Management Report

for

City of Arden Hills, Minnesota

December 31, 2016

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MMKR
CERTIFIED PUBLIC ACCOUNTANTS

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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, 2016. We have organized this report into the following sections:

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

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

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

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

Minneapolis, Minnesota
June 19, 2017

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AUDIT SUMMARY

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

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

We have audited the financial statements of the governmental activities, the business-type activities, each major fund, and the aggregate remaining fund information of the City as of and for the year ended December 31, 2016, and the related notes to the financial statements. Professional standards require that we provide you with information about our responsibilities under auditing standards generally accepted in the United States of America and *Government Auditing Standards*, as well as certain information related to the planned scope and timing of our audit. We have communicated such information to you verbally and in our audit engagement letter. Professional standards also require that we communicate the following information related to our audit.

PLANNED SCOPE AND TIMING OF THE AUDIT

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

AUDIT OPINION AND FINDINGS

Based on our audit of the City's financial statements for the year ended December 31, 2016:

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

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

    - 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 no findings based on our testing of the City's compliance with Minnesota laws and regulations.

FUND BALANCE/NET POSITION DEFICITS

As reported in the City's Comprehensive Annual Financial Report (CAFR), the Equipment, Building, and Replacement Fund; Parks Fund; TCAAP Fund; Central Garage Fund; and Technology Fund had year-end deficit equity balances of $37,102, $36,016, $144,489, $20,652, and $27,114, 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 ended December 31, 2016. We noted no transactions entered into by the City during the year for which there is a lack of authoritative guidance or consensus. All significant transactions have been recognized in the financial statements in the proper period.

ACCOUNTING ESTIMATES AND MANAGEMENT JUDGMENTS

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

- **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 absences balances.

- **Pension Benefits** – The City has recorded amounts and activities for pension benefits. Actuarial estimates of the net pension balances are calculated using actuarial methodologies described in Governmental Accounting Standards Board (GASB) Statement No. 68. The actuarial calculations include significant assumptions, including projected changes, investment returns, retirement ages, proportionate share, and employee turnover.

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 clearly trivial, and communicate them to the appropriate level of management. Where applicable, management has corrected all such misstatements. In addition, none of the misstatements detected as a result of audit procedures and corrected by management, when applicable, were material, either individually or in the aggregate, to each opinion unit's financial statements taken as a whole.

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 19, 2017.

MANAGEMENT CONSULTATIONS WITH OTHER INDEPENDENT ACCOUNTANTS

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

OTHER AUDIT FINDINGS OR ISSUES

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

OTHER MATTERS

We applied certain limited procedures to the 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 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 or statistical sections, which accompany the financial statements but are not RSI. Such information has not been subjected to the auditing procedures applied in the audit of the basic financial statements and, accordingly, we do not express an opinion or provide any assurance on it.

GOVERNMENTAL FUNDS OVERVIEW

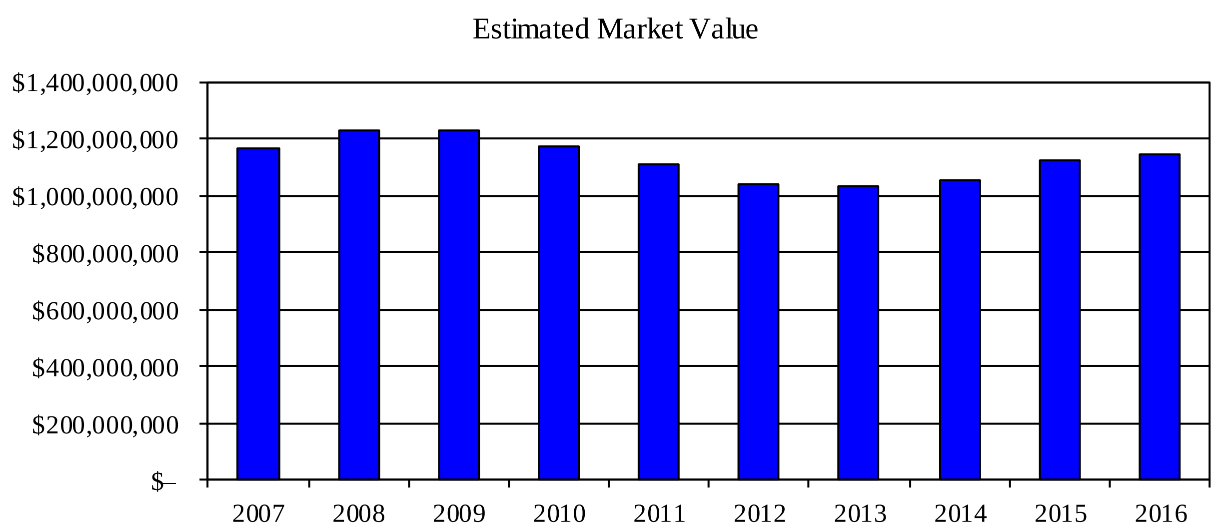
This section of the report provides you with an overview of the financial trends and activities of the City's governmental funds, which includes the General, special revenue, debt service, and capital project funds. These funds are used to account for the basic services the City provides to all of its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

