Management Report

for

City of North St. Paul, Minnesota

December 31, 2018

THIS PAGE INTENTIONALLY LEFT BLANK

MMKR
CERTIFIED PUBLIC ACCOUNTANTS

PRINCIPALS
Thomas A. Karnowski, CPA
Paul A. Radosevich, CPA
William J. Lauer, CPA
James H. Eichten, CPA
Aaron J. Nielsen, CPA
Victoria L. Holinka, CPA/CMA
Jaclyn M. Huegel, CPA

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, 2018. We have organized this report into the following sections:

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

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

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

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

Minneapolis, Minnesota
April 24, 2019

Malloy, Montague, Karnowski, Radosevich & Co., P.A.
5353 Wayzata Boulevard • Suite 410 • Minneapolis, MN 55416 • Phone: 952-545-0424 • Fax: 952-545-0569 • www.mmkr.com

THIS PAGE INTENTIONALLY LEFT BLANK

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, 2018. Professional standards require that we provide you with information about our responsibilities under auditing standards generally accepted in the United States of America and *Government Auditing Standards*, as well as certain information related to the planned scope and timing of our audit. We have communicated such information to you verbally and in our audit engagement letter. Professional standards also require that we communicate the following information related to our audit.

PLANNED SCOPE AND TIMING OF THE AUDIT

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

AUDIT OPINION AND FINDINGS

Based on our audit of the City's financial statements for the year ended December 31, 2018:

- We have issued an unmodified opinion on the City's basic financial statements. Our report included a paragraph emphasizing the City's implementation of Governmental Accounting Standards Board (GASB) Statement No. 75, *Accounting and Financial Reporting for Postemployment Benefits Other Than Pensions* during the year ended December 31, 2018. Our opinion was not modified with respect to this matter.

- 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. Fire Relief Payment
    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, 2018, 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 that when any claim for wages listed on a payroll is paid, the employee shall sign a declaration, which may be a part of the payroll, to the effect that the employee has received the wages and done the work for which the wages have been paid. Each employee claiming payment from the City is required to make the following written declaration: "I declare under penalties of law that I have received the wages stated on this payroll opposite my name and have done the work for which the wages were paid." This declaration was not obtained for the timecard employees tested in fiscal year 2017. 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 acquisition 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, 2018, the City has one special revenue fund that has a deficit fund equity totaling $898, one capital projects fund deficit totaling $47,725, one enterprise fund deficit totaling $872,387, and two internal service fund deficits totaling $438,393. 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, 2018, the Fiber Optic Fund's unrestricted component of net position has a deficit of $2,646,262. 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.

- **Payroll** – Internal controls, processes, and procedures are never perfected and need to be continually reviewed to make sure transaction cycles are performing properly and efficiently. During our inquiries and testing, we noted that certain employee's timesheets were not approved by their direct supervisor. Internal controls should incorporate a monitoring element to ensure records are complete, as well as accurate. We recommend the City review its policies and procedures over payroll reporting to verify proper approvals exist. With the recent change in management and leadership, we also believe it is a good time for the City to review policies and procedures with staff to ensure a consistent understanding exists and that controls are effectively functioning for their designed purpose.

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

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

- GASB Statement No. 85, *Omnibus 2017,* which addressed issues that have been identified during implementation and application of certain GASB statements.

- GASB Statement No. 86, *Certain Debt Extinguishment Issues,* which improves consistency in accounting and financial reporting for in-substance defeasances of debt.

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

ACCOUNTING ESTIMATES AND MANAGEMENT JUDGMENTS

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

- **Total Other Post-Employment Benefit (OPEB) and Net Pension Liabilities** – The City has recorded liabilities and activity for OPEB and pension benefits. These obligations are calculated using actuarial methodologies described in the GASB Nos. 68 and 75. 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 acquisition 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. There were no misstatements detected as a result of audit procedures that 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 24, 2019.

