)</u>	<u>(826,275)</u>	<u>(979,914)</u>
Operating income	163,886	255,582	(39,565)	258,009	119,592
Nonoperating revenue (expenses)	<u>(29,699)</u>	<u>25,694</u>	<u>23,069</u>	<u>27,545</u>	<u>28,887</u>
Income (loss) before transfers	134,187	281,276	(16,496)	285,554	148,479
Net transfers in (out)	<u>(20,000)</u>	<u>(20,000)</u>	<u>(20,000)</u>	<u>(60,000)</u>	<u>(60,000)</u>
Change in net position	<u>\$ 114,187</u>	<u>\$ 261,276</u>	<u>\$ (36,496)</u>	<u>\$ 225,554</u>	<u>\$ 88,479</u>
Income (loss) before transfers as a percentage of operating revenue	<u>12.3 %</u>	<u>25.7 %</u>	<u>(1.5) %</u>	<u>26.3 %</u>	<u>13.5 %</u>

The Solid Waste Fund ended 2017 with a net position of \$666,239, an increase of \$88,479 from the prior year, all of which is reported as unrestricted net position.

Operating revenue increased \$15,222 from the previous year, or about 1.4 percent. Operating expenses increased \$153,639, or about 18.6 percent, as a result of increased 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, 2017 and 2016 for governmental activities, business-type activities (utility fund operations), and the Economic Development Authority (EDA) component unit:

	As of December 31,		Increase (Decrease)
	2017	2016	
Net position			
Primary government			
Governmental activities			
Net investment in capital assets	\$ 19,304,556	\$ 18,613,487	\$ 691,069
Restricted	5,086,728	4,343,924	742,804
Unrestricted	1,906,846	1,535,730	371,116
Total governmental activities	<u>26,298,130</u>	<u>24,493,141</u>	1,804,989
Business-type activities			
Net investment in capital assets	5,125,174	5,361,800	(236,626)
Unrestricted	7,364,722	4,870,810	2,493,912
Total business-type activities	<u>12,489,896</u>	<u>10,232,610</u>	2,257,286
Total primary government	<u>38,788,026</u>	<u>34,725,751</u>	4,062,275
Component unit			
Economic Development Authority			
Restricted	<u>135,809</u>	<u>72,894</u>	62,915
Total net position	<u>\$ 38,923,835</u>	<u>\$ 34,798,645</u>	<u>\$ 4,125,190</u>

The City (including the EDA) ended 2017 with combined total net position of \$38,923,835, an increase of \$4,125,190 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, 2017 and 2016:

	2017		2016	
	Expenses	Program Revenues	Net Change	Net Change
Net (expense) revenue				
Primary government				
Governmental activities				
General government	\$ 2,500,256	\$ 371,906	\$ (2,128,350)	\$ (2,336,595)
Public safety	3,802,714	440,556	(3,362,158)	(3,797,695)
Public works	1,512,014	1,083,675	(428,339)	(595,961)
Parks and recreation	439,167	291,061	(148,106)	(334,640)
Economic development	472,262	1,000	(471,262)	(184,157)
Interest and fiscal charges	409,252	–	(409,252)	(412,714)
Business-type activities				
Electric	8,329,029	9,556,646	1,227,617	812,018
Water	752,207	1,787,786	1,035,579	570,346
Surface water	538,861	727,287	188,426	241,710
Waste water	1,484,530	2,105,802	621,272	555,158
Fiber optic	154,236	148,684	(5,552)	(22,213)
Solid waste	987,790	1,125,765	137,975	278,588
Total primary government	<u>21,382,318</u>	<u>17,640,168</u>	<u>(3,742,150)</u>	<u>(5,226,155)</u>
Component unit				
Economic Development Authority	<u>81,890</u>	<u>–</u>	<u>(81,890)</u>	<u>(122,849)</u>
Total net (expense) revenue	<u>\$ 21,464,208</u>	<u>\$ 17,640,168</u>	<u>(3,824,040)</u>	<u>(5,349,004)</u>
General revenues				
Property and franchise taxes			5,783,355	5,222,789
Grants and contributions not restricted to specific programs			1,812,458	1,919,280
Other general revenues			94,949	42,049
Investment earnings			222,694	145,088
Gain on sale of assets			35,774	–
Total general revenues			<u>7,949,230</u>	<u>7,329,206</u>
Change in net position			<u>\$ 4,125,190</u>	<u>\$ 1,980,202</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. 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 2017 legislative session began with a full agenda, which included adopting a fiscal year 2018–2019 biennial state budget. The February 2017, state budget forecast projected that the state General Fund would end the 2016–2017 biennium with a surplus of \$743 million, eliminating the need for budget cuts or transfers to balance the fund. However, the Legislature was expected to address several significant spending areas for which successful funding appropriations had not been passed in recent legislative sessions. The 2017 regular legislative session ended with four omnibus budget bills being vetoed, potentially leaving a number of these same areas without appropriations. After a three-day special session, the Governor and Legislature were able to agree on budget and appropriation bills addressing most of the state budgetary needs for the upcoming biennium, albeit not without several line item vetoes invoked by the Governor, including striking the appropriations for operating the House and Senate from the bills.

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

## ACCOUNTING AND AUDITING UPDATES

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

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

This statement establishes standards for recognizing and measuring liabilities, deferred outflows of resources, deferred inflows of resources, and expense/expenditures. Similar to changes implemented for pensions, this statement requires the liability of employer 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.

The requirements for this statement are effective for fiscal years beginning after June 15, 2017. Earlier application is encouraged.

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

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

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

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

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

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

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

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

This statement establishes criteria for identifying fiduciary activities of all state and local governments. The focus of the criteria generally is on (1) whether a government is controlling the assets of the fiduciary activity and (2) the beneficiaries with whom a fiduciary relationship exists. Separate criteria are included to identify fiduciary component units and 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. 85, *OMNIBUS 2017***

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

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

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

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

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

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

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

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

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

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

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