PROPERTY TAXES

Minnesota cities rely heavily on local property tax levies to support their governmental fund activities. For the 2015 fiscal year, local ad valorem property tax levies provided 39.8 percent of the total governmental fund revenues for cities over 2,500 in population, and 35.6 percent for cities under 2,500 in population. Property tax levies certified by Minnesota cities for 2016 increased about 4.8 percent over 2015, compared to an increase of 4.0 percent the prior year.

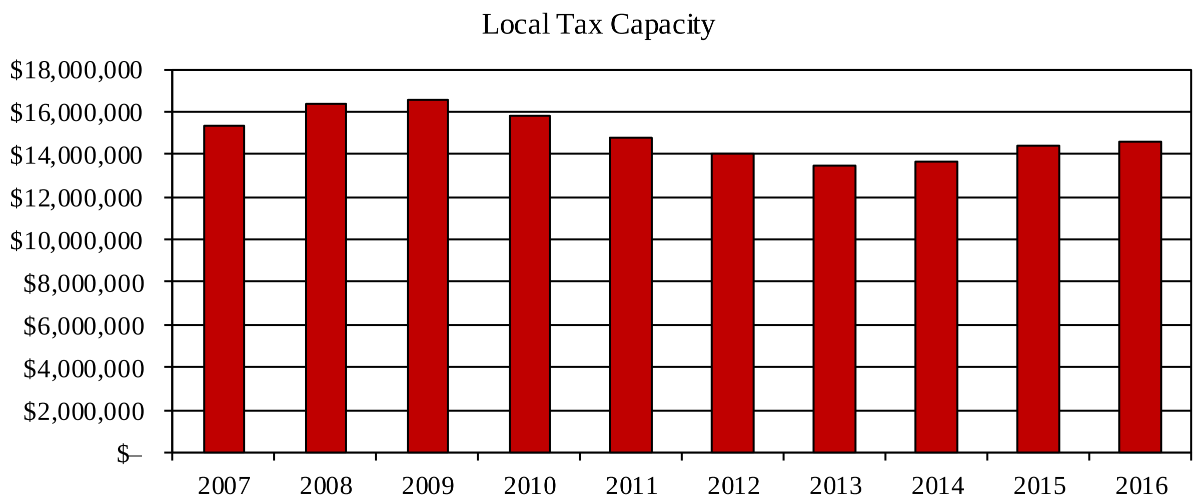
The total market value of property in Minnesota cities increased about 5.7 percent for the 2016 levy year. While the percentage of market value growth was less than the 8.5 percent increase for levy year 2015, it was considerably larger than the 1.1 percent growth experienced in levy year 2014. Market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

The City's estimated market value increased by 6.4 percent for 2015 and increased 1.9 percent for taxes payable in 2016. The following graph shows the City's changes in estimated market value over the past 10 years:



Tax capacity is considered the actual base available for taxation. It is calculated by applying the state's property classification system to each property's market value. Each property classification, such as commercial or residential, has a different calculation and uses different rates. Consequently, a city's total tax capacity will change at a different rate than its total market value, as tax capacity is affected by the proportion of the City's tax base that is in each property classification from year-to-year, as well as legislative changes to tax rates. The City's tax capacity increased 5.6 percent for taxes payable in 2015 and increased 1.5 percent for taxes payable in 2016.

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



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

Rates expressed as a percentage of net tax capacity

	All Cities State-Wide		Seven-County Metro Area		City of Arden Hills	
	2015	2016	2015	2016	2015	2016
Average tax rate						
City	46.9	46.5	43.4	43.0	27.3	26.5
County	44.7	44.1	42.9	42.3	58.9	58.9
School	27.1	27.5	28.3	28.6	27.0	26.0
Special taxing	6.9	6.9	8.8	8.7	9.2	9.1
Total	125.6	125.0	123.4	122.6	122.4	120.5

