

Management Report
for
City of North St. Paul, Minnesota
December 31, 2015

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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, 2015. The purpose of this report is to provide comments resulting from our audit process and to communicate information relevant to city finances in Minnesota. 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
May 11, 2016

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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, 2015, 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, 2015:

- We have issued an unmodified opinion on the City's basic financial statements. Our report included a paragraph emphasizing that the City implemented Governmental Accounting Standards Board (GASB) Statement No. 68, *Accounting and Financial Reporting for Pensions—an amendment of GASB Statement No. 27*, and GASB Statement No. 71, *Pension Transition for Contributions Made Subsequent to the Measurement Date—an amendment of GASB Statement No. 68*, during the year ended December 31, 2015. Our opinion was not modified with respect to this matter.
- We reported one matter involving the City's internal control over financial reporting that we consider to be a significant deficiency. Due to the limited size and turnover of the City's office staff, the City has limited segregation of duties in certain areas.
- The results of our testing disclosed no instances of noncompliance that are required to be reported under *Government Auditing Standards*.
- We reported 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. Claims and Disbursements
 2. Payroll Declaration

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, 2015, we performed procedures to follow-up on the findings and recommendations that resulted from our prior year audit. We reported the following findings that were corrected by the City in the current year:

- Annually, prior to completing an initial investment transaction, Minnesota Statutes require governmental entities to provide their brokers a written statement of investment restrictions through a broker acknowledgement certification form. This certification process requires the broker to acknowledge receipt of the investment restrictions and agree to handle the governmental entity's account in accordance with the restrictions. The governmental entity should retain documentation of compliance with these requirements. For one broker in the prior year, the City did not have the required certification on file to verify compliance with Minnesota Statutes. 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 new 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 net realizable value. Cash resources have been made available primarily through the use of interfund loans and transfers, allowing this fund to purchase various properties as they became available. With interfund borrowing experiencing minimal activity in the current year, a significant balance still remains. Therefore, we continue to recommend that the City adopt a plan that would create a more formal arrangement on the related interfund loans. This plan would include the establishment of the terms of the interfund loans, including interest rates and length of borrowing. We recognize the City is working on an ongoing basis to utilize these assets in the best interest of the City. We also recommend that the City continue to review these property values to ensure a proper reporting of city assets and financial activity between funds for accurate presentation.
- **Individual Fund Deficits** – As reported in the City's comprehensive annual financial report (CAFR) as of December 31, 2015, the City has four special revenue funds that have deficit fund equity totaling \$91,573, one capital project fund totaling \$12,333, one enterprise fund totaling \$704,966, and one internal service fund totaling \$82,210. 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 Electric Fund used to finance required debt payments and capital asset purchases. As of December 31, 2015, the Fiber Optic Fund's unrestricted component of net position has a deficit of \$2,489,024. It is important that the City review the revenue stream over the next year 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.

The City implemented GASB Statement Nos. 68 and 71 during the year ended December 31, 2015. These statements provide new guidance on accounting and financial reporting for pensions accounted for in the financial statements of plan employers. Implementation of these standards resulted in an adjustment to the beginning equity reported in the City's government-wide and enterprise fund financial statements, as described in Note 1 of the notes to basic financial statements. The application of remaining policies was not changed during the year ended December 31, 2015.

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 GASB Statements 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 estimated sales price).

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.

CORRECTED AND UNCORRECTED MISSTATEMENTS

Professional standards require us to accumulate all known and likely misstatements identified during the audit, other than those that are 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.

DIFFICULTIES ENCOUNTERED IN PERFORMING THE AUDIT

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

DISAGREEMENTS WITH MANAGEMENT

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

MANAGEMENT REPRESENTATIONS

We have requested certain representations from management that are included in the management representation letter dated May 11, 2016.

MANAGEMENT CONSULTATIONS WITH OTHER INDEPENDENT ACCOUNTANTS

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

OTHER AUDIT FINDINGS OR ISSUES

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

OTHER MATTERS

We applied certain limited procedures to Management's Discussion and Analysis and the remaining 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. We did not audit or perform other procedures on this other information and we do not express an opinion or provide any assurance on it.

GOVERNMENTAL FUNDS OVERVIEW

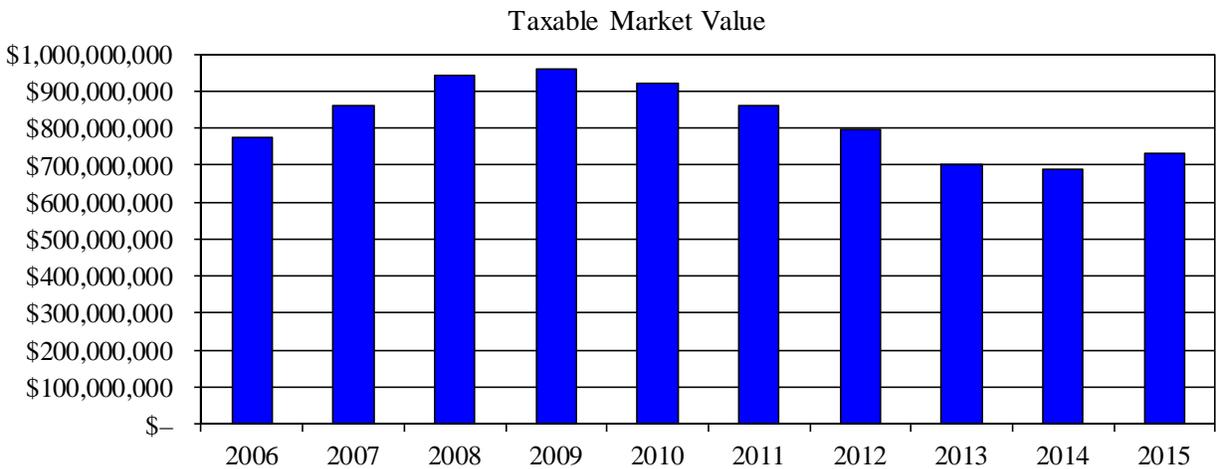
This section of the report provides you with an overview of the financial trends and activities of the City's governmental funds, which includes the General, special revenue, debt service, and capital project funds. These funds are used to account for the basic services the City provides to all of its 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 2014 fiscal year, local ad valorem property tax levies provided 39.0 percent of the total governmental fund revenues for cities over 2,500 in population, and 35.5 percent for cities under 2,500 in population. Property tax levies certified by Minnesota cities for 2015 increased about 4.0 percent over 2014, compared to an increase of 1.6 percent the prior year. A one-year levy limit imposed on cities over 2,500 in population for the 2014 levy year was lifted for the 2015 levy year.

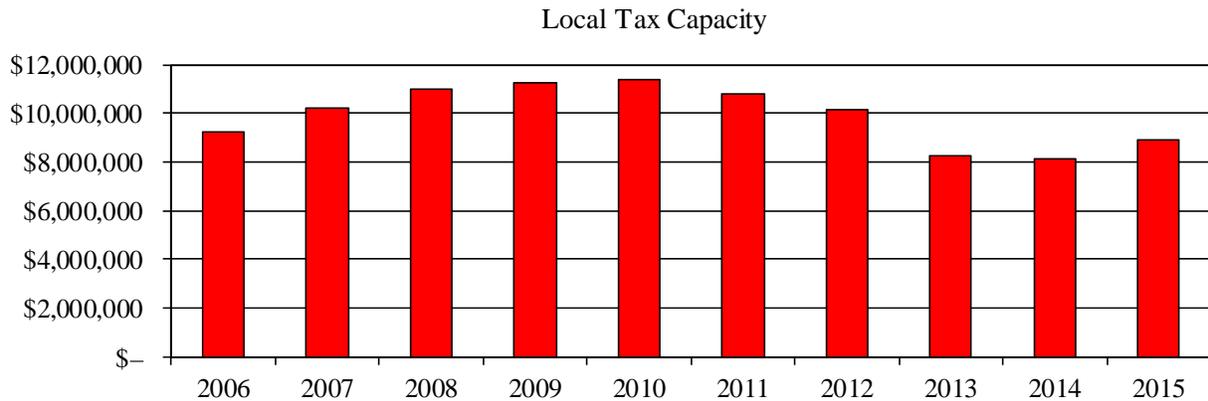
The total market value of property in Minnesota cities increased about 8.5 percent for the 2015 levy year, following a modest increase of 1.1 percent for levy year 2014 and a four-year trend of declining market values for levy years 2010 through 2013. Market values showed increases across all property categories for 2015, with gains in the market values of residential homestead properties (10.0 percent) and non-homestead residential properties (9.7 percent) outpacing the market value gain of commercial/industrial properties (2.2 percent). Because the assessed valuation used for levying property taxes is based on values from the previous fiscal year (e.g., the market value for taxes payable in 2015 is based on estimated values as of January 1, 2014), market value improvement has lagged behind recent upturns in the housing market and the economy in general.