MANAGEMENT CONSULTATIONS WITH OTHER INDEPENDENT ACCOUNTANTS

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

OTHER AUDIT FINDINGS OR ISSUES

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

OTHER MATTERS

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

THIS PAGE INTENTIONALLY LEFT BLANK

GOVERNMENTAL FUNDS OVERVIEW

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

PROPERTY TAXES

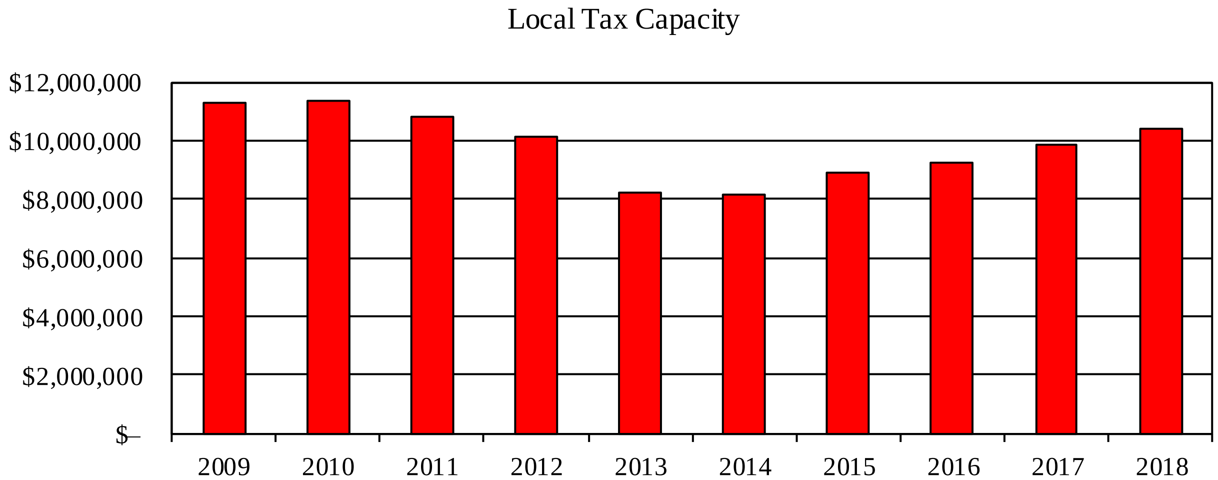
Minnesota cities rely heavily on local property tax levies to support their governmental fund activities. For the 2017 fiscal year, local ad valorem property tax levies provided 41.1 percent of the total governmental fund revenues for cities over 2,500 in population, and 37.4 percent for cities under 2,500 in population. Total property taxes levied by all Minnesota cities for taxes payable in 2018 increased 6.2 percent from the prior year, and total certified levies payable in 2019 are projected to increase by 5.6 percent.

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

The City's taxable market value increased 5.7 percent for taxes payable in 2017 and 4.9 percent for taxes payable in 2018. 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 6.5 percent for 2017 and 5.7 percent for 2018.

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



The following table presents the average tax rates applied to city residents for each of the last three levy years:

Rates Expressed as a Percentage of Net Tax Capacity

	City of North St. Paul		
	2016	2017	2018
Average tax rate			
City	38.7	41.9	42.5
County	58.9	55.9	53.9
School	35.6	33.6	30.1
Special taxing	12.6	12.0	12.3
Total	145.8	143.4	138.8

The total average tax rate decreased from the prior year. An increase in the City and special taxing authority portions were offset by decreases in the county and school rates.

GOVERNMENTAL FUND BALANCES

The following table summarizes the changes in the fund balances of the City's governmental funds during the year ended December 31, 2018, presented both by fund balance classification and by fund:

Governmental Funds Change in Fund Balance

	Fund Balance as of December 31, 2018	Fund Balance as of December 31, 2017	Increase (Decrease)
Fund balances of governmental funds			
Total by classification			
Nonspendable	$ 24,135	$ 26,016	$ (1,881)
Restricted	9,661,240	7,114,605	2,546,635
Committed	3,774,915	3,196,670	578,245
Assigned	1,951,773	1,019,565	932,208
Unassigned	1,740,083	1,701,518	38,565
Total governmental funds	$ 17,152,146	$ 13,058,374	$ 4,093,772
Total by fund			
General	$ 1,832,826	$ 1,757,749	$ 75,077
G.O. Capital Improvement Plan Bonds of 2008A/G.O. Capital Improvement Plan Refunding Bonds of 2016B	3,117,342	3,108,427	8,915
Street Improvement	3,565,784	702,456	2,863,328
Nonmajor	8,636,194	7,489,742	1,146,452
Total governmental funds	$ 17,152,146	$ 13,058,374	$ 4,093,772

In total, the fund balances of the City's governmental funds increased by $4,093,772 during the year ended December 31, 2018. The increase is due largely to the increase in restricted funds in the Street Improvement Capital Projects Fund. This increase was the result of bond proceeds exceeding current year spending on street projects. The increase in assigned funds for street improvements contributed to the remaining change in fund balance in the current year.

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.

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

	State-Wide			City of North St. Paul		
Year	December 31, 2017			2016	2017	2018
Population	2,500–10,000	10,000–20,000	20,000–100,000	12,104	12,069	12,099
Property taxes	$ 474	$ 451	$ 475	$ 343	$ 387	$ 414
Tax increments	26	27	38	32	37	40
Franchise and other taxes	38	43	48	45	44	36
Special assessments	57	48	59	25	26	46
Licenses and permits	39	34	49	23	25	29
Intergovernmental revenues	322	276	147	195	219	221
Charges for services	108	103	103	16	17	13
Other	68	53	48	35	46	57
Total revenue	$ 1,132	$ 1,035	$ 967	$ 714	$ 801	$ 856