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

Governmental Fund Change in Fund Balance

	Fund Balance as of December 31, 2016	Fund Balance as of December 31, 2015	Increase (Decrease)
Fund balances of governmental funds			
Total by classification			
Nonspendable	$ 26,485	$ 24,828	$ 1,657
Restricted	786,678	675,052	111,626
Committed	450,433	449,898	535
Assigned	4,130,709	4,154,395	(23,686)
Unassigned	2,443,164	2,590,409	(147,245)
Total governmental funds	$ 7,837,469	$ 7,894,582	$ (57,113)
Total by fund			
General	$ 2,944,813	$ 3,082,410	$ (137,597)
EDA Operating	283,647	286,609	(2,962)
Equipment, Building, and Replacement	(37,102)	(180,505)	143,403
Permanent Improvement Revolving	3,739,379	3,740,481	(1,102)
Other governmental funds	906,732	965,587	(58,855)
Total governmental funds	$ 7,837,469	$ 7,894,582	$ (57,113)

In total, the fund balances of the City's governmental funds decreased by $57,113 during the year ended December 31, 2016. Current year operations increased fund balance by $717,137, while a prior period adjustment in the current year reduced fund balance by $774,250 to reach the net decrease presented in the table above.

The City reported a prior period adjustment to properly report deferred inflows of resources for advances on state entitlements that apply to future periods.

GOVERNMENTAL FUND REVENUES

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

We have included the most recent comparative state-wide averages available from the Office of the State Auditor to provide a benchmark for interpreting the City's data. The amounts received from the typical major sources of governmental fund revenue will naturally vary between cities based on factors such as a city's stage of development, location, size and density of its population, property values, services it provides, and other attributes. It will also differ from year-to-year due to the effect of inflation and changes in its operation. Also, certain data in these tables may be classified differently than how they appear in the City's financial statements in order to be more comparable to the state-wide information, particularly in separating capital expenditures from current expenditures.

We have designed this section of our management report using per capita data in order to better identify unique or unusual trends and activities of the City. We intend for this type of comparative and trend information to complement, rather than duplicate, information in the management's discussion and analysis. An inherent difficulty in presenting per capita information is the accuracy of the population count, which for most years is based on estimates.

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

	State-Wide			City of Arden Hills		
Year	December 31, 2015			2014	2015	2016
Population	2,500–10,000	10,000–20,000	20,000–100,000	9,652	9,876	9,951
Property taxes	$ 443	$ 414	$ 443	$ 333	$ 324	$ 328
Tax increments	26	33	37	59	71	24
Franchise and other taxes	33	42	39	11	7	13
Special assessments	59	52	59	32	92	38
Licenses and permits	31	31	43	34	53	60
Intergovernmental revenues	285	322	156	146	141	40
Charges for services	110	85	94	41	50	58
Other	69	62	58	69	71	40
Total revenue	$ 1,056	$ 1,041	$ 929	$ 725	$ 809	$ 601

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 $5,979,850 of total revenue in its governmental funds in 2016, a decrease of $2,015,612 (25.2 percent) from the prior year. The City's per capita governmental fund revenues for 2016 were $601, a decrease of $208 (25.7 percent) per capita from the prior year. Special assessments and intergovernmental revenue were down with the City recognizing state funding sources and prepayments on assessments to property owners for significant street projects in the prior year. Tax increment sources were also down with the end of increment collections in the EDA TIF District No. 2 Fund that was closed in the prior year.

GOVERNMENTAL FUND EXPENDITURES

The expenditures of governmental funds will also vary from state-wide averages and from year-to-year, based on the City's circumstances. Expenditures are classified into three types as follows:

- **Current** – These are typically the general operating type expenditures occurring on an annual basis, and are primarily funded by general sources such as taxes and intergovernmental revenues.

- **Capital Outlay and Construction** – These expenditures do not occur on a consistent basis, more typically fluctuating significantly from year-to-year. Many of these expenditures are project-oriented, and are often funded by specific sources that have benefited from the expenditure, such as special assessment improvement projects.

- **Debt Service** – Although the expenditures for debt service may be relatively consistent over the term of the respective debt, the funding source is the important factor. Some debt may be repaid through specific sources such as special assessments or redevelopment funding, while other debt may be repaid with general property taxes.