The City's taxable market value decreased 2.1 percent for taxes payable in 2014 and increased 6.1 percent for taxes payable in 2015. The following graph shows the City's changes in taxable market value over the past 10 years:



Tax capacity is considered the actual base available for taxation. It is calculated by applying the state's property classification system to each property's market value. Each property classification, such as commercial or residential, has a different calculation and uses different rates. Consequently, a city's total tax capacity will change at a different rate than its total market value, as tax capacity is affected by the proportion of the City's tax base that is in each property classification from year-to-year, as well as legislative changes to tax rates. The City's tax capacity decreased 1.2 percent for 2014 and increased 9.3 percent for 2015.

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



The improvement in property tax capacities contributed to decreases to the overall state-wide and metro area tax rates for 2015. The following table presents the average tax rates applied to city residents for each of the last two levy years, along with comparative state-wide and metro area rates.

Rates expressed as a percentage of net tax capacity						
	All Cities State-Wide		Seven-County Metro Area		City of North St. Paul	
	2014	2015	2014	2015	2014	2015
Average tax rate						
City	48.8	46.9	46.0	43.4	36.2	35.2
County	47.6	44.7	46.6	42.9	63.7	58.9
School	28.9	27.1	30.9	28.3	37.6	35.9
Special taxing	<u>7.3</u>	<u>6.9</u>	<u>9.5</u>	<u>8.8</u>	<u>13.7</u>	<u>13.8</u>
Total	<u><u>132.6</u></u>	<u><u>125.6</u></u>	<u><u>133.0</u></u>	<u><u>123.4</u></u>	<u><u>151.2</u></u>	<u><u>143.8</u></u>

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, 2015, presented both by fund balance classification and by fund:

Governmental Funds Change in Fund Balance			
	Fund Balance as of December 31,		Increase (Decrease)
	<u>2015</u>	<u>2014</u>	
Fund balances of governmental funds			
Total by classification			
Nonspendable	\$ 1,800	\$ 2,910	\$ (1,110)
Restricted	3,089,182	3,577,232	(488,050)
Committed	2,042,917	1,470,423	572,494
Assigned	638,601	572,634	65,967
Unassigned	<u>1,622,043</u>	<u>1,556,694</u>	<u>65,349</u>
Total governmental funds	<u>\$ 7,394,543</u>	<u>\$ 7,179,893</u>	<u>\$ 214,650</u>
Total by fund			
General	\$ 1,759,204	\$ 1,685,786	\$ 73,418
Street Improvement	70,300	864,880	(794,580)
Nonmajor	<u>5,565,039</u>	<u>4,629,227</u>	<u>935,812</u>
Total governmental funds	<u>\$ 7,394,543</u>	<u>\$ 7,179,893</u>	<u>\$ 214,650</u>

In total, the fund balances of the City’s governmental funds increased by \$214,650 during the year ended December 31, 2015. The increase is due largely to the increase in committed funds in the Local Government Aid, Street Maintenance, and Park Improvement Special Revenue Funds offset by a decrease in the restricted fund balance in the Street Improvement Capital Projects Fund.

GOVERNMENTAL FUND REVENUES

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

We have included the most recent comparative state-wide averages available from the Office of the State Auditor to provide a benchmark for interpreting the City's data. The amounts received from the typical major sources of governmental fund revenue will naturally vary between cities based on factors such as the City's stage of development, location, size and density of its population, property values, services it provides, and other attributes. It will also differ from year-to-year due to the effect of inflation and changes in the City's operation. Also, certain data on these tables may be classified differently than how it appears 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 your 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						
Year	State-Wide			City of North St. Paul		
	December 31, 2014			2013	2014	2015
Population	2,500-10,000	10,000-20,000	20,000-100,000	11,618	11,951	12,006
Property taxes	\$ 427	\$ 396	\$ 427	\$ 302	\$ 305	\$ 309
Tax increments	26	37	46	22	16	15
Franchise and other taxes	32	42	37	37	44	47
Special assessments	59	51	64	3	22	10
Licenses and permits	28	27	41	19	25	20
Intergovernmental revenues	298	264	166	228	192	185
Charges for services	105	82	90	26	17	18
Other	66	72	65	36	44	31
Total revenue	<u>\$ 1,041</u>	<u>\$ 971</u>	<u>\$ 936</u>	<u>\$ 673</u>	<u>\$ 665</u>	<u>\$ 635</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 \$7,625,863 of total revenue in its governmental funds in 2015, a decrease of \$311,385 (3.9 percent) from the prior year. The City's per capita governmental funds revenue for 2015 was \$635, a decrease of \$30, from the prior year including the effect of a change in estimated population. The largest changes occurred with decreases in special assessments and other revenues. Special assessment revenue decreased with the collection of about \$230,000 in prepayments for street improvement projects in the prior year compared to just \$16,000 in the current year. The decrease in other revenues was due to the general decrease in miscellaneous revenue, which includes donations and investment earnings.

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

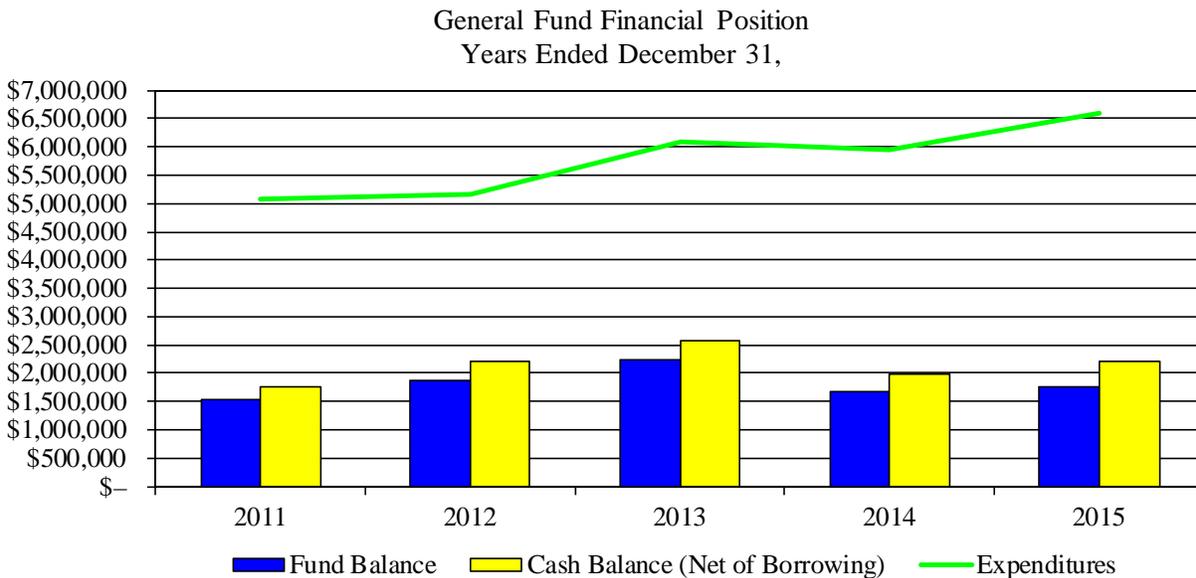
Governmental Funds Expenditures per Capita With State-Wide Averages by Population Class						
Year	State-Wide			City of North St. Paul		
	December 31, 2014			2013	2014	2015
Population	2,500–10,000	10,000–20,000	20,000–100,000	11,618	11,951	12,006
Current						
General government	\$ 131	\$ 104	\$ 87	\$ 91	\$ 69	\$ 174
Public safety	248	237	254	287	271	261
Street maintenance and lighting	121	119	114	110	125	66
Parks and recreation	86	101	92	36	30	47
All other	69	89	98	17	33	7
	<u>655</u>	<u>650</u>	<u>645</u>	<u>541</u>	<u>528</u>	<u>555</u>
Capital outlay and construction	357	278	276	14	187	86
Debt service						
Principal	180	163	115	58	64	65
Interest and fiscal	54	40	34	37	27	32
	<u>234</u>	<u>203</u>	<u>149</u>	<u>95</u>	<u>91</u>	<u>97</u>
Total expenditures	<u>\$ 1,246</u>	<u>\$ 1,131</u>	<u>\$ 1,070</u>	<u>\$ 650</u>	<u>\$ 806</u>	<u>\$ 738</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 2015 were \$8,870,240, a decrease of \$774,458 (8.0 percent). The City's per capita governmental funds total expenditures decreased \$68, or 8.4 percent. This decrease was in capital outlay and construction related to decreased costs from street improvement projects offset by an increase in general government expenditures for central services charges. During 2015, 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.



