

Management Report  
for  
City of Arden Hills, Minnesota  
December 31, 2014

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PRINCIPALS

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To the City Council and Management  
City of Arden Hills, Minnesota

We have prepared this management report in conjunction with our audit of the City of Arden Hills, Minnesota's (the City) financial statements for the year ended December 31, 2014. 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  
June 4, 2015

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## AUDIT SUMMARY

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

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

We have audited the financial statements of the governmental activities, the business-type activities, each major fund, and the aggregate remaining fund information of the City as of and for the year ended December 31, 2014, 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, 2014:

- We have issued an unmodified opinion on the City's basic financial statements.
- We reported no deficiencies in the City's internal control over financial reporting that we considered to be material weaknesses.

It should be understood that internal controls are never perfected, and those controls which protect the City's funds from such things as fraud and accounting errors need to be continually reviewed and modified as necessary.

- The results of our testing disclosed no instances of noncompliance required to be reported under *Government Auditing Standards*.
- We reported one finding based on our testing of the City's compliance with Minnesota laws and regulations. For two contracts tested, the City was not in compliance with state statutes requiring a certificate from the Commissioner of Revenue on certain contracts to ensure compliance with withholding requirements of Minnesota Statute § 290.92.

### **FUND BALANCE/NET POSITION DEFICITS**

As reported in the City's comprehensive annual financial report (CAFR), the Equipment, Building, and Replacement Fund; Parks Fund; and Central Garage Fund had year-end deficit equity balances of \$63,517, \$87,376, and \$14,605, respectively. Management has disclosed that these deficits will be eliminated with future contributions, grants, and internal fund transfers if needed.

## **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.

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

## **ACCOUNTING ESTIMATES AND MANAGEMENT JUDGMENTS**

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

- **Depreciation** – Management's estimates of depreciation expense are based on the estimated useful lives of the assets.
- **Compensated Absences** – Management's estimate is based on current rates of pay and unused compensated absence balances.

We evaluated the key factors and assumptions used by management to develop these estimates in determining that they are reasonable in relation to the basic financial statements taken as a whole.

The financial statement disclosures are neutral, consistent, and clear.

## **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 June 4, 2015.

## **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 Budgetary Comparison Schedule for the General Fund and EDA Operating Fund, which are required supplementary information (RSI) that supplement 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 supplemental information accompanying the financial statements which are not RSI. With respect to this supplemental 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 supplemental 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

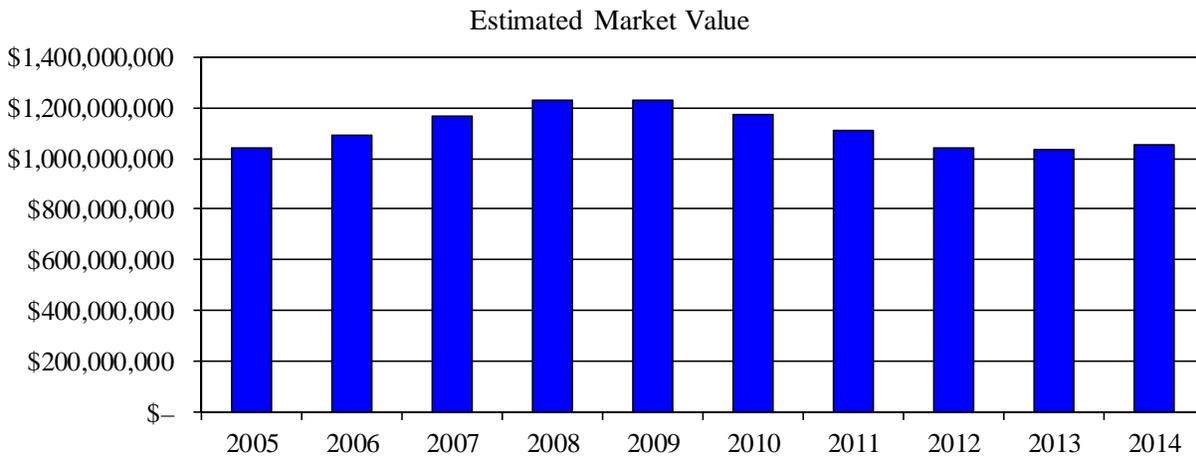
This section of the report provides you with an overview of the financial trends and activities of the City's governmental funds, which includes the General, special revenue, debt service, and capital project funds. These funds are used to account for the basic services the City provides to all of its 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 2013 fiscal year, local property tax levies provided 41.1 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 2014 increased about 1.6 percent over 2013, compared to an increase of 2.3 percent the prior year. This moderate increase was due in part to a one-year levy limit for 2014 imposed on cities over 2,500 in population.

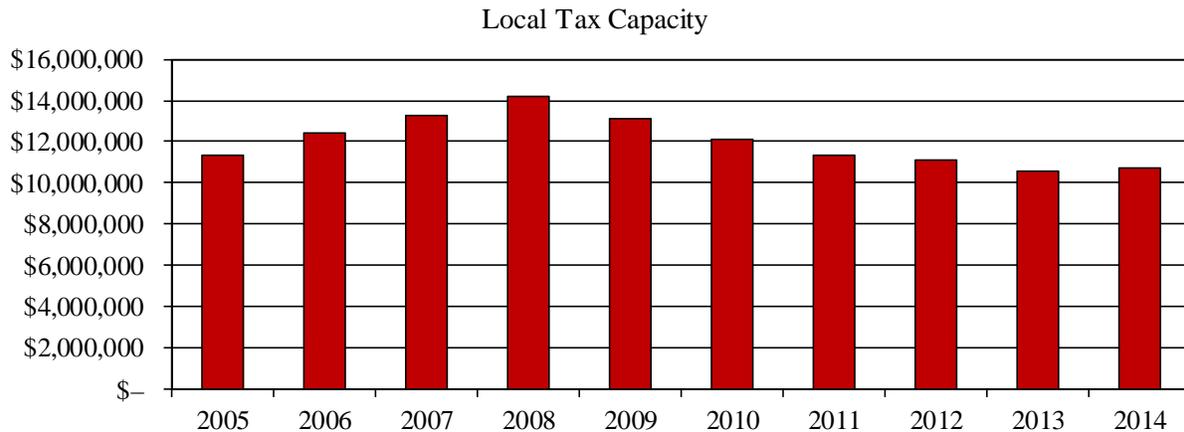
The total market value of Minnesota cities increased about 1.1 percent for the 2014 levy year, ending a four-year trend of declining market values that began in 2010 and peaked with a state-wide decline of about 8.8 percent for levy year 2012. Market values showed modest increases in all property categories for 2014, with the largest gains in agricultural and non-homestead residential properties. 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 2014 is based on estimated values as of January 1, 2013), market value improvement has lagged behind recent upturns in the housing market and the economy in general.

The City's taxable market value decreased by 0.8 percent for 2013 and increased 1.9 percent for taxes payable in 2014. 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 4.9 percent for taxes payable in 2013 and increased 1.4 percent for taxes payable in 2014.