The City's expenditures per capita of its governmental funds for the past three years, together with state-wide averages, are presented in the following table:

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

	State-Wide			City of Arden Hills		
Year	December 31, 2015			2014	2015	2016
Population	2,500–10,000	10,000–20,000	20,000–100,000	9,652	9,876	9,951
Current						
General government	$ 134	$ 109	$ 89	$ 120	$ 116	$ 120
Public safety	255	244	261	189	194	199
Public works	119	117	99	60	34	48
Parks and recreation	88	108	94	67	58	62
All other	64	70	89	30	25	23
	660	648	632	466	427	452
Capital outlay and construction	372	389	286	223	684	99
Debt service						
Principal	181	178	117	28	28	–
Interest and fiscal	51	40	33	2	–	–
	232	218	150	30	28	–
Total expenditures	$ 1,264	$ 1,255	$ 1,068	$ 719	$ 1,139	$ 551

Total expenditures in the City's governmental funds for 2016 were $5,493,478, a decrease of $5,768,250 (51.2 percent). The City's per capita governmental funds current expenditures for 2016 were $452, an increase of $25 (5.9 percent) per capita over the prior year. The largest increase occurred in public works with more noncapital spending for maintenance and repairs compared to the prior year.

Capital outlay and construction decreased dramatically by $585 per capita, with significant pavement management program projects, street projects, and trail projects ongoing in the prior year.

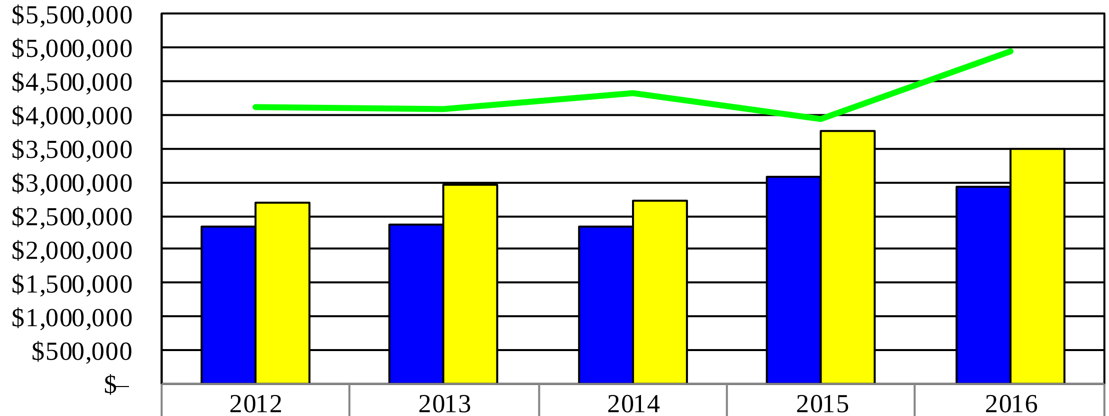
Debt service expenditures decreased as final debt payments were made in the prior year.

GENERAL FUND

The City's General Fund accounts for the financial activity of the basic services provided to the community. The primary services included within this fund are the administration of the municipal operation, police and fire protection, building inspection, 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.

General Fund Financial Position
Year Ended December 31,



	2012	2013	2014	2015	2016
Fund Bal	$2,350,919	$2,365,706	$2,345,942	$3,082,410	$2,944,813
Cash Bal	$2,707,784	$2,960,646	$2,734,366	$3,752,294	$3,506,967
Exp & Trans Out	$4,110,043	$4,086,640	$4,324,507	$3,926,100	$4,940,586

The City's General Fund cash and investments balance at December 31, 2016 was $3,506,967 (net of borrowing), a decrease of $245,327 from the previous year. Total fund balance at December 31, 2016 was $2,944,813, a decrease of $137,597 from the prior year. This fund balance level represents approximately 71 percent of the City's annual General Fund expenditures, based on 2016 expenditure levels, which compares to a prior year fund balance level of 80 percent. The overall impact of operations on fund balance was $587,850 better than anticipated in the final budget.