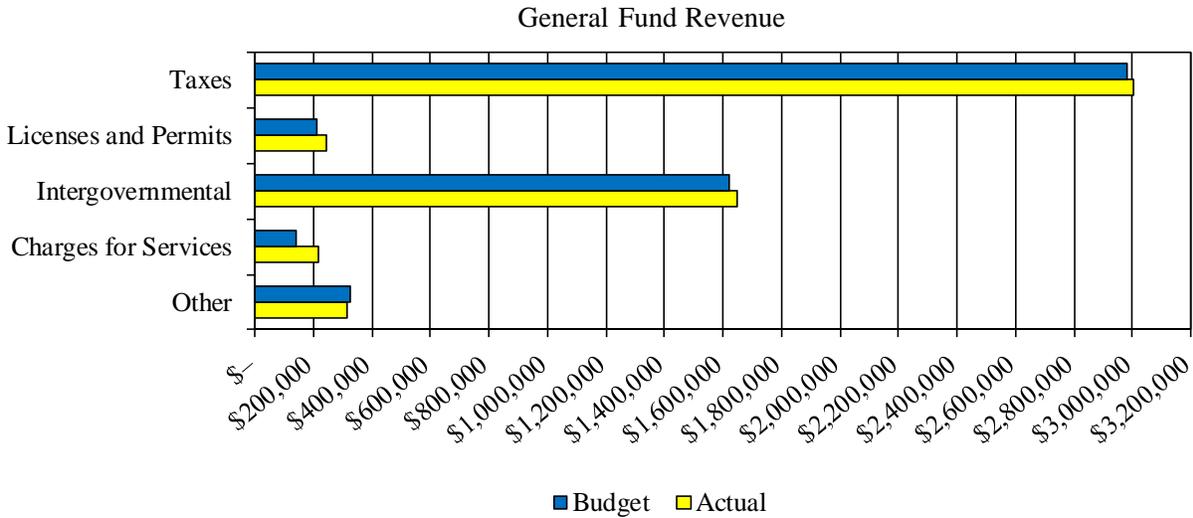
The City's General Fund cash and investment balance (net of borrowing) at December 31, 2015 was \$2,208,507, an increase of \$212,445 from the previous year. Total fund balance at December 31, 2015 was \$1,759,204, an increase of \$73,418 from the prior year. The unassigned portion of this fund balance level represents approximately 25 percent of the City's 2016 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.

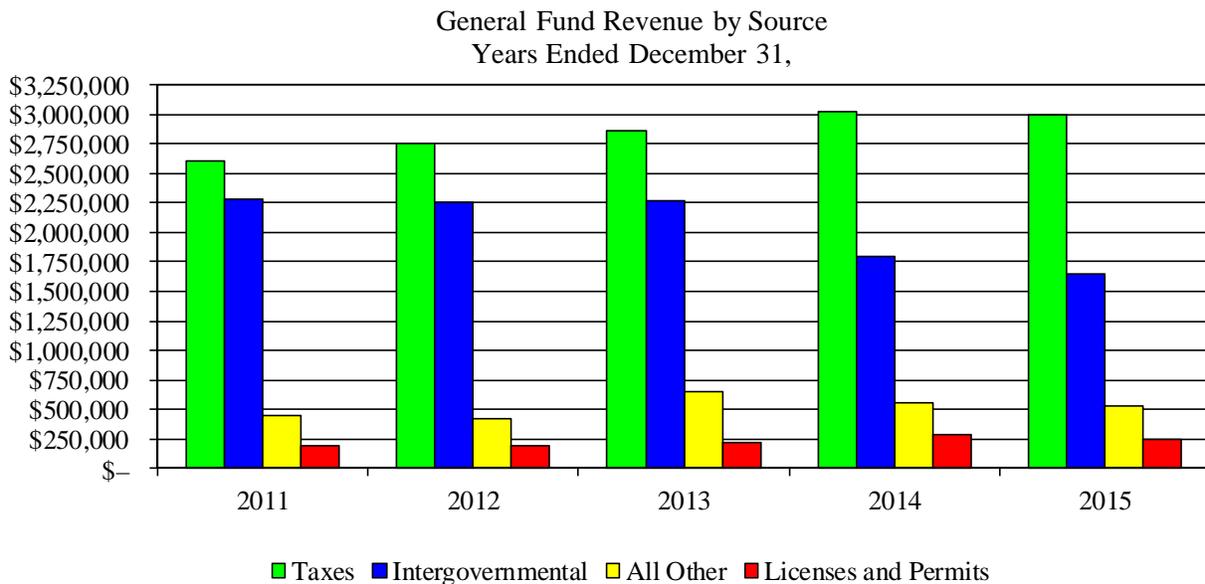
Current city policy allows fund balance in the General Fund to grow to 25 percent of the subsequent year's budgeted expenditures, while the State Auditor recommends that cities maintain an unrestricted fund balance that is between 35 percent and 50 percent of total current expenditures. The City should 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 2015:



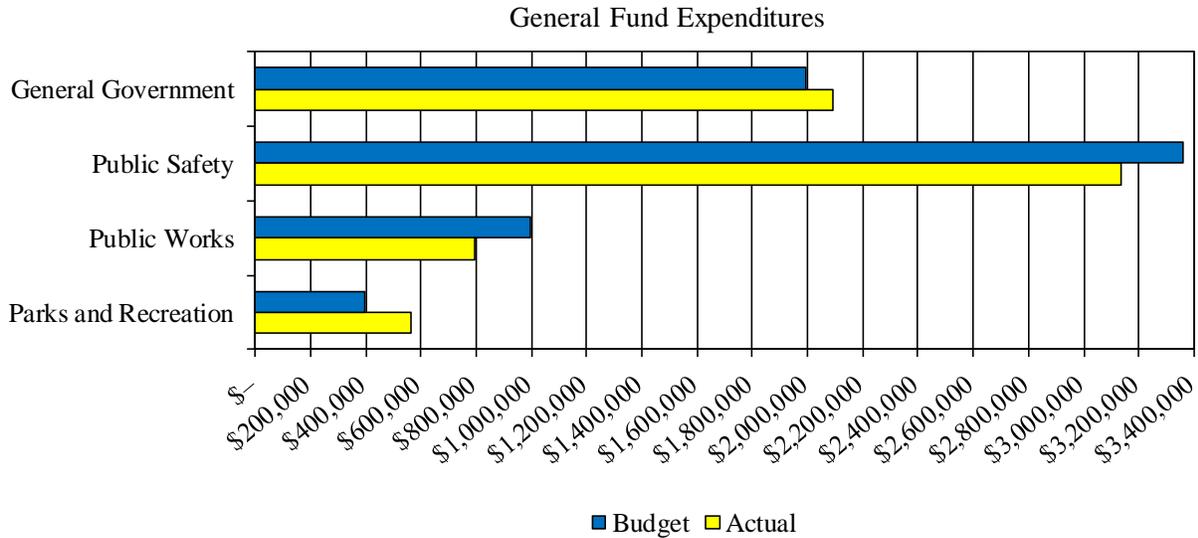
Total General Fund revenues for 2015 were \$5,416,542, a decrease of \$238,452 from the previous year, and were \$143,443 (2.7 percent) over budget. Revenues were more than projected in each category as presented above except for the other revenue category, with the largest variance in charges for services, which were \$72,425 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:



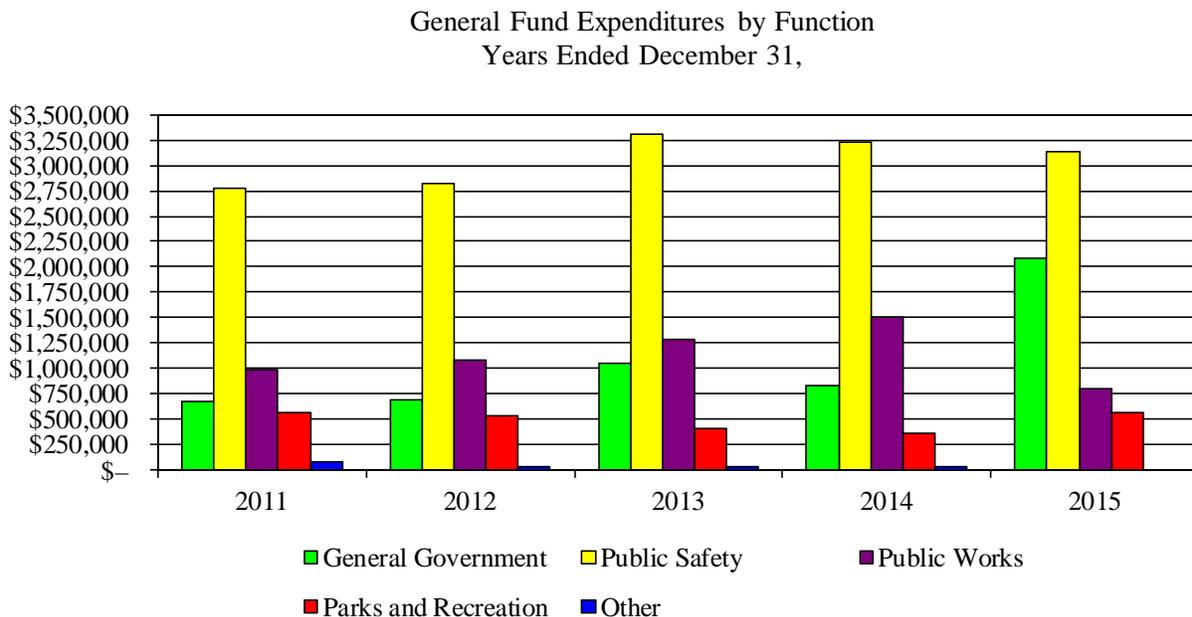
The General Fund is primarily financed by property and other taxes, along with local government aid, to operate activities in this fund. The largest change occurred in intergovernmental sources, which decreased by \$145,748 from the prior year as a result of the City recording the state aid street maintenance aid in the Street Maintenance Fund in the current year.

The following graph reflects the City's General Fund expenditures compared to budget for 2015:



Total General Fund expenditures for 2015 were \$6,585,504, an increase of \$640,391, or 10.8 percent, from the previous year, and \$155,289, or 2.3 percent, under budget. The largest variances occurred in the public safety, public works, and parks and recreation functions. Public safety and public works expenditures were \$225,141 and \$202,824, respectively, less than anticipated, while parks spending was over budget by \$171,859. Underspending was largely caused by positions that went unfilled during 2015 and anticipating more spending for streets projects than actually occurred in the current year.

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. As previously discussed, the City reclassified certain expenditure presentations within the General Fund, contributing to the functional changes presented in the graph above. The City also discontinued the use of an Internal Service Fund for building maintenance that is now included in the General Fund, contributing to the overall increase in General Fund expenditures.

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

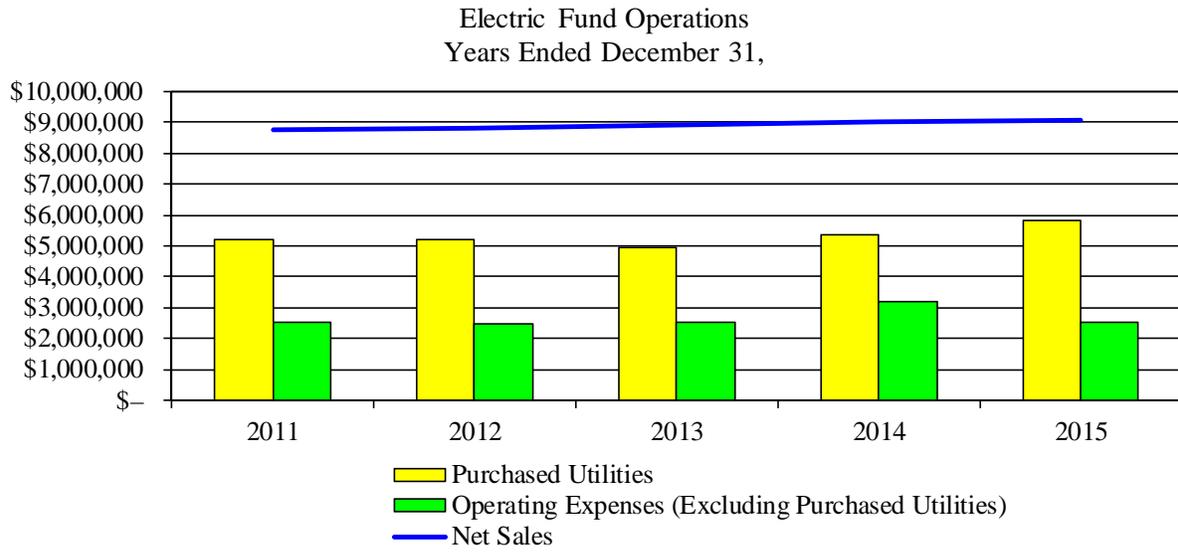
The following table summarizes the changes in the financial position of the City's enterprise funds during the year ended December 31, 2015, presented both by classification and by fund:

Enterprise Funds Change in Financial Position			
	Net Position as of December 31,		Increase (Decrease)
	2015	2014	
Net position of enterprise funds			
Total by classification			
Net investment in capital assets	\$ 5,230,857	\$ 5,050,697	\$ 180,160
Unrestricted	<u>4,045,686</u>	<u>4,719,389</u>	<u>(673,703)</u>
Total enterprise funds	<u><u>\$ 9,276,543</u></u>	<u><u>\$ 9,770,086</u></u>	<u><u>\$ (493,543)</u></u>
Total by fund			
Electric	\$ 4,472,785	\$ 5,609,445	\$ (1,136,660)
Water	2,238,225	2,060,270	177,955
Surface Water	1,933,952	1,614,944	319,008
Waste Water	984,341	768,933	215,408
Fiber Optic	(704,966)	(690,092)	(14,874)
Solid Waste	<u>352,206</u>	<u>406,586</u>	<u>(54,380)</u>
Total enterprise funds	<u><u>\$ 9,276,543</u></u>	<u><u>\$ 9,770,086</u></u>	<u><u>\$ (493,543)</u></u>

In total, the net position of the City's enterprise funds decreased by \$493,543 during the year ended December 31, 2015. The change in accounting principle, as previously mentioned, reduced net position by \$966,174 while current year operating results increased net position by \$472,631.

ELECTRIC FUND

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



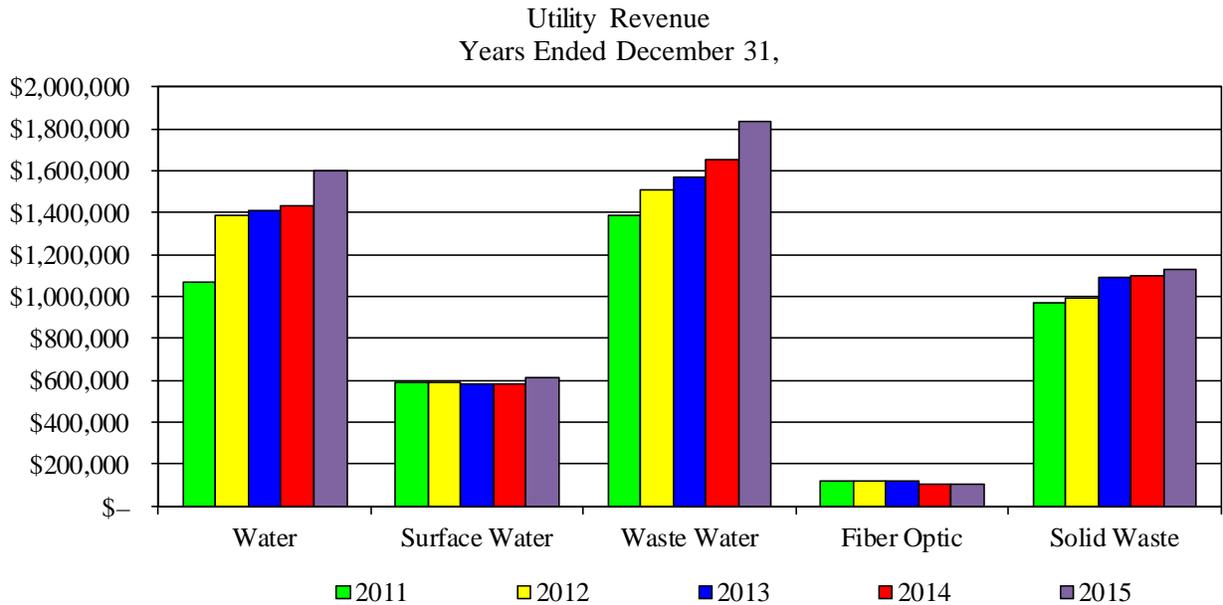
	2011	2012	2013	2014	2015
Total operating revenue	\$ 8,759,818	\$ 8,796,555	\$ 8,903,555	\$ 9,000,195	\$ 9,089,050
Purchased utilities	5,181,991	5,216,641	4,960,032	5,383,056	5,800,842
Gross profit	3,577,827	3,579,914	3,943,523	3,617,139	3,288,208
Other operating expenses	(2,526,171)	(2,457,377)	(2,508,062)	(3,187,473)	(2,513,005)
Depreciation	(217,712)	(201,450)	(155,852)	(56,960)	(65,916)
Interest expense	(92,915)	(89,799)	(85,625)	(81,524)	(76,546)
Other income (loss)	1,059	(10,523)	(27,751)	75,482	73,904
Income (loss) before transfers	742,088	820,765	1,166,233	366,664	706,645
Transfers to other funds	(1,252,414)	(42,910)	(343,175)	(600,000)	(1,146,021)
Net income (loss)	\$ (510,326)	\$ 777,855	\$ 823,058	\$ (233,336)	\$ (439,376)
Income (loss) before transfers as a percentage of net sales	8.5 %	9.3 %	13.1 %	4.1 %	7.8 %