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 $10,352,386 of total revenue in its governmental funds in 2018, an increase of $686,252 (7.1 percent) from the prior year. The City's per capita governmental funds revenue for 2018 was $856, an increase of $55, from the prior year, including the effect of a change in estimated population. The largest changes occurred with increases in property taxes and special assessment revenues. The increase in property taxes was mainly due to the increased general property tax levy. Special assessment revenue increased with the collection of about $358,000 in prepayments for street improvement projects in the current year, compared to about $141,000 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, 2017			2016	2017	2018
Population	2,500–10,000	10,000–20,000	20,000–100,000	12,104	12,069	12,099
Current						
General government	$ 147	$ 120	$ 101	$ 174	$ 178	$ 119
Public safety	270	259	287	285	297	326
Streets and highways	128	127	101	75	73	84
Parks and recreation	96	112	99	29	31	43
All other	76	64	77	14	37	39
	717	682	665	577	616	611
Capital outlay and construction	403	319	263	304	125	137
Debt service						
Principal	228	147	121	83	85	105
Interest and fiscal	44	35	32	30	36	36
	272	182	153	113	121	141
Total expenditures	$ 1,392	$ 1,183	$ 1,081	$ 994	$ 862	$ 889

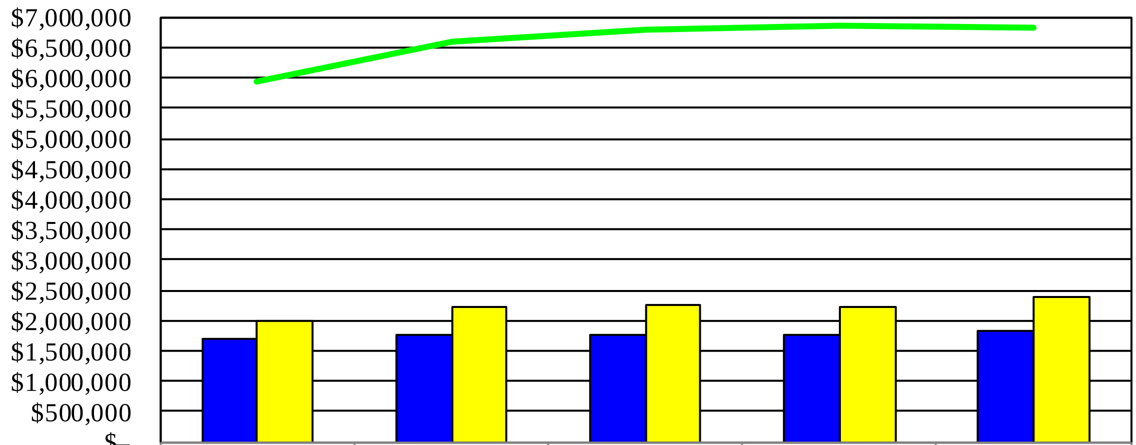
As the above table reflects, the City's expenditures per capita have also been below the state-wide averages in recent years. A significant reason for this difference is in capital outlay and debt service, which is reasonable for a city that is not in the middle of a major development or redevelopment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

Total expenditures in the City's governmental funds for 2018 were $10,742,195, an increase of $352,481 (3.4 percent). The City's per capita governmental funds total expenditures increased $27, or 3.1 percent. This increase was mainly in debt service costs as a result of scheduled bond payments. During 2018, the City reclassified certain expenditure presentations within the General Fund, contributing to the functional changes presented in the table above.

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,



	2014	2015	2016	2017	2018
Fund Balance	$1,685,786	$1,759,204	$1,761,874	$1,757,749	$1,832,826
Cash (Net)	$1,996,062	$2,208,507	$2,261,283	$2,224,485	$2,378,154
Expenditures	$5,945,113	$6,585,504	$6,814,126	$6,854,703	$6,845,264

The City's General Fund cash and investment balance (net of borrowing) at December 31, 2018 was $2,378,154, an increase of $153,669 from the previous year. Total fund balance at December 31, 2018 was $1,832,826, an increase of $75,077 from the prior year. The unassigned portion of this fund balance level represents approximately 25 percent of the City's 2019 budgeted General Fund expenditure levels.

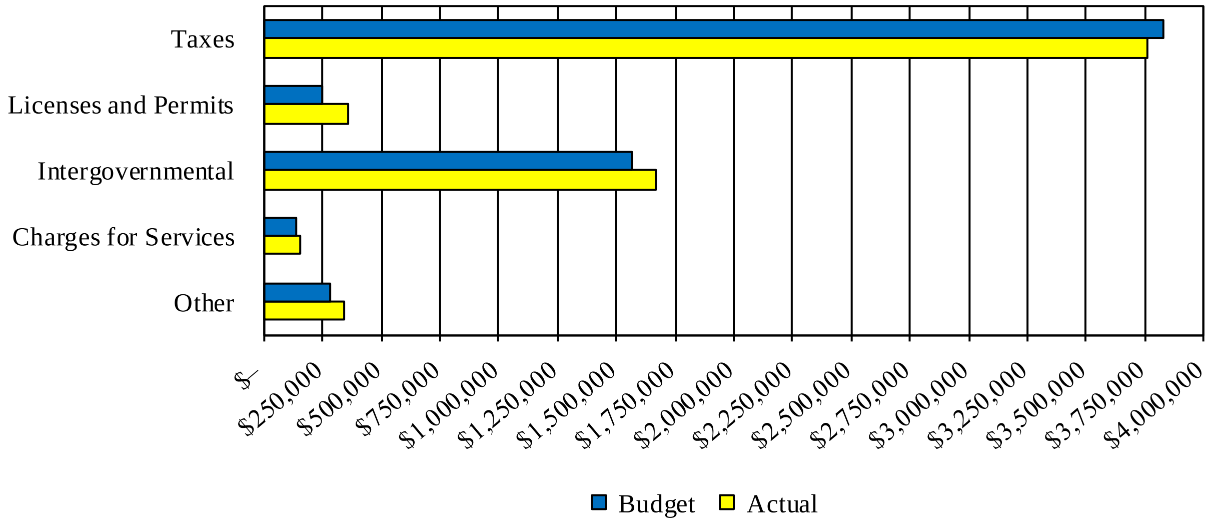
The level of General Fund balance is greatly attributed to the City's fund balance policies as well as the general budgeting policies. These policies have allowed the City to provide funding for the General Fund operations as well as equipment replacement and street improvement programs without disrupting 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 2018:

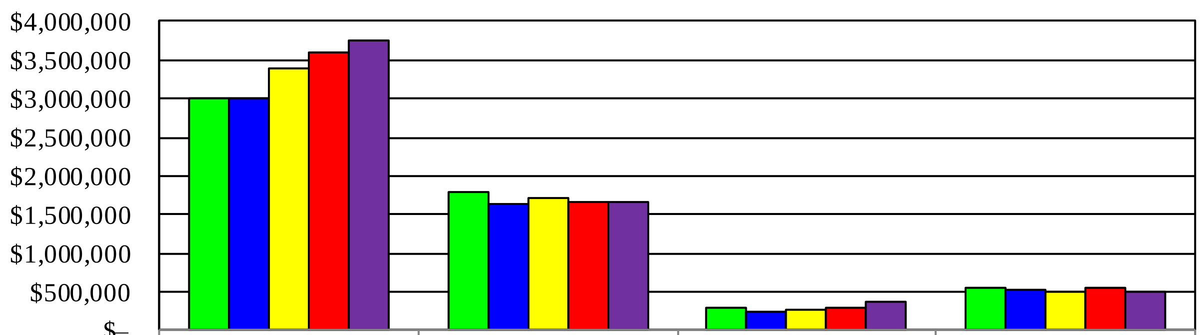
General Fund Revenue



Total General Fund revenues for 2018 were $6,277,829, an increase of $185,903 from the previous year, and were $220,761 (3.6 percent) over budget. Revenues were more than projected in each category as presented above, except for the tax revenue category. The largest variances were in licenses and permits and intergovernmental, which were $105,698 and $100,244, 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,

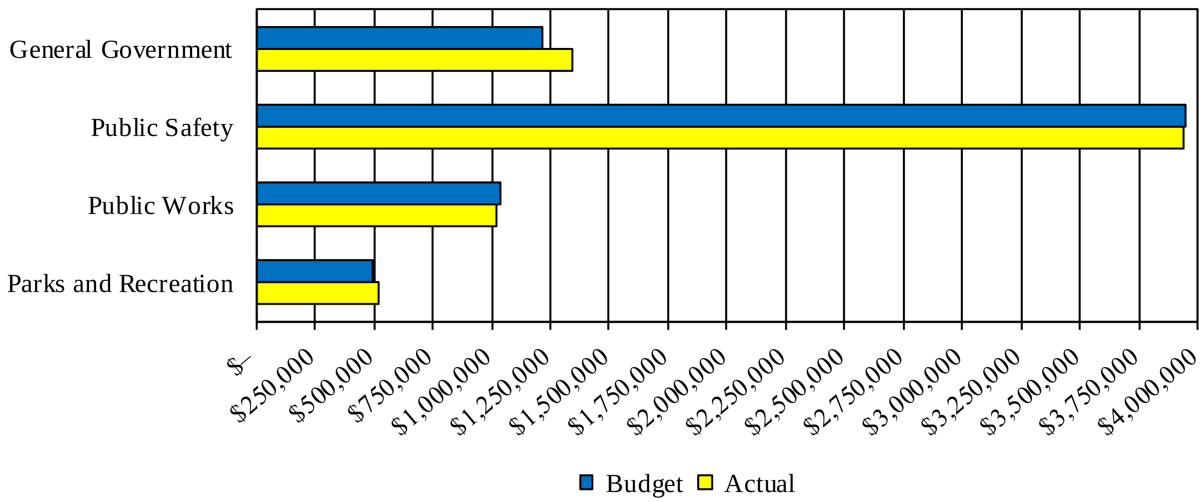


	Taxes	Intergovernmental	Licenses and Permits	All Other
2014	$3,016,970	$1,792,686	$293,691	$551,647
2015	$3,001,290	$1,646,938	$241,532	$526,782
2016	$3,403,580	$1,710,429	$275,704	$487,624
2017	$3,587,226	$1,647,917	$302,716	$554,067
2018	$3,762,372	$1,664,846	$355,448	$495,163

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 $175,146 from the prior year as a result of an increase in the general property tax levy approved by the City Council for 2018.