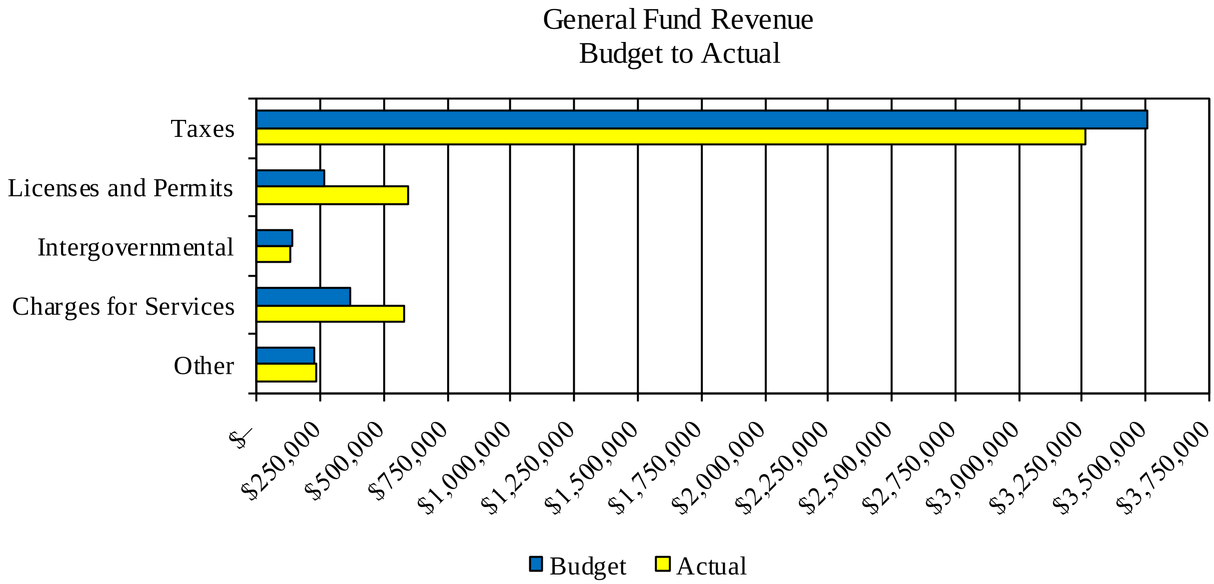
The increase in the level of expenditures and transfers out was due in part to a resolution approved by the City Council to make a transfer of General Fund sources of $565,121 to the Permanent Improvement Revolving Fund in the current year.

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 68 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.

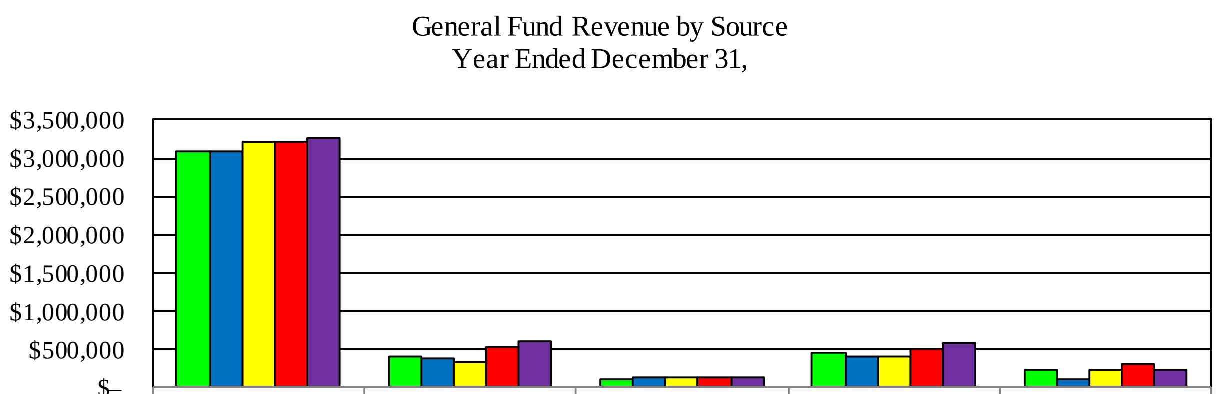
GENERAL FUND REVENUES

The following graph reflects the City's General Fund revenues, budget and actual, for 2016:



Total General Fund revenues for 2016 were $4,802,989, which was $292,698 (6.5 percent) over the final budget. Licenses and permits ($333,156) and charges for services ($210,738) were over budget, related to increased development, building activity, and conservative budgeting for these sources. Taxes were $248,338 below anticipated levels, due to abatements and lower collection rates than expected.

The following graph presents the City's General Fund revenues by source for the last five years. The graph reflects the City's reliance on property taxes and other local sources of revenue:

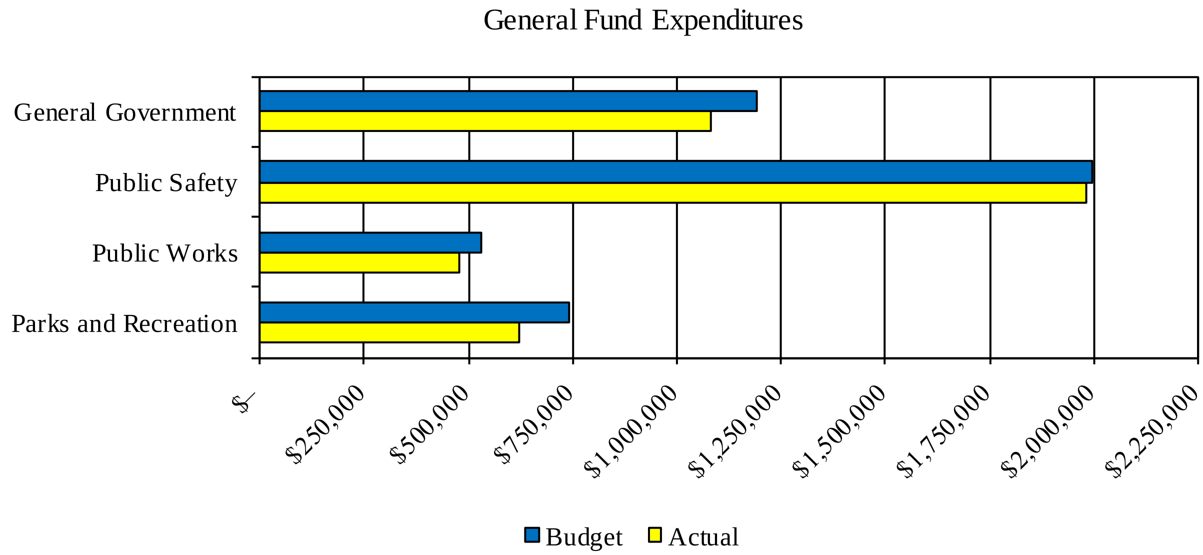


	Taxes	Licenses and Permits	Intergovernmental	Charges for Services	Other
2012	$3,087,160	$415,070	$118,800	$450,589	$238,008
2013	$3,086,064	$382,039	$120,811	$410,995	$101,518
2014	$3,210,025	$327,727	$136,249	$400,224	$230,518
2015	$3,203,004	$518,846	$130,023	$496,908	$313,787
2016	$3,260,537	$598,686	$131,914	$577,041	$234,811

Total General Fund revenues for 2016 were $140,421 (3.0 percent) more than prior year. Licenses and permits and charges for services increased $79,840 and $80,133, respectively, due to greater levels of building activity. Other revenues decreased $78,976 as a result of fewer lease contracts, while property tax revenue and intergovernmental revenues increased $57,533 and $1,891, respectively, from the prior year.

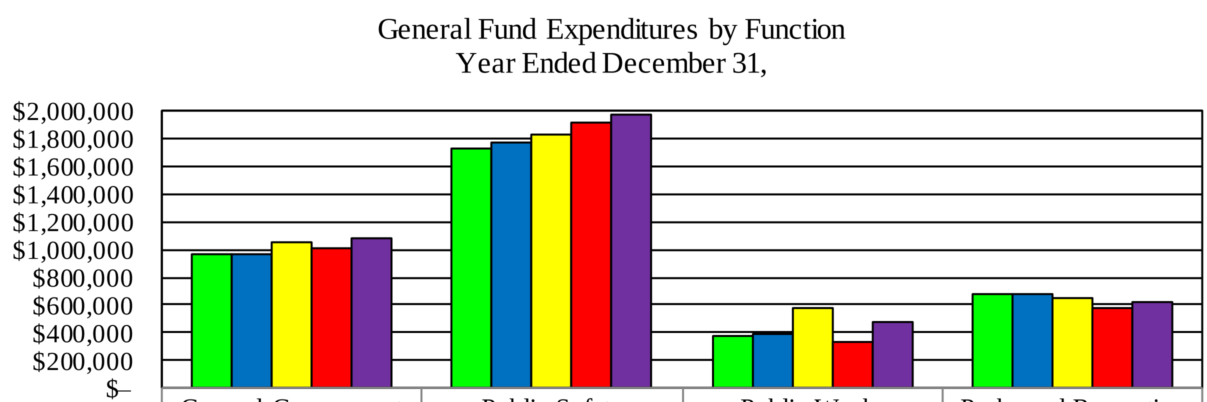
GENERAL FUND EXPENDITURES

The following graph reflects the City's General Fund expenditures, budget and actual, for 2016:



Total General Fund expenditures for 2016 were $4,165,465, which was $295,152 (6.6 percent) under the final budget. As presented in the budgetary comparison schedule (within the City's CAFR), expenditure variances were both favorable and unfavorable within the various functions and departments while overall, they remained within total appropriations approved by the City Council. The general government function was $108,937 under budget, mainly in administration ($120,092). The parks and recreation function was under budget by $120,808, mainly in personnel services and other service and charges for park maintenance.