Gross profit results for the City's Electric Fund decreased by \$328,931 from the prior year. This decrease was due in part to an increase in purchased utilities charges paid to the Minnesota Municipal Power Agency in the current year.

The Electric Fund ended fiscal 2015 with a total net position of \$4,472,785, of which \$3,548,758 remains unrestricted, with the remaining balance being classified as net investment in capital assets. At December 31, 2015, unrestricted cash and investments totaled \$1,634,759. As of the end of fiscal 2015, the Electric Fund has made interfund loans totaling \$3,113,698 primarily to finance development activities in the City.

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 2006A, 2009C, 2014A, and 2015A.

WATER FUND

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

	<u>2011</u>	<u>2012</u>	<u>2013</u>	<u>2014</u>	<u>2015</u>
Operating revenue	\$ 1,071,303	\$ 1,384,986	\$ 1,408,464	\$ 1,429,871	\$ 1,597,494
Operating expenses	(860,728)	(748,680)	(962,340)	(905,104)	(934,400)
Depreciation	<u>(236,156)</u>	<u>(196,666)</u>	<u>(212,357)</u>	<u>(160,457)</u>	<u>(162,240)</u>
Operating income (loss)	(25,581)	439,640	233,767	364,310	500,854
Nonoperating revenue (expenses)	<u>(80,990)</u>	<u>(79,602)</u>	<u>(76,817)</u>	<u>(73,485)</u>	<u>(80,462)</u>
Income (loss) before transfers	<u>\$ (106,571)</u>	<u>\$ 360,038</u>	<u>\$ 156,950</u>	<u>\$ 290,825</u>	<u>\$ 420,392</u>
Operating income (loss) as a percentage of operating revenue	<u>(2.4) %</u>	<u>31.7 %</u>	<u>16.6 %</u>	<u>25.5 %</u>	<u>31.4 %</u>

The Water Fund ended 2015 with a net position of \$2,238,225, an increase of \$177,955 from the prior year. Of this, \$1,210,864 represents the net investment in capital assets, while \$1,027,361 is considered unrestricted.

Operating revenue increased \$167,623 from the previous year, or about 11.7 percent. Increased rates and charges resulted in this overall increase in operating revenue. Operating expenses increased \$29,296, or about 3.2 percent.

During the current year, this utility operation also made transfers to other funds totaling \$185,000.

SURFACE WATER FUND

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

	<u>2011</u>	<u>2012</u>	<u>2013</u>	<u>2014</u>	<u>2015</u>
Operating revenue	\$ 591,946	\$ 588,515	\$ 586,525	\$ 581,341	\$ 613,504
Operating expenses	(114,505)	(348,443)	(345,793)	(271,762)	(246,858)
Depreciation	(94,615)	(94,673)	(94,673)	(79,073)	(99,533)
Operating income	382,826	145,399	146,059	230,506	267,113
Nonoperating revenue (expense)	(45,849)	(50,609)	(56,278)	(16,802)	(33,472)
Income (loss) before transfers	<u>\$ 336,977</u>	<u>\$ 94,790</u>	<u>\$ 89,781</u>	<u>\$ 213,704</u>	<u>\$ 233,641</u>
Operating income as a percentage of operating revenue	<u>64.7 %</u>	<u>24.7 %</u>	<u>24.9 %</u>	<u>39.7 %</u>	<u>43.5 %</u>

The Surface Water Fund ended 2015 with a net position of \$1,933,952, an increase of \$319,008 from the prior year. Of this, \$941,623 represents the net investment in capital assets, while \$992,329 is considered unrestricted.

Operating revenues increased \$32,163 from the previous year, or 5.5 percent. Operating expenses decreased \$24,904 from the previous year primarily in personal services and materials and supplies.

During the current year, this utility operation also made transfers to other funds totaling \$40,000.

WASTE WATER FUND

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

	2011	2012	2013	2014	2015
Operating revenue	\$ 1,387,346	\$ 1,508,674	\$ 1,568,817	\$ 1,653,655	\$ 1,832,616
Operating expenses	(1,014,598)	(1,086,642)	(977,277)	(1,011,362)	(1,270,007)
Depreciation	(184,009)	(185,183)	(197,498)	(148,457)	(113,889)
Operating income (loss)	188,739	236,849	394,042	493,836	448,720
Nonoperating revenue (expenses)	(114,004)	(115,191)	(115,448)	(80,637)	(99,808)
Income (loss) before transfers	<u>\$ 74,735</u>	<u>\$ 121,658</u>	<u>\$ 278,594</u>	<u>\$ 413,199</u>	<u>\$ 348,912</u>
Operating income (loss) as a percentage of operating revenue	<u>13.6 %</u>	<u>15.7 %</u>	<u>25.1 %</u>	<u>29.9 %</u>	<u>24.5 %</u>

The Waste Water Fund ended 2015 with a net position of \$984,341, an increase of \$215,408 from the prior year. Of this, \$370,285 represents the net investment in capital assets, while the unrestricted portion has a balance of \$614,056.

Operating revenue increased \$178,961 from the previous year, or about 10.8 percent, largely due to the increase in rates applied in fiscal 2015. Operating expenses increased \$258,645, or about 25.6 percent, due to increased spending in all areas of this fund, including Metropolitan Council of Environmental Services charges.

During the current year, this utility operation also made transfers to other funds totaling \$125,000.

FIBER OPTIC FUND

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

	2011	2012	2013	2014	2015
Operating revenue	\$ 120,715	\$ 117,651	\$ 118,059	\$ 104,472	\$ 108,615
Operating expenses	(173,307)	(128,301)	(94,045)	(157,661)	(73,756)
Depreciation	(46,475)	(46,558)	(46,558)	(46,558)	(44,440)
Operating income (loss)	(99,067)	(57,208)	(22,544)	(99,747)	(9,581)
Nonoperating revenue (expenses)	(51,308)	(42,195)	(32,665)	(22,699)	(5,293)
Change in net position	(150,375)	(99,403)	(55,209)	(122,446)	(14,874)
Net position					
Beginning of year	(262,659)	(413,034)	(512,437)	(567,646)	(690,092)
End of year	<u>\$ (413,034)</u>	<u>\$ (512,437)</u>	<u>\$ (567,646)</u>	<u>\$ (690,092)</u>	<u>\$ (704,966)</u>
Net position					
Net investment in capital assets	\$ 1,169,296	\$ 1,330,977	\$ 1,409,163	\$ 1,590,340	\$ 1,784,058
Unrestricted	(1,582,330)	(1,843,414)	(1,976,809)	(2,280,432)	(2,489,024)
Total net position	<u>\$ (413,034)</u>	<u>\$ (512,437)</u>	<u>\$ (567,646)</u>	<u>\$ (690,092)</u>	<u>\$ (704,966)</u>

The Fiber Optic Fund ended 2015 with a net position deficit of \$704,966, down \$14,874 from the prior year. Of this, \$1,784,058 represents the net investment in capital assets, while the unrestricted portion has a deficit balance of \$2,489,024.