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 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 Arden Hills	
	2013	2014	2013	2014	2013	2014
<b>Average tax rate</b>						
City	48.8	48.8	46.1	46.0	<b>27.9</b>	<b>28.0</b>
County	48.5	47.6	47.1	46.6	<b>65.2</b>	<b>63.7</b>
School	28.5	28.9	30.3	30.9	<b>29.4</b>	<b>29.2</b>
Special taxing	<u>7.2</u>	<u>7.3</u>	<u>9.4</u>	<u>9.5</u>	<b><u>10.2</u></b>	<b><u>9.8</u></b>
Total	<u><u>133.0</u></u>	<u><u>132.6</u></u>	<u><u>132.9</u></u>	<u><u>133.0</u></u>	<b><u><u>132.7</u></u></b>	<b><u><u>130.7</u></u></b>

There are a number of reasons contributing to the change in the average total tax rate. The City's portion of the tax capacity rates 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 because of the City's high property values and strong commercial tax base. The City does not have any outstanding debt levy requirement, which also contributes to the lower than average city tax rate.

**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, 2014, presented both by fund balance classification and by fund:

<b>Governmental Fund Change in Fund Balance</b>			
	Fund Balance as of December 31,		Increase (Decrease)
	<u>2014</u>	<u>2013</u>	
Fund balances of governmental funds			
Total by classification			
Nonspendable	\$ 21,454	\$ 23,664	\$ (2,210)
Restricted	917,300	888,707	28,593
Committed	471,161	421,989	49,172
Assigned	7,485,899	7,230,650	255,249
Unassigned	<u>2,034,269</u>	<u>2,089,196</u>	<u>(54,927)</u>
Total governmental funds	<u>\$ 10,930,083</u>	<u>\$ 10,654,206</u>	<u>\$ 275,877</u>
Total by fund			
General	\$ 2,345,942	\$ 2,365,706	\$ (19,764)
EDA Operating	310,687	268,408	42,279
Tax Increment Bonds	-	2,123	(2,123)
Equipment, Building, and Replacement	(63,517)	(62,854)	(663)
Permanent Improvement Revolving	7,090,959	6,610,900	480,059
Other governmental funds	<u>1,246,012</u>	<u>1,469,923</u>	<u>(223,911)</u>
Total governmental funds	<u>\$ 10,930,083</u>	<u>\$ 10,654,206</u>	<u>\$ 275,877</u>

In total, the fund balances of the City’s governmental funds increased by \$275,877 during the year ended December 31, 2014. The increase was primarily in the Permanent Improvement Revolving Fund assigned for capital improvements.

## 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.

<b>Governmental Funds Revenue per Capita</b>						
With State-Wide Averages by Population Class						
Year	State-Wide			City of Arden Hills		
	December 31, 2013			2012	2013	2014
Population	2,500–10,000	10,000–20,000	20,000–100,000	9,642	9,750	9,652
Property taxes	\$ 422	\$ 388	\$ 423	\$ 320	\$ 317	\$ 333
Tax increments	30	42	40	45	48	59
Franchise and other taxes	31	39	34	10	10	11
Special assessments	63	58	72	26	39	32
Licenses and permits	27	26	38	43	39	34
Intergovernmental revenues	253	268	148	15	32	146
Charges for services	109	84	91	47	42	41
Other	56	33	30	45	(1)	69
Total revenue	<u>\$ 991</u>	<u>\$ 938</u>	<u>\$ 876</u>	<u>\$ 551</u>	<u>\$ 526</u>	<u>\$ 725</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 \$6,982,261 of total revenue in its governmental funds in 2014, an increase of \$1,852,967 (36.1 percent) from the prior year. The City's per capita governmental fund revenues for 2014 were \$725, an increase of \$199 (37.8 percent) per capita from the prior year. The largest increases were in intergovernmental and other revenue sources. Intergovernmental revenues increased by \$114 per capita due to an increase in MSA funds received for the 2014 street project. The \$70 increase in the "other" category was caused primarily by the unrealized adjustment on marking investments to market at year-end in accordance with Governmental Accounting Standards Board (GASB) standards.

## 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:

<b>Governmental Funds Expenditures per Capita</b>						
With State-Wide Averages by Population Class						
Year	State-Wide			City of Arden Hills		
	December 31, 2013			2012	2013	2014
Population	2,500–10,000	10,000–20,000	20,000–100,000	9,642	9,750	9,652
<b>Current</b>						
General government	\$ 129	\$ 100	\$ 83	\$ 109	\$ 108	\$ 120
Public safety	244	235	239	179	183	189
Public works	123	121	91	39	40	60
Parks and recreation	83	99	85	70	69	67
All other	66	73	91	6	9	30
	<u>645</u>	<u>628</u>	<u>589</u>	<u>403</u>	<u>409</u>	<u>466</u>
Capital outlay and construction	303	288	219	70	164	223
<b>Debt service</b>						
Principal	164	133	102	26	27	28
Interest and fiscal	55	43	39	3	2	2
	<u>219</u>	<u>176</u>	<u>141</u>	<u>29</u>	<u>29</u>	<u>30</u>
<b>Total expenditures</b>	<u>\$ 1,167</u>	<u>\$ 1,092</u>	<u>\$ 949</u>	<u>\$ 502</u>	<u>\$ 602</u>	<u>\$ 719</u>

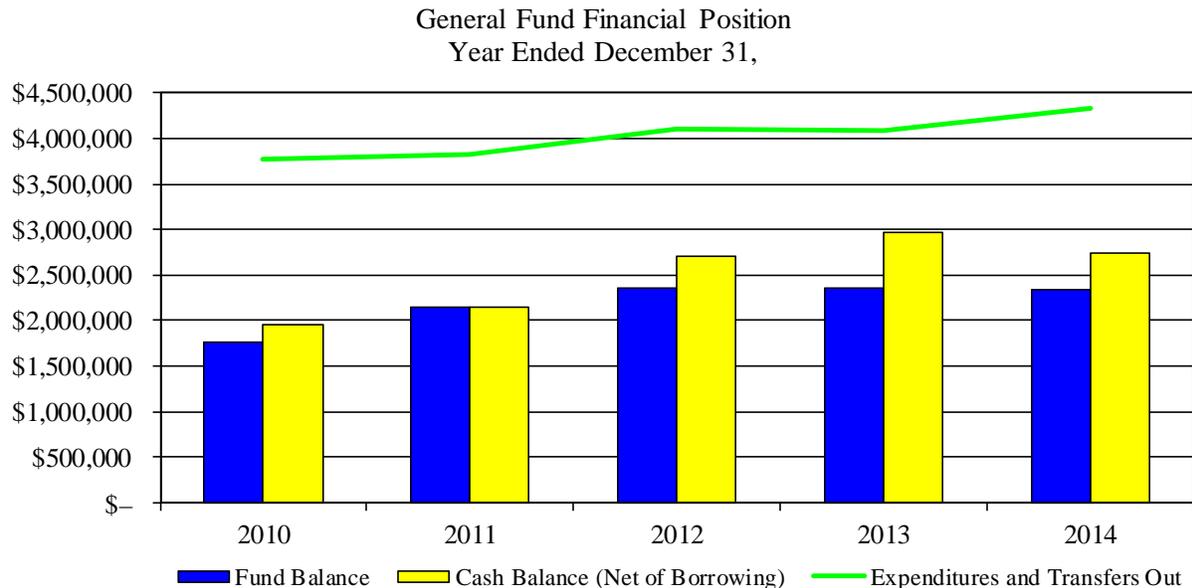
As the above table reflects, the City's expenditures per capita have also been below the state-wide average. A significant reason for this difference has generally been in capital outlay and debt service, which is reasonable for a city that is not in the middle of a major development or redevelopment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

Total expenditures in the City's governmental funds for 2014 were \$6,937,149, an increase of \$1,068,097 (18.2 percent). The City's per capita governmental funds current expenditures for 2014 were \$466, an increase of \$57 (13.9 percent) per capita from the prior year. Increases in public safety for police and fire contract service fees, in public works, and economic development spending in the current year contributed to the overall increase in current expenditures. Capital outlay and construction experienced an increase for the Round Lake Road project in the current year. Debt service expenditures were similar to the prior year as planned with scheduled debt payments.