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



	General Government	Public Safety	Public Works	Parks and Recreation
2012	$960,036	$1,728,669	$377,101	$679,282
2013	$970,307	$1,779,549	$391,711	$675,073
2014	$1,056,906	$1,826,098	$580,872	$648,214
2015	$1,015,835	$1,920,280	$336,398	$573,587
2016	$1,082,313	$1,981,506	$479,814	$621,832

Overall, General Fund expenditures increased $319,365 (8.3 percent) from the prior year. The increase was spread across all functions as anticipated with all functions ending below amounts appropriated in the budget. The largest change occurred in public works, which increased $143,416, due to increased spending in other contractual services and charges.

ENTERPRISE FUNDS OVERVIEW

The City maintains 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, 2016, presented both by classification and by fund:

Enterprise Funds Change in Financial Position

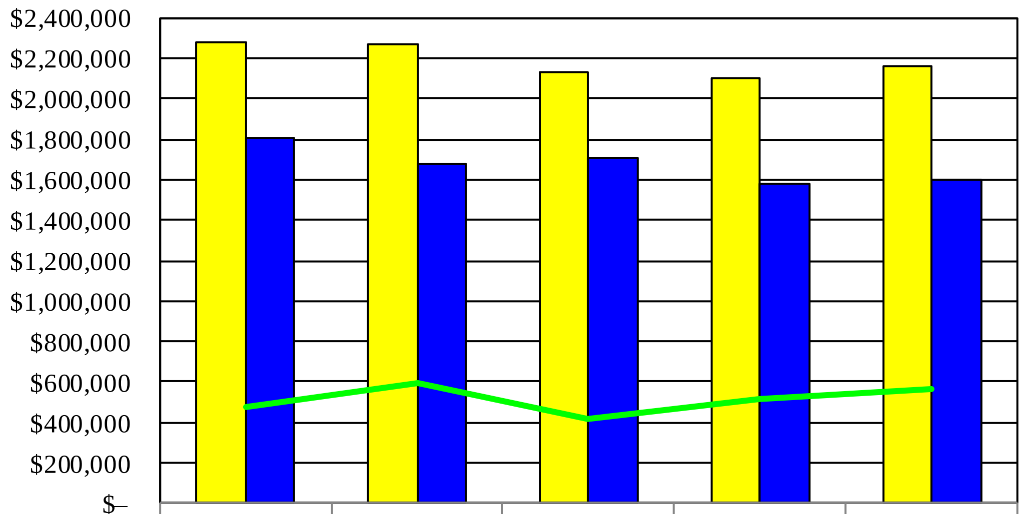
	Net Position as of December 31, 2016	Net Position as of December 31, 2015	Increase (Decrease)
Net position of enterprise funds			
Total by classification			
Investment in capital assets	$ 16,306,381	$ 16,167,536	$ 138,845
Unrestricted	1,116,957	238,381	878,576
Total enterprise funds	$ 17,423,338	$ 16,405,917	$ 1,017,421
Total by fund			
Water	$ 7,597,937	$ 7,320,729	$ 277,208
Sewer	5,845,684	5,406,329	439,355
Surface Water Management	3,877,304	3,595,092	282,212
Nonmajor Recycling	102,413	83,767	18,646
Total enterprise funds	$ 17,423,338	$ 16,405,917	$ 1,017,421

In total, the net position of the City's enterprise funds increased by $1,017,421 during the year ended December 31, 2016. The change in net position is due to increases in all enterprise funds in the current year.

WATER FUND

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

Water Fund
Year Ended December 31,



	2012	2013	2014	2015	2016
Oper Rev	$2,285,161	$2,271,072	$2,132,191	$2,099,242	$2,165,773
Oper Exp, Excl Dep	$1,811,901	$1,679,255	$1,711,191	$1,579,215	$1,601,171
Oper Inc Before Dep	$473,260	$591,817	$421,000	$520,027	$564,602