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 scheduled debt payments and 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>2011</u>	<u>2012</u>	<u>2013</u>	<u>2014</u>	<u>2015</u>
Operating revenue	\$ 970,566	\$ 992,495	\$ 1,087,665	\$ 1,095,158	\$ 1,127,975
Operating expenses	<u>(846,974)</u>	<u>(886,897)</u>	<u>(923,779)</u>	<u>(839,576)</u>	<u>(1,167,540)</u>
Operating income	123,592	105,598	163,886	255,582	(39,565)
Nonoperating revenue (expenses)	<u>(23,468)</u>	<u>(25,982)</u>	<u>(29,699)</u>	25,694	23,069
Income (loss) before transfers	<u>\$ 100,124</u>	<u>\$ 79,616</u>	<u>\$ 134,187</u>	<u>\$ 281,276</u>	<u>\$ (16,496)</u>
Operating income as a percentage of operating revenue	<u>12.7 %</u>	<u>10.6 %</u>	<u>15.1 %</u>	<u>23.3 %</u>	<u>(3.5) %</u>

The Solid Waste Fund ended 2015 with a net position of \$352,206, a decrease of \$54,380 from the prior year, all of which is reported as unrestricted net position.

Operating revenue increased \$32,817 from the previous year, or about 3.0 percent, due to an increase in rates applied in fiscal 2015. Operating expenses increased \$327,964, or about 39.1 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 \$20,000.

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 your 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, 2015 and 2014 for governmental activities, business-type activities (utility fund operations), and the Economic Development Authority (EDA) component unit:

	As of December 31,		Increase (Decrease)
	2015	2014	
Net position			
Governmental activities			
Net investment in capital assets	\$ 18,732,114	\$ 18,499,040	\$ 233,074
Restricted	3,734,922	3,083,209	651,713
Unrestricted	1,113,925	3,473,659	(2,359,734)
Total governmental activities	<u>23,580,961</u>	<u>25,055,908</u>	<u>(1,474,947)</u>
Business-type activities			
Net investment in capital assets	5,230,857	5,050,697	180,160
Unrestricted	3,946,517	4,560,899	(614,382)
Total business-type activities	<u>9,177,374</u>	<u>9,611,596</u>	<u>(434,222)</u>
Economic Development Authority			
Restricted	<u>60,108</u>	<u>65,506</u>	<u>(5,398)</u>
Total net position	<u>\$ 32,818,443</u>	<u>\$ 34,733,010</u>	<u>\$ (1,914,567)</u>

The City (including the EDA) ended 2015 with combined total net position of \$32,818,443, a decrease of \$1,914,567 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 its participation in the Public Employees Retirement Association and the North St. Paul Fire Department Relief Association pension plans that reduced beginning unrestricted net position by \$3,476,676.

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, 2015 (excluding the change in accounting principle) and 2014:

	2015			2014
	Expenses	Program Revenues	Net Change	Net Change
Net (expense) revenue				
Governmental activities				
General government	\$ 2,548,971	\$ 287,497	\$ (2,261,474)	\$ (743,021)
Public safety	2,706,191	377,086	(2,329,105)	(2,747,456)
Public works	1,655,722	400,351	(1,255,371)	(1,397,665)
Parks and recreation	457,126	214,408	(242,718)	(161,287)
Economic development	109,130	13,742	(95,388)	(394,293)
Interest and fiscal charges	356,642	-	(356,642)	(346,375)
Business-type activities				
Electric	8,447,378	9,103,924	656,546	314,936
Water	1,168,913	1,601,572	432,659	291,416
Surface water	401,214	630,825	229,611	203,184
Waste water	1,480,667	1,840,523	359,856	413,050
Fiber optic	130,473	115,599	(14,874)	(122,446)
Solid waste	1,186,419	1,163,337	(23,082)	272,105
Economic Development Authority	137,847	-	(137,847)	(126,978)
Total net (expense) revenue	<u>\$ 20,786,693</u>	<u>\$ 15,748,864</u>	(5,037,829)	(4,544,830)
General revenues				
Property and franchise taxes			4,581,882	4,471,007
Grants and contributions not restricted to specific programs			1,828,503	1,900,433
Other general revenues			4,606	52,840
Investment earnings (charged)			184,947	181,087
Total general revenues			<u>6,599,938</u>	<u>6,605,367</u>
Change in net position			<u>\$ 1,562,109</u>	<u>\$ 2,060,537</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

Despite the 2015 legislative session beginning with a projected budget excess of \$1.87 billion for the 2016–2017 biennium, the most favorable budget forecast in over a decade, little was accomplished during the regular legislative session due to partisan disagreement. The regular session adjourned without the Legislature bringing forth a number of significant funding bills, including the Omnibus Legacy Bill (funding for outdoor heritage, clean water, parks and trails, arts, and cultural heritage) and a bonding bill for capital projects. The Governor subsequently vetoed a number of other funding bills, including the Omnibus E–12 Education Bill due to the Legislature not addressing his demand for a universal preschool provision. Eventually, a one-day special session produced funding bills for E–12 education, jobs and energy, Legacy programs, environment and agriculture, and capital investment.

The following is a summary of recent legislation affecting Minnesota cities in 2015 and into the future:

Local Government Aid (LGA) – The Legislature completely overhauled the LGA formula for fiscal year 2014 and thereafter, creating a three-tiered formula that includes separate “need factor” calculations for cities with populations under 2,500, between 2,500 and 10,000, or over 10,000. The new formula simplified the LGA calculation, and reduced the volatility of the LGA distribution by limiting the amount it may decline in a given year. Beginning in 2015, any reduction to a city’s calculated LGA distribution will be limited to the lesser of \$10 per capita, or 5 percent of their previous year net tax levy. For cities that gain under the new formula, the increases will be distributed proportionate to their unmet need, as determined by the new “need factor” calculations. The state-wide LGA appropriation was \$516.9 million for fiscal 2015, and is \$519.4 million for fiscal 2016 and thereafter.

Sales Tax Exemption – Cities (both home-rule and statutory) were exempted from paying sales tax on qualifying purchases, effective for purchases made on or after January 1, 2014. Purchases of goods or services by an exempt local government for a publicly-provided liquor store, gas or electric utility, golf course, marina, campground, café, laundromat, solid waste hauling or recycling operation, or landfill will remain taxable.

The 2014 Legislature extended the definition of tax exempt local government to include all special district; city, county, or township instrumentalities; economic development authorities; housing and redevelopment authorities; and all joint power boards or organizations. However, the effective date of this expanded exemption list was delayed until January 1, 2017 by the 2015 Legislature.

Omnibus Bonding Bill – The Legislature approved a scaled-down Omnibus Bonding Bill during the special session, authorizing approximately \$370 million in capital improvements. Included in the funding approved was \$172.5 million for transportation infrastructure, \$23.5 million for flood hazard mitigation, \$10 million for Public Financing Agency (PFA) grants to municipalities for wastewater infrastructure, and \$1.5 million to the Metropolitan Council for inflow and infiltration improvement grants to metro area cities.

Legacy Funding – The Legacy bill included \$9.25 million annually to finance grants for city water infrastructure improvements through the PFA. It also included \$17.25 million annually to fund “SCORE” block grants to counties for recycling and waste reduction (a portion of which is passed through to cities) and \$1 million of annual funding for a new grant program to establish or improve recycling programs in non-metro area cities.

Broadband Initiative – The Omnibus Jobs and Energy Bill passed in the special session included \$10.6 million to finance the Border-to-Border Broadband Grant Program, a one-time appropriation available until June 30, 2017.

Municipal State-Aid Streets – Included in the Omnibus Transportation Bill were annual funding allocations for municipal state-aid streets of \$107.7 million for fiscal 2016 and \$178.1 million for fiscal 2017, which represents an increase of approximately \$41 million over the previous biennium.

Small Cities Assistance Account – A one-time appropriation of \$12.5 million was provided to create a new Small Cities Assistance Account to assist with construction and maintenance of roads located within eligible cities, defined as a statutory or home-rule charter city that does not receive municipal state aid street financing (generally those with a population under 5,000). The aid will be distributed to eligible cities biannually in each year funds are available based on the following formula: 5 percent equally to all eligible cities; 35 percent allocated proportionately on each city’s share of lane miles to the total for all eligible cities; 35 percent allocated proportionately on each city’s population to the total for all eligible cities; and 25 percent allocated proportionately on each city’s state-aid adjustment factor to the total for all eligible cities.