## 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, street 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 and transfers out to reflect the change in the size of the General Fund operation over the same period.

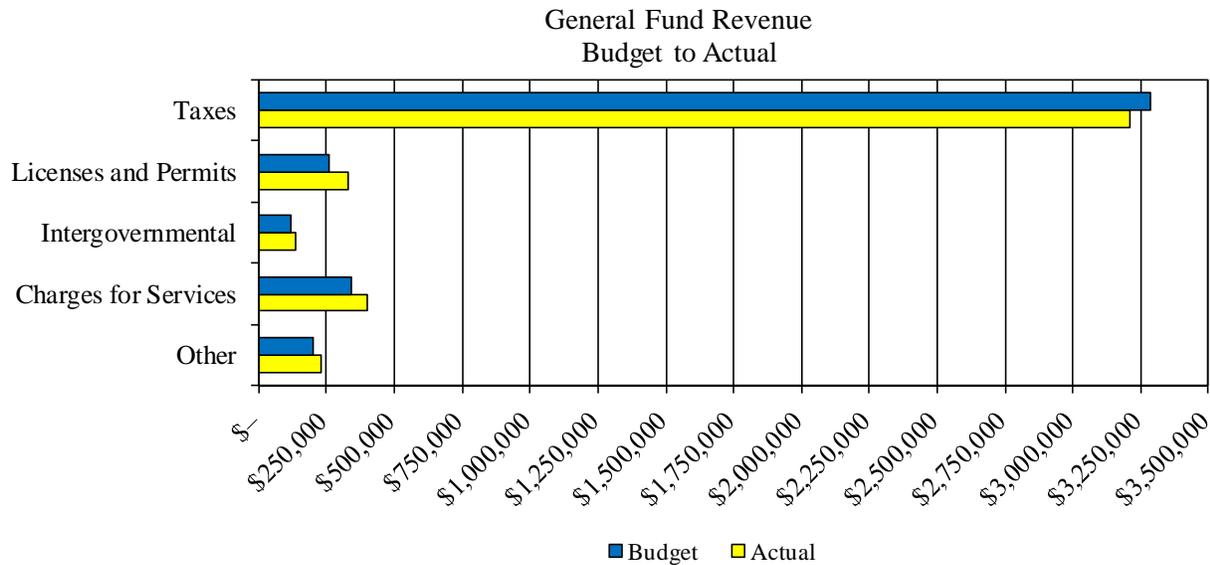


The City's General Fund cash and investments balance at December 31, 2014 was \$2,734,366 (net of borrowing), a decrease of \$226,280 from the previous year. Total fund balance at December 31, 2014 was \$2,345,942, a decrease of \$19,764 from the prior year. This fund balance level represents approximately 57 percent of the City's annual General Fund expenditures, based on 2014 expenditure levels, which compares to a prior year fund balance level of 62 percent. The overall impact of operations on fund balance was \$142,653 better than anticipated in the final budget.

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.

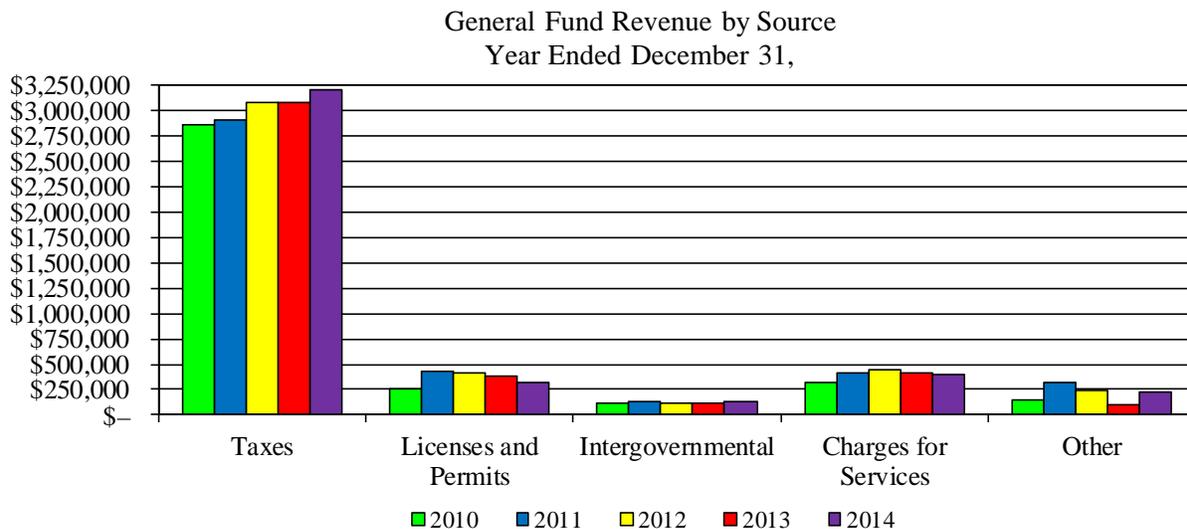
A trend that is typical to Minnesota local governments, especially the General Fund of cities, is the unusual cash flow experienced throughout the year. The City's General Fund cash disbursements are made fairly evenly during the year other than the impact of seasonal services such as snowplowing, street maintenance, and park activities. Cash receipts of the General Fund are quite a different story. Property taxes comprise approximately 75 percent of the fund's total annual revenue. Approximately half of these revenues are received by the City in July and the rest in December. Consequently, the City needs to have adequate cash reserves to finance its everyday operations between these payments.