The following graph reflects the City’s General Fund expenditures compared to budget for 2018:

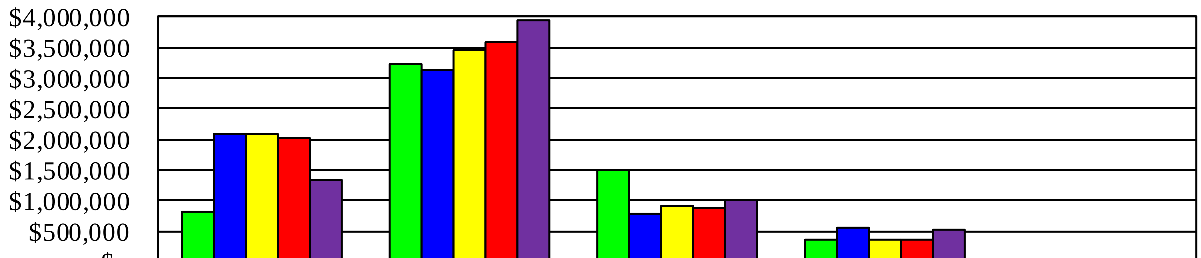
General Fund Expenditures



Total General Fund expenditures for 2018 were $6,845,264, a decrease of $9,439, or 0.1 percent, from the previous year, and $138,981, or 2.1 percent, over budget. The largest variance occurred in the general government function, which was over budget by $128,835, mainly in the community services and administration 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
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	$–
2017	$2,013,213	$3,582,496	$884,974	$374,020	$–
2018	$1,343,042	$3,939,799	$1,021,445	$522,972	$18,006

Typical to other cities we audit, public safety costs comprise the largest portion of General Fund spending. As previously discussed, the City reclassified certain expenditure presentations within the General Fund, contributing to the functional changes presented in the graph above.

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, 2018, presented both by classification and by fund:

Enterprise Funds Change in Financial Position

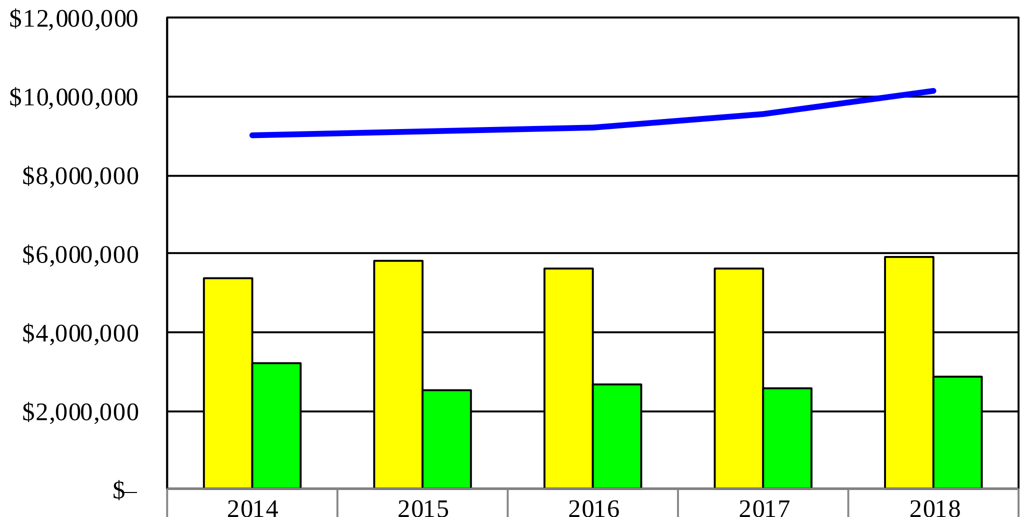
	Net Position as of December 31,		Increase
	2018	2017	(Decrease)
Net position of enterprise funds			
Total by classification			
Net investment in capital assets	$ 5,118,537	$ 5,125,174	$ (6,637)
Unrestricted	9,464,885	7,378,119	2,086,766
Total enterprise funds	$ 14,583,422	$ 12,503,293	$ 2,080,129
Total by fund			
Electric	$ 5,973,206	$ 5,101,257	$ 871,949
Water	4,166,606	3,450,075	716,531
Surface Water	2,342,439	2,213,845	128,594
Waste Water	2,183,171	1,862,732	320,439
Fiber Optic	(872,387)	(790,855)	(81,532)
Solid Waste	790,387	666,239	124,148
Total enterprise funds	$ 14,583,422	$ 12,503,293	$ 2,080,129

In total, the net position of the City's enterprise funds increased by $2,080,129 during the year ended December 31, 2018. The change in accounting principle, as previously mentioned, reduced net position by $135,036 while current year operating results increased net position by $2,215,165.