Workforce Housing Grant Program – The Omnibus Jobs and Energy Bill included annual funding of \$2 million for fiscal 2016 and 2017 for a new Workforce Housing Grant Program. Eligible cities can use the grants to develop “market rate residential rental property” to serve employees of businesses located in the eligible project areas. The maximum grant award may not exceed 25 percent of the rental housing development project cost; and awards must be matched by a local unit of government, business, or nonprofit organization with \$1 for each \$2 of grant funding.

Automated License Plate Reader (ALPR) Policy – Law enforcement agencies that utilize ALPRs are required to establish policies governing their use that are consistent with statutory guidelines. The Legislature placed limitations on the type of data that can be collected using ALPRs, and clarified the circumstances under which that data is considered public or private. A limitation of 60 days was established for the retention of data collected by ALPR not related to an active criminal investigation. Standards were established for the sharing of ALPR data between law enforcement agencies.

Elections – The Elections Omnibus Bill made numerous changes to elections administration laws, including requirements for filing fees for statutory cities, ballot formatting and marking, absentee ballots, and election recounts.

Energy Conservation Measures – The Uniform Municipal Contracting Law was amended to add water metering devices that increase efficiency to the definition of energy conservation measures, enabling municipalities to enter into guaranteed energy savings contracts for the use of water metering devices.

Responsible Contractor Requirement – The “responsible contractor” law enacted by the 2014 Legislature became effective on January 1, 2015. Contractors who bid on public contracts in excess of \$50,000 are now required to certify that they are a “responsible bidder” in order to be awarded a contract as the lowest responsible bidder or best value alternative. The 2015 Legislature made several clarifications and modifications to the law, including: exempting design professionals and materials suppliers from the requirements; making motor carriers subject to the requirements and establishing a separate verification standard for them; excluding tax increment financing revenue from the value of a construction contract under the law; and allowing general contractors to submit bids without obtaining verification from all subcontractors that bid on the project (the successful prime contractor must submit a supplemental verification under oath prior to the execution of the contract).

Appraisal Requirements for Eminent Domain – Effective July 1, 2015, the appraisal requirements for the acquisition of property by eminent domain are changed to require the acquiring entity to obtain at least one appraisal for the property proposed to be acquired only if the acquisition value is greater than \$25,000. For acquisitions less than \$25,000, the acquiring entity may obtain a minimum damage acquisition report in lieu of an appraisal.

Firefighter Employment Provisions and Volunteer Benefits – The Omnibus Public Safety Finance and Policy Bill made a number of changes related to firefighters, including: allowing relief association dues as a voluntarily payroll deduction, allowing volunteer firefighters to be paid less frequently than every 31 days, requiring the licensure of all full-time firefighters by the State Board of Firefighter Training and Education, and expanding “continued employer health insurance benefits” to include dependents of volunteer firefighters killed in the line of duty.

Police and Firefighter Retirement Supplemental State Aid – The volunteer firefighter portion of the Police and Firefighter Retirement Supplemental State Aid Program was made permanent. The minimum obligation of municipalities to an associated relief association special fund is now reduced by the amount of both fire state aid and police and firefighter retirement supplemental state aid. Police and firefighter retirement supplemental state aid is also added to the calculation of the exception to municipal ratification requirement for lump-sum plans.

Pensions – A number of changes to the pension plans administered by the Public Employees Retirement Association (PERA) were adopted, effective June 30, 2015, including:

- The future interest rate actuarial assumption for the PERA General Plan and PERA Police and Fire Plan are changed from 8.5 percent to 8.0 percent for actuarial valuations prepared after June 30, 2015.
- The refund repayment interest rate and prior service credit purchase payment determination rate for the PERA General Plan and PERA Police and Fire Plan are also changed from 8.5 percent to 8.0 percent.
- The CPI-based post-retirement adjustment mechanism for the PERA Police and Fire Plan is replaced with a flat 2.5 percent increase when the plan reaches a 90 percent funding level.
- The contribution stabilizer mechanisms applicable to the PERA General Plan are revised, broadening the factors the plan’s Board of Trustees may consider before recommending an increase in the plan contribution rates.
- Definitions of salary, termination of service, allowable service, retirement, and volunteer firefighter were revised for all applicable PERA plans.
- Changes in eligibility, service pension levels, ancillary benefits, and service time calculations were made to the PERA Statewide Volunteer Firefighter Plan, lump sum retirement division. A change was also made to create a “monthly benefit retirement division” within this plan to facilitate the transfer of individual volunteer firefighter association monthly benefit plans to the statewide plan.
- A number of administrative language changes were made to complete the merger of the Minneapolis Employees Retirement Fund into the PERA General Plan, which was effective January 1, 2015.

ACCOUNTING AND AUDITING UPDATES

GASB STATEMENT NO. 72, *FAIR VALUE MEASURE AND APPLICATION*

The primary objective of this statement is to address accounting and financial reporting issues related to fair value measurements. Fair value is the price that would be received to sell an asset or paid to transfer a liability in an orderly transaction between market participants at the measurement date. This statement provides guidance for determining a fair value measurement for financial reporting purposes. It also provides guidance for applying fair value to certain investments and disclosures related to all fair value measurements.

This statement generally requires investments to be measured at fair value. An investment is defined as a security or other asset that (a) a government holds primarily for the purpose of income or profit and (b) has a present service capacity based solely on its ability to generate cash or to be sold to generate cash. This statement is effective for financial statements for fiscal years beginning after June 15, 2015. Earlier application is encouraged.

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

The objective of this statement is to improve the usefulness of information about pensions included in financial statements of state and local governments for making decisions and assessing accountability. This statement also clarifies the application of certain provisions of GASB Statement Nos. 67 and 68 regarding 10-year schedules of required supplementary information (RSI) and other recognition issues pertaining to employers and nonemployer contributing entities. These changes will improve financial reporting by establishing a single framework for the presentation of information about pensions, enhancing comparability for similar information reported by employers and nonemployer contributing entities.

The requirements of this statement that address accounting and financial reporting by employers and governmental nonemployer contributing entities for pensions not within the scope of GASB Statement No. 68 are effective for financial statements for fiscal years beginning after June 15, 2016, and the requirements of this statement that address financial reporting for assets accumulated for purposes of providing those pensions are effective for fiscal years beginning after June 15, 2015. The requirements of this statement for pension plans that are within the scope of GASB Statement No. 67 or for pensions that are within the scope of GASB Statement No. 68 are effective for fiscal years beginning after June 15, 2015. Earlier application is encouraged.

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

The objective of this statement is to improve the usefulness of information about post-employment benefits other than pensions (other post-employment benefits [OPEB]). This statement replaces GASB Statement Nos. 43 and 57. It also includes requirements for defined contribution OPEB plans that replace the requirements for those OPEB plans in GASB Statement Nos. 25, 43, and 50. GASB Statement No. 75, *Accounting and Financial Reporting for Postemployment Benefits Other Than Pensions*, establishes new accounting and financial reporting requirements for governments whose employees are provided with OPEB, as well as for certain nonemployer governments that have a legal obligation to provide financial support for OPEB provided to the employees of other entities.

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

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

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

The primary objective of this statement is to improve accounting and financial reporting by state and local governments for post-employment benefits other than pensions (OPEB). It also improves information provided by state and local governmental employers about financial support for OPEB that is provided by other entities. This statement replaces the requirements of GASB Statement Nos. 45 and 57. GASB Statement No. 74 establishes new accounting and financial reporting requirements for OPEB plans.

This statement establishes standards for recognizing and measuring liabilities, deferred outflows of resources, deferred inflows of resources, and expense/expenditures. For defined benefit OPEB, this statement identifies the methods and assumptions that are required to be used to project benefit payments, discount projected benefit payments to their actuarial present value, and attribute that present value to periods of employee service. Note disclosure and RSI requirements about defined benefit OPEB also are addressed. This statement is effective for fiscal years beginning after June 15, 2017. Earlier application is encouraged.

Similar to changes implemented for pensions, this statement requires the liability of employers and nonemployer contributing entities to employees for defined benefit OPEB (net OPEB liability) to be measured as the portion of the present value of projected benefit payments to be provided to current active and inactive employees that is attributed to those employees' past periods of service (total OPEB liability), less the amount of the OPEB plan's fiduciary net position.