The following graph reflects the City's General Fund revenues, budget and actual, for 2014:



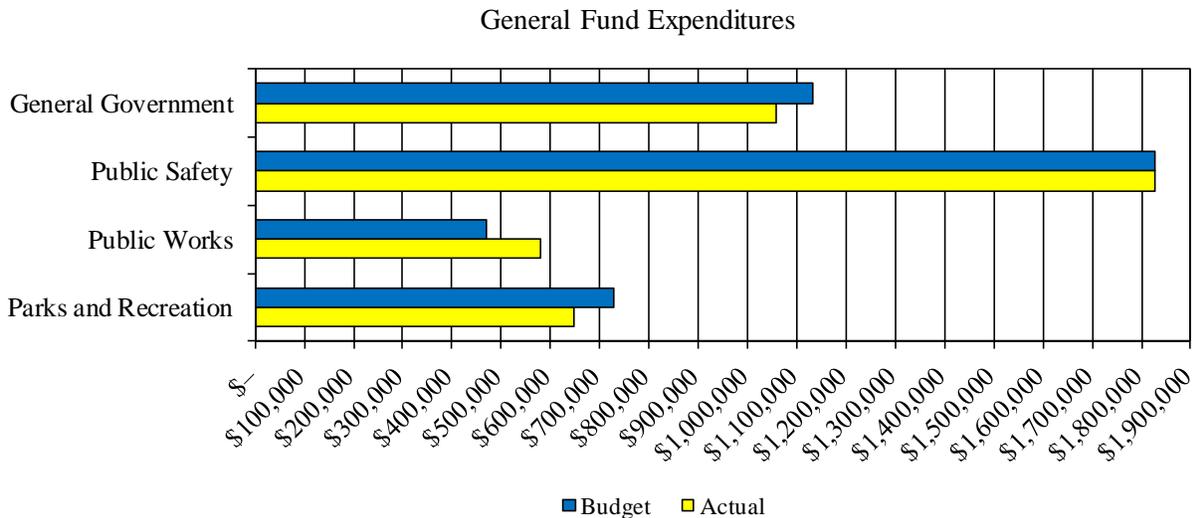
Total General Fund revenues for 2014 were \$4,304,743, which was \$99,895 (2.4 percent) over the final budget. The largest variance occurred in general property taxes, which were \$77,531 below anticipated levels. The impact of building permit fees related to new construction caused actual amounts for licenses and permits to surpass budget. Charges for services were also over budget due to plan check fees related to the new construction. Intergovernmental and other sources also experienced favorable variances due to conservative budgeting in these areas.

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



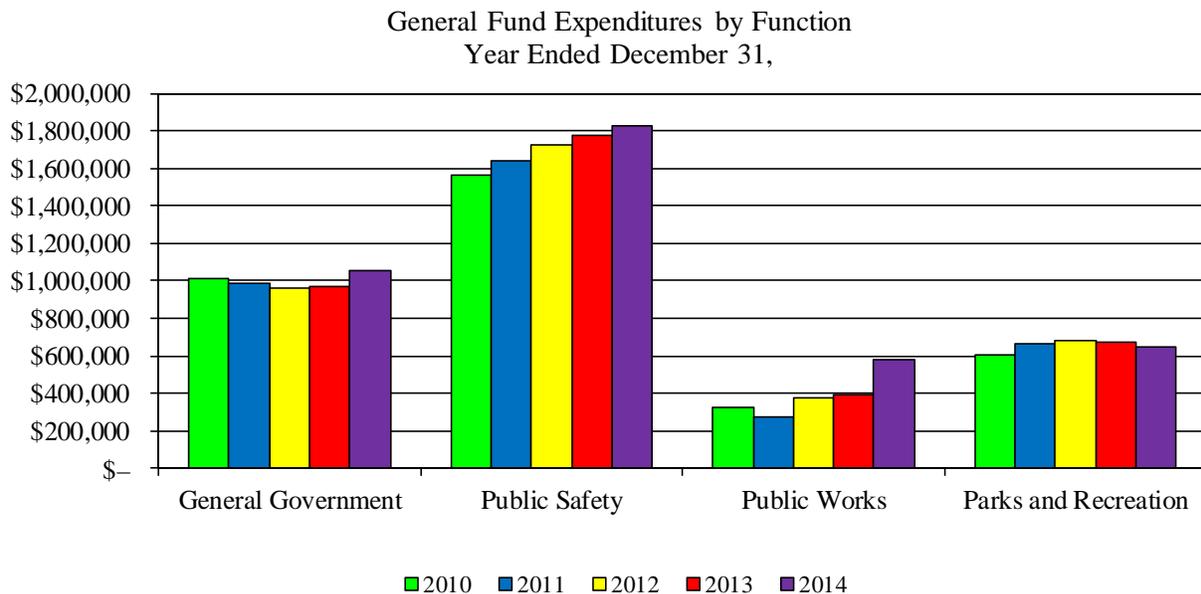
Total General Fund revenue for 2014 was \$203,316 (5.0 percent) more than prior year. Licenses and permits and charges for services decreased \$54,312 and \$10,771, respectively, due to greater levels of building activity in the prior year. Taxes increased in the current year with an increase in certified levy and improved collection rate. Other revenues increased as a result of improved investment earnings due to a large negative market value adjustment in the prior year.

The following graph reflects the City's General Fund expenditures, budget and actual, for 2014:



Total General Fund expenditures for 2014 were \$4,112,090, which was \$42,758 (1.0 percent) under the final budget. As presented in the budgetary comparison schedule (within the City's CAFR), expenditure variances were both over and under within various functions and departments while remaining within total appropriations approved by the City Council. The general government function was \$75,175 under budget, mainly in the administration (\$47,623) and planning and zoning (\$28,269) departments. Parks and recreation were \$79,079 under budget, mainly for park maintenance. These favorable variances were partially offset by the public safety and public works functions being over budget \$217 and \$111,279, respectively.

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



Overall, General Fund expenditures increased \$295,450 (7.7 percent) from the prior year. The largest change occurred in public works, which increased \$189,161 due to increased street maintenance 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 Water, Sewer, Surface Water Management, and Recycling 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 assets for future capital improvements and to provide a cushion in the event of a negative trend in operations.

### ENTERPRISE FUNDS FINANCIAL POSITION

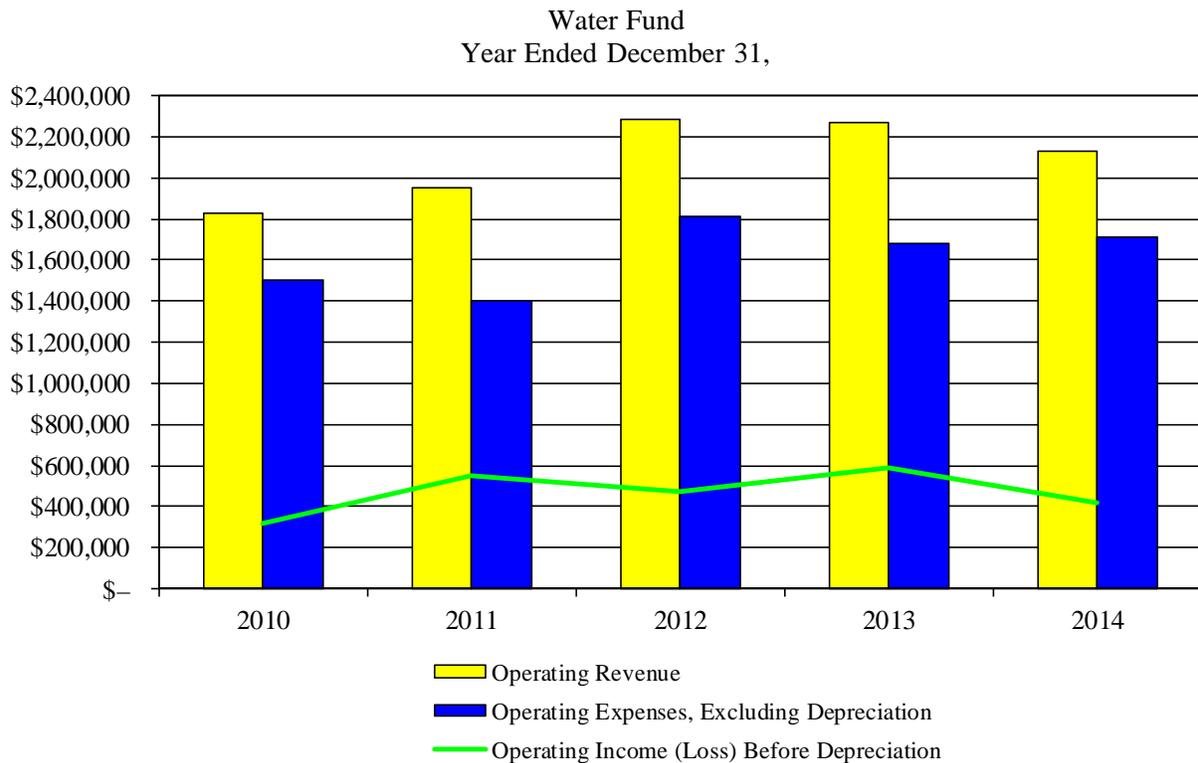
The following table summarizes the changes in the financial position of the City's enterprise funds during the year ended December 31, 2014, presented both by classification and by fund:

<b>Enterprise Funds Change in Financial Position</b>			
	Net Position as of December 31,		Increase (Decrease)
	2014	2013	
Net position of enterprise funds			
Total by classification			
Investment in capital assets	\$ 14,464,713	\$ 14,356,782	\$ 107,931
Unrestricted	1,793,112	1,158,470	634,642
Total enterprise funds	<u>\$ 16,257,825</u>	<u>\$ 15,515,252</u>	<u>\$ 742,573</u>
Total by fund			
Water	\$ 7,249,692	\$ 7,049,873	\$ 199,819
Sewer	5,440,704	5,183,180	257,524
Surface Water Management	3,498,518	3,215,300	283,218
Nonmajor Recycling	68,911	66,899	2,012
Total enterprise funds	<u>\$ 16,257,825</u>	<u>\$ 15,515,252</u>	<u>\$ 742,573</u>

In total, the net position of the City's enterprise funds increased by \$742,573 during the year ended December 31, 2014. The City's continued investment in utility infrastructure split the increase in net position between the equity components of the utility operations.

## WATER FUND

The following graph presents five years of operating results for the Water Fund:



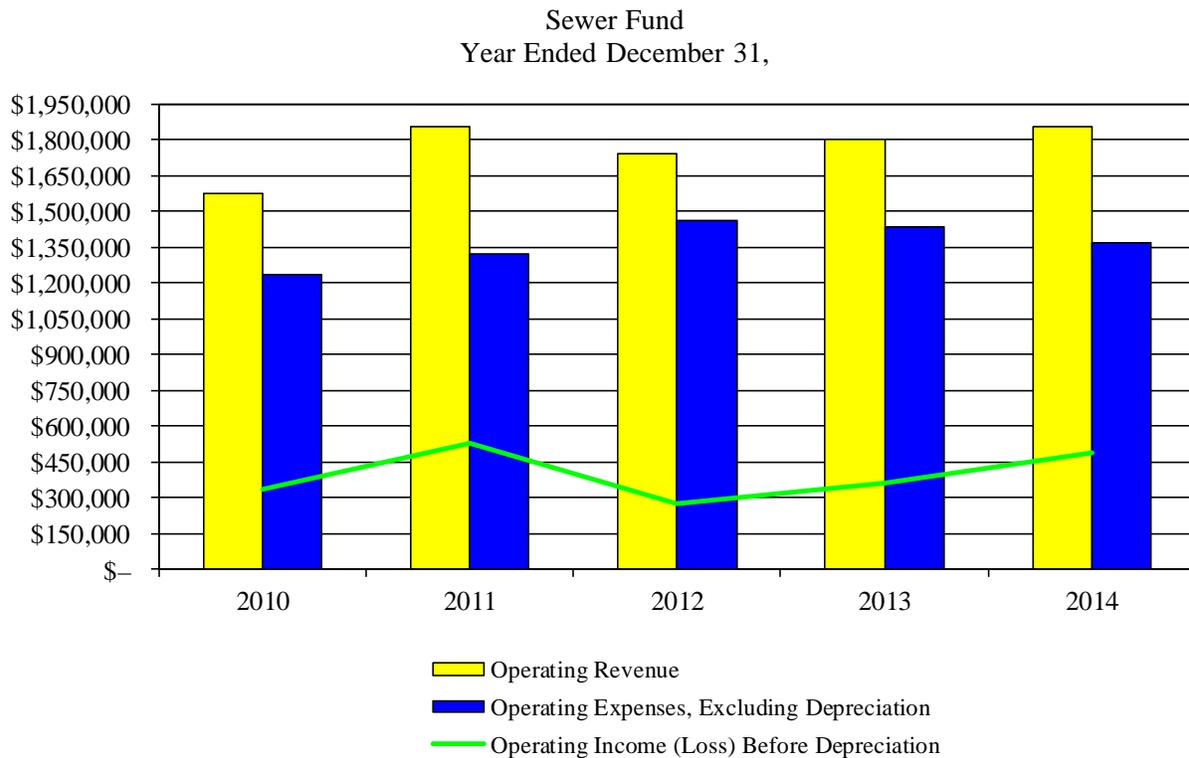
The Water Fund ended 2014 with a net position of \$7,249,692, an increase of \$199,819 from the prior year. Of this, \$6,256,498 represents the investment in capital assets, leaving \$993,194 of unrestricted net position.

Water Fund operating revenues were \$2,132,191 for 2014, a decrease of \$138,881. This decrease was primarily due to decreased consumption as a result of an unusually wet and cool season in the current year. Operating expenses (excluding depreciation of \$182,026) were \$1,711,191, which represents an increase of \$31,936 (1.9 percent). This increase was largely due to an increase in purchased services.

Consumption will fluctuate from year-to-year based on many factors, including weather patterns and number of utility customers.

## SEWER FUND

The following graph presents five years of operating results for the Sewer Fund:

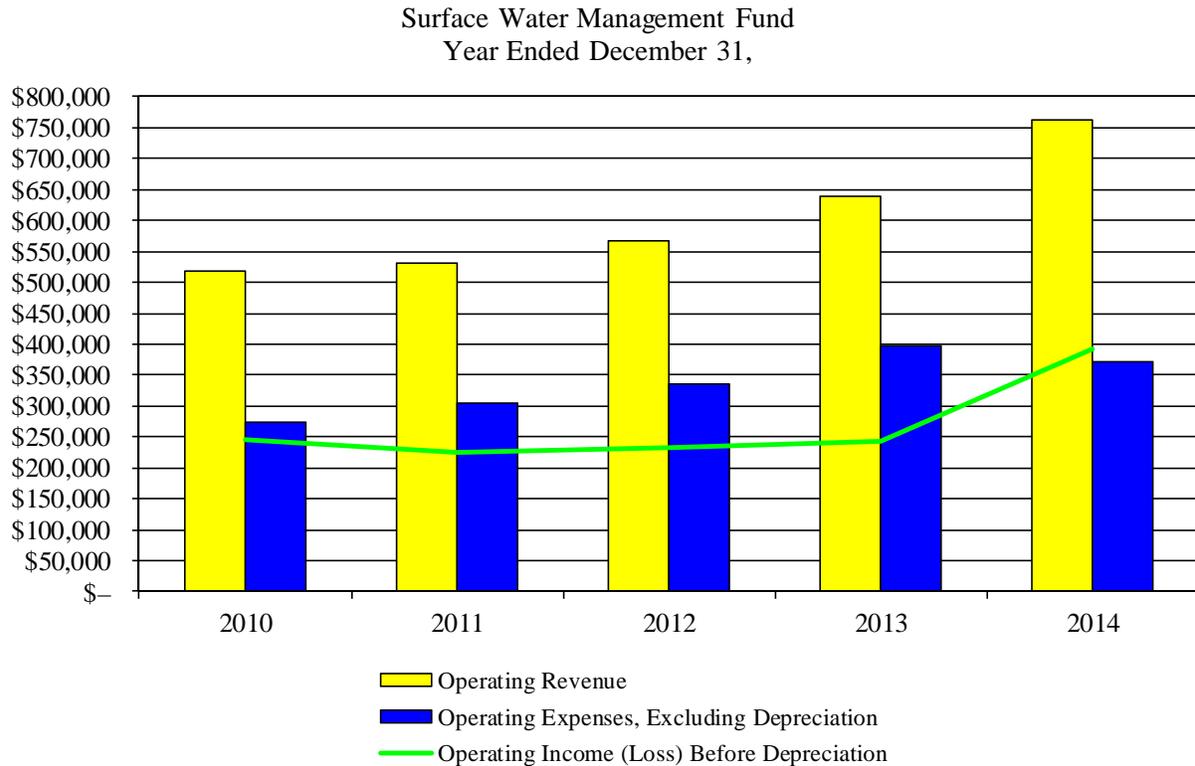


The Sewer Fund ended 2014 with a net position of \$5,440,704, an increase of \$257,524 from the prior year. Of this, \$5,291,835 represents the investment in capital assets, leaving \$148,869 of unrestricted net position.

Sewer Fund operating revenues for 2014 were \$1,857,272, an increase of \$58,383 from last year. This increase was a result of approved credits in 2013 reducing revenue in the prior year. Operating expenses for 2014 (excluding depreciation of \$139,107) were \$1,367,820, down \$66,451 from the prior year, or 4.6 percent, with the largest decrease in other services and changes.

## SURFACE WATER MANAGEMENT FUND

The following graph presents five years of operating results for the Surface Water Management Fund:

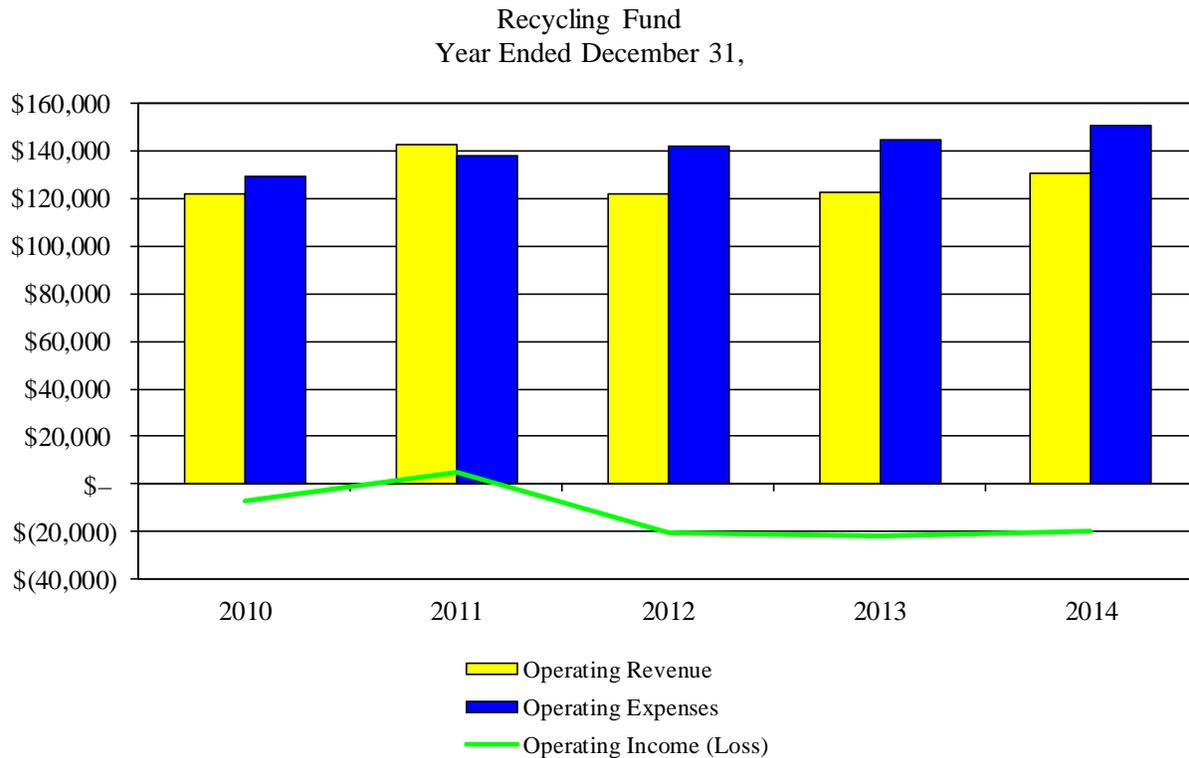


The Surface Water Management Fund ended 2014 with a net position of \$3,498,518, an increase of \$283,218 from the prior year. Of this, \$2,916,380 represents the investment in capital assets, leaving \$582,138 of unrestricted net position.

Surface Water Management Fund operating revenues for 2014 were \$762,884, an increase of \$123,137 from last year. This increase is primarily due to the utility rate increase approved for 2014. Operating expenses for 2014 (excluding depreciation of \$62,041) were \$370,747, or \$26,493, less than the prior year due primarily to a reduction in other services and charges to this utility operation.

## RECYCLING FUND

The following graph presents five years of operating results for the Recycling Fund:



The Recycling Fund ended 2014 with an unrestricted net position of \$68,911, an increase of \$2,012 from the prior year.

Recycling Fund operating revenues for 2014 were \$130,369, an increase of \$7,703 from last year. This increase is primarily due to the utility rate increase approved for 2014. Operating expenses for 2014 were \$150,417, an increase of \$5,876 from the prior year. The Recycling Fund also received \$19,611 of intergovernmental revenues which are not reflected in the graph above that are available for the operation of the City's recycling program.

## 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: investment in capital assets, restricted, and unrestricted.

- **Investment in Capital Assets** – The portion of net position reflecting equity in capital assets.
- **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 *investment in capital assets* and *restricted net position*.