ELECTRIC FUND

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

Electric Fund Operations
Years Ended December 31,



	2014	2015	2016	2017	2018
Purchased Utilities	$5,383,056	$5,800,842	$5,612,907	$5,598,551	$5,934,267
Other Operating Expenses	$3,187,473	$2,513,005	$2,676,080	$2,575,595	$2,847,699
Net Sales	$9,000,195	$9,089,050	$9,215,980	$9,533,890	$10,148,273

	2014	2015	2016	2017	2018
Total operating revenue	$ 9,000,195	$ 9,089,050	$ 9,215,980	$ 9,533,890	$ 10,148,273
Purchased utilities	5,383,056	5,800,842	5,612,907	5,598,551	5,934,267
Gross profit	3,617,139	3,288,208	3,603,073	3,935,339	4,214,006
Other operating expenses	(3,187,473)	(2,513,005)	(2,676,080)	(2,575,595)	(2,847,699)
Depreciation	(56,960)	(65,916)	(71,606)	(73,602)	(85,306)
Interest expense	(81,524)	(76,546)	(74,761)	(66,894)	(64,256)
Other income (loss)	75,482	73,904	69,321	75,077	97,891
Income (loss) before transfers	366,664	706,645	849,947	1,294,325	1,314,636
Net transfers in (out)	(600,000)	(1,146,021)	(959,000)	(556,800)	(351,130)
Change in net position	$ (233,336)	$ (439,376)	$ (109,053)	$ 737,525	$ 963,506
Income (loss) before transfers as a percentage of net sales	4.1 %	7.8 %	9.2 %	13.6 %	13.0 %

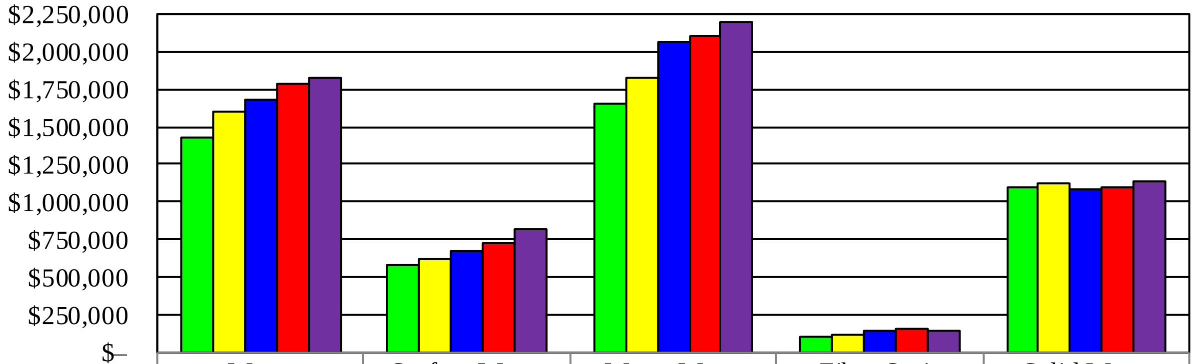
Gross profit results for the City's Electric Fund increased by $278,667 from the prior year. This increase was mainly due to increased rates in the current year as approved by the City Council.

The Electric Fund ended fiscal 2018 with a total net position of $5,973,206, of which $4,610,768 was unrestricted, with the remaining balance being classified as net investment in capital assets. At December 31, 2018, unrestricted cash and investments totaled $5,671,309.

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
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
2017	$1,787,727	$727,237	$2,105,749	$148,684	$1,099,506
2018	$1,823,416	$820,017	$2,194,476	$141,209	$1,135,528

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, 2017A, and 2018A.

WATER FUND

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

	2014	2015	2016	2017	2018
Operating revenue	$ 1,429,871	$ 1,597,494	$ 1,676,387	$ 1,787,727	$ 1,823,416
Operating expenses	(905,104)	(934,400)	(825,720)	(532,654)	(642,292)
Depreciation	(160,457)	(162,240)	(162,915)	(167,070)	(194,217)
Operating income	364,310	500,854	687,752	1,088,003	986,907
Nonoperating revenue (expenses)	(73,485)	(80,462)	(111,442)	(42,463)	(50,743)
Income before transfers	290,825	420,392	576,310	1,045,540	936,164
Net transfers in (out)	(185,000)	(142,201)	(205,000)	(205,000)	(205,000)
Change in net position	$ 105,825	$ 278,191	$ 371,310	$ 840,540	$ 731,164
Income before transfers as a percentage of operating revenue	20.3 %	26.3 %	34.4 %	58.5 %	51.3 %

The Water Fund ended 2018 with a net position of $4,166,606, an increase of $716,531 from the prior year. Of this, $1,117,542 represents the net investment in capital assets, while $3,049,064 is considered unrestricted.

Operating revenue increased $35,689 from the previous year, or about 2.0 percent. Increased rates resulted in this overall increase in operating revenue. Operating expenses increased $109,638, or about 20.6 percent, from the prior year primarily in professional services. Professional services were up with more building maintenance, utilities, and water main repairs.