GASB STATEMENT NO. 77, TAX ABATEMENT DISCLOSURES

This statement requires disclosure of tax abatement information about (1) a reporting government's own tax abatement agreements, and (2) those that are entered into by other governments and that reduce the reporting government's tax revenues. Tax abatements are widely used by state and local governments, particularly to encourage economic development. For financial reporting purposes, this statement defines a tax abatement as resulting from an agreement between a government and an individual or entity in which the government promises to forgo tax revenues and the individual or entity promises to subsequently take a specific action that contributes to economic development or otherwise benefits the government or its citizens.

The requirements of this statement improve financial reporting by giving users of financial statements essential information that is not consistently or comprehensively reported to the public at present. Disclosure of information about the nature and magnitude of tax abatements will make these transactions more transparent to financial statement users. As a result, users will be better equipped to understand (1) how tax abatements affect a government's future ability to raise resources and meet its financial obligations, and (2) the impact those abatements have on a government's financial position and economic condition. The requirements of this statement are effective for financial statements for periods beginning after December 15, 2015. Earlier application is encouraged.

GASB STATEMENT NO. 78, PENSIONS PROVIDED THROUGH CERTAIN MULTIPLE-EMPLOYER DEFINED BENEFIT PENSION PLANS

The objective of this statement is to address a practice issue regarding the scope and applicability of GASB Statement No. 68, *Accounting and Financial Reporting for Pensions—an amendment of GASB Statement No. 27*. This issue is associated with pensions provided through certain multiple-employer defined benefit pension plans and to state or local governmental employers whose employees are provided with such pensions. Prior to the issuance of this statement, the requirements of GASB Statement No. 68 applied to the financial statements of all state and local governmental employers whose employees are provided with pensions through pension plans that are administered through trusts that meet the criteria in paragraph 4 of GASB Statement No. 68.

This statement amends the scope and applicability of GASB Statement No. 68 to exclude pensions provided to employees of state or local governmental employers through a cost-sharing, multiple-employer defined benefit pension plan that (1) is not a state or local governmental pension plan, (2) is used to provide defined benefit pensions both to employees of state or local governmental employers and to employees of employers that are not state or local governmental employers, and (3) has no predominant state or local governmental employer (either individually or collectively with other state or local governmental employers that provide pensions through the pension plan). This statement establishes requirements for recognition and measurement of pension expense, expenditures, and liabilities; note disclosures; and RSI for pensions that have the characteristics described above. The requirements of this statement are effective for reporting periods beginning after December 15, 2015. Early application is encouraged.

GASB STATEMENT NO. 79, CERTAIN EXTERNAL INVESTMENT POOLS AND POOL PARTICIPANTS

This statement establishes criteria for an external investment pool to qualify for making the election to measure all of its investments at amortized cost for financial reporting purposes. An external investment pool qualifies for that reporting if it meets all of the applicable criteria established in this statement. The specific criteria address (1) how the external investment pool transacts with participants; (2) requirements for portfolio maturity, quality, diversification, and liquidity; and (3) calculation and requirements of a shadow price. Significant noncompliance prevents the external investment pool from measuring all of its investments at amortized cost for financial reporting purposes. If an external investment pool meets the criteria in this statement and measures all of its investments at amortized cost, the pool's participants also should measure their investments in that external investment pool at amortized cost for financial reporting purposes. If an external investment pool does not meet the criteria in this statement, the pool's participants should measure their investments in that pool at fair value.

This statement establishes additional note disclosure requirements for qualifying external investment pools that measure all of their investments at amortized cost for financial reporting purposes and for governments that participate in those pools. Those disclosures for both the qualifying external investment pools and their participants include information about any limitations or restrictions on participant withdrawals. The requirements of this statement are effective for reporting periods beginning after June 15, 2015, except for certain provisions on portfolio quality, custodial credit risk, and shadow pricing. Those provisions are effective for reporting periods beginning after December 15, 2015. Earlier application is encouraged.

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

The objective of this statement is to clarify the financial statement presentation requirements for certain component units. This statement amends the blending requirements for the financial statement presentation of component units of all state and local governments. The additional criterion requires blending of a component unit incorporated as a not-for-profit corporation in which the primary government is the sole corporate member. The additional criterion does not apply to component units included in the financial reporting entity pursuant to the provisions of GASB Statement No. 39, *Determining Whether Certain Organizations Are Component Units—an amendment of GASB Statement No. 14*. The requirements of this statement are effective for reporting periods beginning after June 15, 2016. Earlier application is encouraged.

CHANGES TO REQUIREMENTS FOR FEDERAL GRANTS

In December 2013, the U.S. Office of Management and Budget (OMB) Circular released final guidance on administrative requirements, cost principles, and audit requirements for federal awards. The final guidance, Uniform Administrative Requirements, Cost Principles, and Audit Requirements for Federal Awards (“Uniform Guidance”), supersedes and streamlines eight existing OMB Circulars into one document that includes OMB Circulars A-21, A-87, A-89, A-102, A-110, A-122, A-133, and the guidance in OMB Circular A-50 on Single Audit Act follow-up.

The Uniform Guidance, which is located in Title 2 of the Code of Federal Regulations (CFR), consolidates previous guidance into a streamlined format that aims to improve both its clarity and accessibility, lessen administrative burdens for federal award recipients, and reduce the risk of waste, fraud, and abuse.

The Following is a Summary of Significant Changes for Grant Recipients:

- Changes time and effort documentation requirements by providing possibilities for alternative methods of accounting for salaries and wages based on achievement of performance outcomes.
- Non-federal entities must have a financial management system that includes, but is not limited to: a comparison of expenditures with budget amounts for each federal award, written procedures to implement the requirements of cash management, and written procedures for determining the allowability of costs in accordance with Subpart E – Cost Principles.
- Governments must comply with the new general procurement standards which include, but are not limited to: written standards covering conflicts of interest of employees engaged in the selection, award, and administration of contracts and documented procurement procedures that include an analysis of lease versus purchase alternatives when appropriate.
- Governments will now be required to follow the five procurement methods which include, at times, more restrictive compliance requirements than Minnesota Statutes. For example: small purchases (over \$3,000 prior to October 1, 2015 and over \$3,500 after October 1, 2015) will require quotes.
- There are new requirements for governments with subrecipients (or those making subawards), which include, but are not limited to: a required written risk assessment of each subrecipient, which may require you to provide training and on-site reviews of their program operations.
- For governments with subrecipients or those that operate as a fiscal host of a federal grant award and thus provide subawards, payments must be made in advance to the subrecipients, unless certain requirements are not met, then the reimbursement method can be used.

Among Other Matters Specifically Applicable to Auditors, Changes to the Uniform Guidance Include:

- Raising both the threshold that triggers a Single Audit and the threshold for Type A/B program determination to \$750,000.
- Changing the high-risk program criteria for Type A programs.
- Reducing the number of high-risk Type B programs that must be tested as major programs.
- Revising the Type B small program floor.
- Reducing the percentage of coverage requirement to 40 percent for normal auditees and 20 percent for low-risk auditees.
- Revising the criteria for low-risk auditee status.
- Increasing the threshold for reporting findings to \$25,000 in questioned costs and requiring more detailed information to be reported.

Effective Dates:

Year beginning January 1, 2015 –

- All administrative requirements and cost principles will apply to new awards made after December 26, 2014.
- Governmental entities are required to comply with the Uniform Guidance once the new regulations are in effect at the Federal government level (December 26, 2014).
- Any funding drawdowns made after January 1, 2015 must comply with the Uniform Guidance.
- Must document whether the entity is in compliance with the old or new procurement standards listed in Subpart D, Sections 200.317–200.326. The federal government has provided a two-year grace period for implementing the new procurement standards.

Year beginning January 1, 2016 –

- All administrative requirements and cost principles will apply to new awards made after December 26, 2014.
- Subpart F – Audit Requirements are applicable.

Year beginning January 1, 2017 –

- Must have implemented the new procurement standards of the Uniform Guidance, if the government initially elected the two-year grace beginning January 1, 2015.
- At this point, all of the new Uniform Guidance at Title 2 CFR 200 is applicable.

Recommended Action Items:

We recommend that award recipients familiarize themselves with the new requirements contained in the Uniform Guidance and develop a plan to become compliant with the new regulations.

Consider the following –

- Attend training on the new uniform administrative requirements.
- Identify needed policy and procedure changes, especially in the areas of:
 - Financial management
 - Payment
 - Procurement
 - Compensation
 - Travel costs
- Identify internal controls that might need to be established or modified.
- Determine who within your organization is responsible for each action item.
- Determine the timing of each action item.
- Determine when you will implement the new procurement standards and document in writing.