The following table presents the components of the City’s net position as of December 31, 2014 and 2013 for governmental activities and business-type activities (utility fund operations):

	As of December 31,		Increase (Decrease)
	2014	2013	
Net position			
Governmental activities			
Investment in capital assets	\$ 18,837,904	\$ 17,435,976	\$ 1,401,928
Restricted	917,300	896,106	21,194
Unrestricted	11,472,102	10,274,835	1,197,267
Total governmental activities	<u>31,227,306</u>	<u>28,606,917</u>	<u>2,620,389</u>
Business-type activities			
Investment in capital assets	14,464,713	14,356,782	107,931
Unrestricted	1,793,112	1,158,470	634,642
Total business-type activities	<u>16,257,825</u>	<u>15,515,252</u>	<u>742,573</u>
Total net position	<u>\$ 47,485,131</u>	<u>\$ 44,122,169</u>	<u>\$ 3,362,962</u>

The City ended 2014 with combined total net position of \$47,485,131, an increase of \$3,362,962 from the prior year. At the end of the current fiscal year, the City is able to present positive balances in all three categories of net position, both for the government as a whole, as well as for its separate governmental and business-type activities. The same situation held true for the prior fiscal year.

## STATEMENT OF ACTIVITIES

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

The following table presents the change in the net position of the City for the years ended December 31, 2014 and 2013:

	2014		2013	
	Expenses	Program Revenues	Net Change	Net Change
Net (expense) revenue				
Governmental activities				
General government	\$ 1,294,830	\$ 495,794	\$ (799,036)	\$ (699,609)
Public safety	1,887,877	401,652	(1,486,225)	(1,513,110)
Public works	852,109	2,350,889	1,498,780	(563,326)
Parks and recreation	711,174	118,751	(592,423)	(693,839)
Economic development	522,193	–	(522,193)	(311,632)
Interest on long-term debt	11,004	–	(11,004)	(25,767)
Business-type activities				
Water	1,893,217	2,132,191	238,974	427,542
Sewer	1,506,927	1,857,272	350,345	394,678
Surface water management	432,788	762,884	330,096	186,020
Recycling	150,417	149,980	(437)	(2,181)
Total net (expense) revenue	<u>\$ 9,262,536</u>	<u>\$ 8,269,413</u>	(993,123)	(2,801,224)
General revenues				
Property taxes			3,182,331	3,094,036
Tax increment collections			565,422	466,280
Franchise taxes			103,711	96,820
Unrestricted investment earnings			504,621	(192,432)
Total general revenues			<u>4,356,085</u>	<u>3,464,704</u>
Change in net position			<u>\$ 3,362,962</u>	<u>\$ 663,480</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.

The major change in the public works function compared to the prior year was due to receipt of MSA grants and special assessments for street projects recognized in the current year.

## LEGISLATIVE UPDATES

The 2014 legislative session began with a projected budget excess for the remainder of the biennium of \$1.09 billion, later revised upward to a projected excess of \$1.23 billion in the February 2014 economic forecast. The Legislature utilized a portion of the projected excess to bolster the state's financial condition; repaying \$246 million "borrowed" from K-12 education through previous financing shifts, and using \$150 million to replenish the state "Rainy Day Fund" budget reserve. The Legislature also approved increases to future funding for local government aid, and expanded the sales tax exemption approved for cities in 2013 to include joint powers entities and other instrumentalities of local government.

The following is a summary of recent legislation affecting Minnesota cities in 2014 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. Under the new formula, the minimum LGA 2014 distribution for each city was an amount equal to their 2013 LGA. 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 \$507.6 million for fiscal 2014, \$516.9 million for 2015, and \$519.4 million for fiscal 2016 and thereafter.

**Sales Tax Exemption** – Cities are 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 publically 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 definition of "cities" for this statute include both home-rule and statutory cities.

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, this expanded exemption list is not effective until January 1, 2016.

**Proposed Property Tax Levy Certification Date** – The deadline for cities to certify their proposed annual tax levies was extended from September 15 to September 30.

**Agricultural Homestead Market Value Credit** – The rate of agricultural homestead market value was increased to a maximum of \$490 at a market value of \$270,000 and over.

**Capital Investment Act Requirements** – The Legislature approved capital improvement projects totaling about \$1.1 billion under two separate capital investment (bonding) acts. Both require that, to the extent practicable, a public entity receiving an appropriation of public money for a project under these acts must assure those facilities are built with American-made steel.

**Authority to Inspect Public Buildings and State-Licensed Facilities** – A formal delegation process was established that must be used by the state Department of Labor and Industry (DLI) when delegating the authority to inspect public buildings and state-licensed facilities to local building officials. The new provisions did not alter the circumstances under which the DLI is required to delegate this authority in most circumstances, only the process to be followed. However, for certain smaller construction projects designated as "reserved projects," the DLI is now required to delegate inspection authority to any municipality with a designated building official without going through the formal delegation process.

**Open Meeting Law** – A change was made to the Open Meeting Law to clarify that the use of social media by members of a public body does not violate the Open Meeting Law if the use is limited to exchanges open to the public. The new statute specifically excludes email but does not otherwise define the term social media.

**Deputy Registrar Residency** – The statutory requirement that an individual appointed as deputy registrar for a statutory or home-rule charter city be a resident of the county in which the city is located was repealed.

**Local Campaign Finance** – Changes were made to increase the campaign contribution limits for local elections. For candidates in a territory with a population of 100,000 or less, the contribution limits were raised to \$600 in an election year and \$250 in a non-election year. For candidates in a territory with a population over 100,000, the limits were raised to \$1,000 in an election year and \$250 in a non-election year. In addition, all campaign finance reports required to be filed with a local government must now be published on the local government’s website, if the local government maintains a website.

**Data Practices** – Several changes were made to address unauthorized access of private data by public employees, requiring local governments to: establish security measures to help ensure private data is only accessible to public employees whose work assignment reasonably requires access to the data, and that the data is only being accessed by those individuals for the purposes of their work assignment; follow the data breach reporting requirements that were previously only applicable to state agencies; and perform annual security assessments of personal information maintained by the entity. The statute also states that accessing private data without authorization is a misdemeanor, and willful violation by a public employee constitutes just cause for suspension without pay or dismissal.

**Part-Time Peace Officers** – A change in the statutes now prohibits law enforcement agencies from hiring new part-time peace officers, existing part-time peace officers from transferring to new agencies, and the Peace Officer Standards and Training Board from licensing new part-time peace officers. Part-time peace officers that are currently employed may continue to serve indefinitely with their current employer, but must turn in their license upon leaving their current place of employment or otherwise becoming unemployed.

**Responsible Contractor Requirement** – 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. A responsible contractor must be in compliance with various state and federal requirements for income tax, workers’ compensation, unemployment insurance, minimum wage, and safety. City solicitations for bid must include: the definition of “responsible contractor,” which may include criteria in addition to the statutory requirements established by the city, or reference to the statutory definition; a statement that a contractor failing to meet the criteria or verify compliance is ineligible to be awarded or perform work on the contract; a statement that submitting a false verification renders the contractor ineligible and can result in termination of the contract; and a statement requiring the contractor to provide copies of verification forms for all subcontractors upon request. Cities are not obligated to verify any of the information in the contractor verification; and have no liability if reasonably relying on the certification when awarding the contract, or declining to award the contract based on a reasonable determination that a contractor failed to verify compliance.

**Disaster Assistance Contingency Fund** – A new state account was created to provide emergency cash flow for local governments located in counties declared federal disaster areas. The fund may be used to meet non-federal fund matching requirements to speed the availability of federal funds.