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:

	2014	2015	2016	2017	2018
Operating revenue	$ 581,341	$ 613,504	$ 669,380	$ 727,237	$ 820,017
Operating expenses	(271,762)	(246,858)	(301,498)	(413,569)	(457,275)
Depreciation	(79,073)	(99,533)	(99,533)	(106,553)	(127,752)
Operating income	230,506	267,113	268,349	207,115	234,990
Nonoperating revenue (expense)	(16,802)	(33,472)	(23,831)	(11,740)	(14,690)
Income before transfers	213,704	233,641	244,518	195,375	220,300
Net transfers in (out)	(40,000)	164,599	(80,000)	(80,000)	(80,000)
Change in net position	$ 173,704	$ 398,240	$ 164,518	$ 115,375	$ 140,300
Income before transfers as a percentage of operating revenue	36.8 %	38.1 %	36.5 %	26.9 %	26.9 %

The Surface Water Fund ended 2018 with a net position of $2,342,439, an increase of $128,594 from the prior year. Of this, $615,945 represents the net investment in capital assets, while $1,726,494 is considered unrestricted.

Operating revenues increased $92,780 from the previous year, or about 12.8 percent, due to the increased rates. Operating expenses increased $43,706, or about 10.6 percent, from the previous year primarily in professional services, due to the new rate study conducted in the current year.

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:

	2014	2015	2016	2017	2018
Operating revenue	$ 1,653,655	$ 1,832,616	$ 2,060,406	$ 2,105,749	$ 2,194,476
Operating expenses	(1,011,362)	(1,270,007)	(1,362,513)	(1,298,095)	(1,474,719)
Depreciation	(148,457)	(113,889)	(106,296)	(108,295)	(156,383)
Operating income	493,836	448,720	591,597	699,359	563,374
Nonoperating revenue (expenses)	(80,637)	(99,808)	(32,810)	(89,755)	(84,975)
Income before transfers	413,199	348,912	558,787	609,604	478,399
Net transfers in (out)	(125,000)	(61,966)	(145,000)	(145,000)	(145,000)
Change in net position	$ 288,199	$ 286,946	$ 413,787	$ 464,604	$ 333,399
Income before transfers as a percentage of operating revenue	25.0 %	19.0 %	27.1 %	29.0 %	21.8 %

The Waste Water Fund ended 2018 with a net position of $2,183,171, an increase of $320,439 from the prior year. Of this, $248,737 represents the net investment in capital assets, while the unrestricted portion has a balance of $1,934,434.

Operating revenue increased $88,727 from the previous year, or about 4.2 percent, largely due to the increase in rates applied in fiscal 2018. Operating expenses increased $176,624, or about 13.6 percent, due to increased spending in professional services related to engineering and legal services and due to increased charges to the Metropolitan Council of Environmental Services.

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:

	2014	2015	2016	2017	2018
Operating revenue	$ 104,472	$ 108,615	$ 145,673	$ 148,684	$ 141,209
Operating expenses	(157,661)	(73,756)	(121,364)	(109,781)	(136,660)
Depreciation	(46,558)	(44,440)	(44,440)	(44,440)	(44,439)
Operating income (loss)	(99,747)	(9,581)	(20,131)	(5,537)	(39,890)
Nonoperating revenue (expenses)	(22,699)	(5,293)	(24,000)	(36,221)	(41,642)
Change in net position	(122,446)	(14,874)	(44,131)	(41,758)	(81,532)
Net position					
Beginning of year	(567,646)	(690,092)	(704,966)	(749,097)	(790,855)
End of year	$ (690,092)	$ (704,966)	$ (749,097)	$ (790,855)	$ (872,387)
Net position					
Net investment in capital assets	$ 1,590,340	$ 1,784,058	$ 1,862,754	$ 1,818,314	$ 1,773,875
Unrestricted	(2,280,432)	(2,489,024)	(2,611,851)	(2,609,169)	(2,646,262)
Total net position	$ (690,092)	$ (704,966)	$ (749,097)	$ (790,855)	$ (872,387)

The Fiber Optic Fund ended 2018 with a net position deficit of $872,387, down $81,532 from the prior year. Of this, $1,773,875 represents the net investment in capital assets, while the unrestricted portion has a deficit balance of $2,646,262.

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:

	2014	2015	2016	2017	2018
Operating revenue	$ 1,095,158	$ 1,127,975	$ 1,084,284	$ 1,099,506	$ 1,135,528
Operating expenses	(839,576)	(1,167,540)	(826,275)	(979,914)	(984,930)
Operating income	255,582	(39,565)	258,009	119,592	150,598
Nonoperating revenue (expenses)	25,694	23,069	27,545	28,887	37,730
Income (loss) before transfers	281,276	(16,496)	285,554	148,479	188,328
Net transfers in (out)	(20,000)	(20,000)	(20,000)	(60,000)	(60,000)
Change in net position	$ 261,276	$ (36,496)	$ 265,554	$ 88,479	$ 128,328
Income (loss) before transfers as a percentage of operating revenue	25.7 %	(1.5) %	26.3 %	13.5 %	16.6 %

The Solid Waste Fund ended 2018 with a net position of $790,387, an increase of $124,148 from the prior year, all of which is reported as unrestricted net position.

Operating revenue increased $36,022 from the previous year, or about 3.3 percent, due to the increased rates. Operating expenses increased $5,016, or about 0.5 percent.

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, 2018 and 2017 for governmental activities, business-type activities (utility fund operations), and the Economic Development Authority (EDA) component unit:

	As of December 31,		Increase
	2018	2017	(Decrease)
Net position			
Primary government			
Governmental activities			
Net investment in capital assets	$ 18,936,454	$ 19,304,556	$ (368,102)
Restricted	5,905,069	5,086,728	818,341
Unrestricted	3,798,923	1,906,846	1,892,077
Total governmental activities	28,640,446	26,298,130	2,342,316
Business-type activities			
Net investment in capital assets	5,118,537	5,125,174	(6,637)
Unrestricted	9,430,795	7,364,722	2,066,073
Total business-type activities	14,549,332	12,489,896	2,059,436
Total primary government	43,189,778	38,788,026	4,401,752
Component unit			
Economic Development Authority			
Restricted	134,731	135,809	(1,078)
Total net position	$ 43,324,509	$ 38,923,835	$ 4,400,674

The City (including the EDA) ended 2018 with a combined total net position of $43,324,509, an increase of $4,400,674 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.

As discussed earlier, the City recorded a change in accounting principle for reporting OPEB that reduced beginning unrestricted net position by $418,070.

Statement of Activities

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

The following table presents the change in the net position of the City and the EDA for the years ended December 31, 2018 and 2017:

	2018			2017
	Expenses	Program Revenues	Net Change	Net Change
Net (expense) revenue				
Primary government				
Governmental activities				
General government	$ 1,852,924	$ 340,303	$ (1,512,621)	$ (2,128,350)
Public safety	4,006,547	639,862	(3,366,685)	(3,362,158)
Public works	1,790,048	1,690,397	(99,651)	(428,339)
Parks and recreation	636,499	169,999	(466,500)	(148,106)
Economic development	508,783	–	(508,783)	(471,262)
Interest and fiscal charges	415,264	–	(415,264)	(409,252)
Business-type activities				
Electric	8,960,653	10,176,106	1,215,453	1,227,617
Water	938,780	1,824,511	885,731	1,035,579
Surface water	642,322	820,900	178,578	188,426
Waste water	1,744,588	2,199,434	454,846	621,272
Fiber optic	181,099	141,209	(39,890)	(5,552)
Solid waste	991,685	1,167,695	176,010	137,975
Total primary government	22,669,192	19,170,416	(3,498,776)	(3,742,150)
Component unit				
Economic Development Authority	154,961	–	(154,961)	(81,890)
Total net (expense) revenue	$ 22,824,153	$ 19,170,416	(3,653,737)	(3,824,040)
General revenues				
Property and franchise taxes			6,077,250	5,783,355
Grants and contributions not restricted to specific programs			1,838,514	1,812,458
Other general revenues			184,277	94,949
Investment earnings			339,809	222,694
Gain on sale of assets			32,631	35,774
Total general revenues			8,472,481	7,949,230
Change in net position			$ 4,818,744	$ 4,125,190

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 2018 legislative session, falling in the second half of the state's fiscal biennium, was a short session in which only two major finance-related bills were passed, omnibus bonding bills related to bonding, and pensions. The following is a brief summary of specific legislative changes from the 2018 session or previous legislative sessions potentially impacting Minnesota cities.

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

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

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

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

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

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

- Reforms impacting the PERA General Employees Retirement Fund (GERF) plan included:

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

- Reforms impacting the PERA Public Employees Police and Fire Fund (PEPFF) plan included:
    - Post-retirement COLAs were permanently set at 1.00 percent.
    - Employer contribution rates increase from the current 16.20 percent of covered salaries to 16.95 percent beginning January 1, 2019, and 17.70 percent beginning January 1, 2020.
    - Employee contribution rates increase from the current 10.80 percent of covered salaries to 11.30 percent beginning January 1, 2019, and 11.80 percent beginning January 1, 2020.
    - To reduce the need for additional contribution increases, the state will contribute an additional $4.5 million to the plan annually for fiscal years 2019 and 2020, increasing to $9.0 million annually thereafter through fiscal 2048, or until the plan is fully funded.
    - The rate of interest paid on refunds of employee contributions to former public employees was reduced from an annual rate of 4.00 percent to 3.00 percent.

- Reforms impacting the volunteer firefighter relief associations plan included:
    - Added a requirement that the fire chief annually certify each firefighter’s service credit to the relief association and the related municipality effective January 1, 2019.

ACCOUNTING AND AUDITING UPDATES

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

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

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

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

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

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

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

GASB STATEMENT NO. 84, *FIDUCIARY ACTIVITIES*

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

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

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

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

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

GASB STATEMENT NO. 87, *LEASES*

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

UNIFORM GUIDANCE, MICRO-PURCHASE THRESHOLD

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