**Pensions** – A number of changes to the Public Employees Retirement Association (PERA) General Plan were adopted, including:

- The minimum salary threshold for inclusion into the PERA General Plan was changed from \$425 in any one month to \$5,100 on any year for non-school employees or \$3,800 in any year for school employees.
- Employers are required to provide written notice to any employee excluded from membership in the PERA General Plan within two weeks of the determination on a form prescribed by the PERA executive director.
- PERA contribution rates for both employees and employers were increased by 0.25 percent of salary effective January 1, 2015.

## ACCOUNTING AND AUDITING UPDATES

### **GASB STATEMENT NO. 68 – ACCOUNTING AND FINANCIAL REPORTING FOR PENSIONS—AN AMENDMENT OF GASB STATEMENT NOS. 27 AND 50**

The primary objective of this statement is to improve accounting and financial reporting by state and local governments for pensions. This statement replaces the requirements of GASB Statement Nos. 27 and No. 50, as they relate to pensions that are provided through pension plans administered as trusts or equivalent arrangements that meet certain criteria. The requirements of GASB Statement Nos. 27 and No. 50 remain applicable for pensions that are not covered by the scope of this statement.

This statement establishes standards for measuring and recognizing liabilities, deferred outflows of resources, deferred inflows of resources, and expenses/expenditures. In addition, this statement details the recognition and disclosure requirements for employers with liabilities (payables) to a defined benefit pension plan and for employers whose employees are provided with defined contribution pensions. This statement also addresses circumstances in which a non-employer entity has a legal requirement to make contributions directly to a pension plan. This statement is effective for financial statements for fiscal years beginning after June 15, 2014. Earlier application is encouraged.

Included in this statement are major changes in how employers that participate in cost-sharing pension plans, such as the Teachers' Retirement Association (TRA) and PERA, account for pension benefit expenses and liabilities. In financial statements prepared using the economic resources measurement focus and accrual basis of accounting (government-wide and proprietary funds), a cost-sharing employer that does not have a special funding situation is required to recognize a liability for its proportionate share of the net pension liability of all employers with benefits provided through the pension plan. A cost-sharing employer is required to recognize pension expense and report deferred outflows of resources and deferred inflows of resources related to pensions for its proportionate share of collective pension expense and collective deferred outflows of resources and deferred inflows of resources related to pensions. In addition, the effects of (1) a change in the employer's proportion of the collective net pension liability and (2) differences during the measurement period between the employer's contributions and its proportionate share of the total of contributions from employers included in the collective net pension liability are required to be determined. These effects are required to be recognized in the employer's pension expense in a systematic and rational manner over a closed period equal to the average of the expected remaining service lives of all active and inactive employees that are provided with pensions through the pension plan.

### **GASB STATEMENT NO. 72 – FAIR VALUE MEASURE AND APPLICATION**

GASB Statement No. 72 addresses accounting and financial reporting issues related to fair value measurements. The requirements of this statement are intended to enhance comparability among government financial statements by requiring certain assets and liabilities be reported at fair value, using a consistent definition of fair value and accepted valuation techniques. The requirements of this statement are effective for financial statements for periods beginning after June 15, 2015, with earlier application encouraged.

GASB Statement No. 72 defines fair value as 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. Fair value measurements are generally assumed to take place in the government's principal or most advantageous market, taking into account the highest and best use for a nonfinancial asset, and assuming market participants would act in their economic best interest. The statement requires a government to use measurement techniques that are appropriate under the circumstances and for which sufficient data are available to measure fair value; consistent with a market, (replacement) cost, or income approach. It also establishes a hierarchy of inputs to be used in valuation techniques.

The statement establishes or clarifies the applicability of fair value measurement for certain assets and liabilities. Fair value is generally required for investments, defined as securities or other assets held primarily for the purpose of generating income, or which have a present service capacity based solely on their ability to generate cash. The statement requires measurement at acquisition value for donated capital assets, donated works of art, historical treasures, and capital assets received through a service concession arrangement. The statement also outlines the required financial statement disclosures about fair value measurements, valuation techniques, and the hierarchy of inputs used for valuation.

#### **CHANGES TO REQUIREMENTS FOR FEDERAL GRANTS**

In December 2013, the OMB issued *Uniform Administrative Requirements, Cost Principles, and Audit Requirements for Federal Audits*, which supersedes all or parts of eight OMB circulars; consolidating federal cost principles, administrative principles, and audit requirements in one document. The “Super Circular” includes a number of significant changes to the federal Single Audit process, including: an increase in dollar threshold for requiring a Single Audit from \$500,000 to \$750,000; changes to the thresholds and process used for determining major programs; reductions in the percentages of expenditures required to be covered by a Single Audit from 50 percent to 40 percent for high-risk auditees and from 25 percent to 20 percent for low-risk auditees; revised criteria for determining low-risk auditees; and an increase in the threshold for reporting questioned costs from \$10,000 to \$25,000. Auditees are required to implement the administrative requirements of the new “Super Circular” by December 26, 2014. The revised audit requirements will be effective for fiscal year 2015 city audits, with an optional one-year grace period for implementing the new procurement standards included in this guidance.

## **COSO INTERNAL CONTROL FRAMEWORK**

The clarified auditing standards applicable to governmental audits incorporate a definition of internal control that is based on the internal control integrated framework developed and issued in 1992 by the Committee of Sponsoring Organizations of the Treadway Commission (COSO). In May 2013, COSO issued an updated framework which supersedes the original after December 15, 2014. The new COSO framework retains the basic definition of internal control and its five components established in its original framework, along with the fundamental requirements to consider these five components and to use judgment when assessing and evaluating the effectiveness of a system of internal controls. The new COSO framework enhances and clarifies a number of concepts from the original framework to make it easier to use and apply. One of the more significant enhancements was the establishment of 17 principles, associated with the 5 components of internal control, intended to assist users in understanding the requirements of effective internal control and designing effective systems of internal control.

The 5 components of internal control and 17 underlying principles are as follows:

### **Control Environment –**

1. Organization demonstrates a commitment to integrity and ethical values.
2. Governing body is independent from management and exercises oversight control.
3. Management establishes structure, reporting lines, authority, and responsibilities.
4. Organization demonstrates a commitment to the competence of individuals involved with internal control.
5. Organization holds individuals accountable for internal control responsibilities.

### **Risk Assessment –**

6. Organization specifies clear objectives for the identification and assessment of risks.
7. Organization identifies and analyzes risk.
8. Organization assesses the potential for fraud risks.
9. Organization identifies and assesses significant changes that could impact internal control.

### **Control Activities –**

10. Organization selects and develops control activities to mitigate risks.
11. Organization selects and develops general IT controls.
12. Organization establishes and implements control policies and procedures.

### **Information and Communication –**

13. Organization uses relevant, quality information to support internal control.
14. Organization communicates internal control information internally.
15. Organization communicates internal control information externally.

### **Monitoring –**

16. Organization conducts ongoing and/or separate internal control evaluations.
17. Organization evaluates and communicates deficiencies to responsible parties for corrective action.

COSO defines an effective system of internal control as one that reduces to an acceptable level the risk of failing to achieve an organizational objective in the areas of operations, compliance, or reporting. According to the new framework, an organization can achieve effective internal control by applying all of the principles listed above. To achieve this, each of these five components and the relevant principles must be present and functioning, and the five components must operate in an integrated manner. Local governments should be reviewing their internal control systems to assure these principles have been incorporated and implemented.