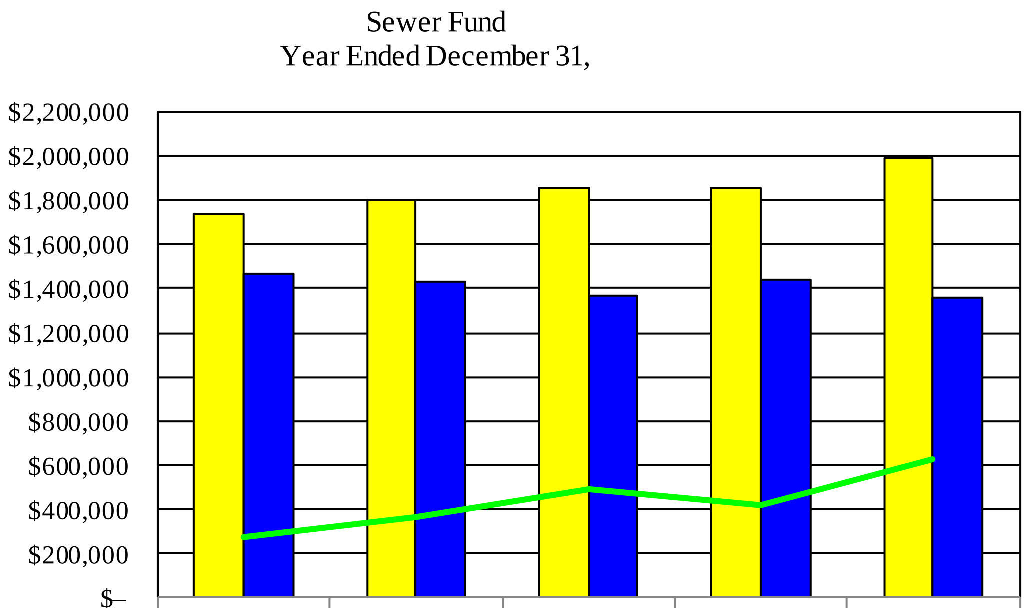
The Water Fund ended 2016 with a net position of $7,597,937, an increase of $277,208 from the prior year, due to positive operating results. Of total net position, $6,767,471 represents the investment in capital assets, leaving $830,466 of unrestricted net position.

Water Fund operating revenues were $2,165,773 for 2016, an increase of $66,531. Operating expenses (excluding depreciation of $232,297) were $1,601,171, which represents an increase of $21,956. This increase was largely due to an increase in purchased services and purchased water charges.

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:



	2012	2013	2014	2015	2016
Oper Rev	$1,739,123	$1,798,889	$1,857,272	$1,855,802	$1,989,066
Oper Exp, Excl Dep	$1,464,177	$1,434,271	$1,367,820	$1,438,589	$1,362,274
Oper Inc Before Dep	$274,946	$364,618	$489,452	$417,213	$626,792

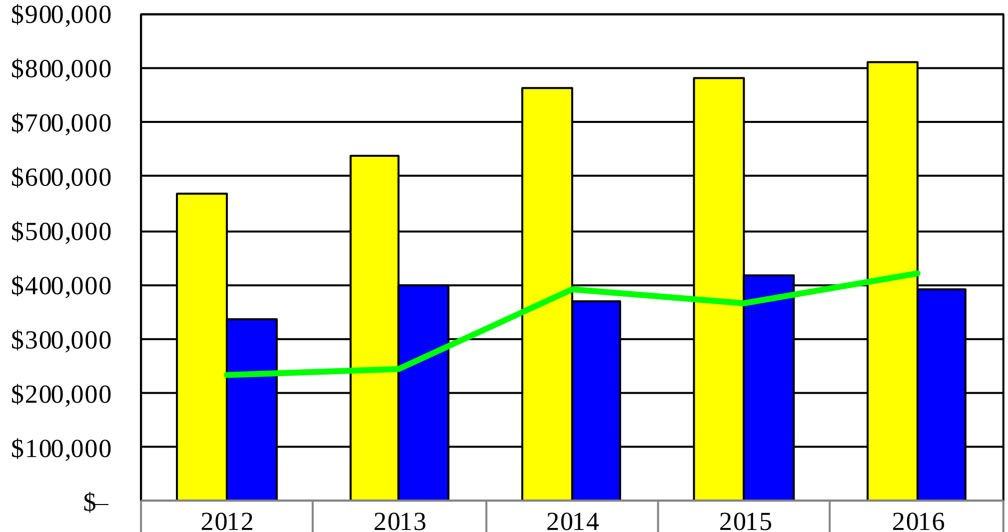
The Sewer Fund ended 2016 with a net position of $5,845,684, an increase of $439,355 from the prior year. Of total net position, $5,935,433 represents the investment in capital assets, leaving a deficit $89,749 of unrestricted net position.

Sewer Fund operating revenues for 2016 were $1,989,066, an increase of $133,264 over last year. Operating expenses for 2016 (excluding depreciation of $150,945) were $1,362,274, down $76,315 from the prior year, with decreases in supplies, maintenance, and other services and charges.

SURFACE WATER MANAGEMENT FUND

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

Surface Water Management Fund
Year Ended December 31,



	2012	2013	2014	2015	2016
Oper Rev	$567,361	$639,747	$762,884	$782,501	$812,044
Oper Exp, Excl Dep	$335,258	$397,240	$370,747	$416,945	$390,935
Oper Inc Before Dep	$232,103	$242,507	$392,137	$365,556	$421,109

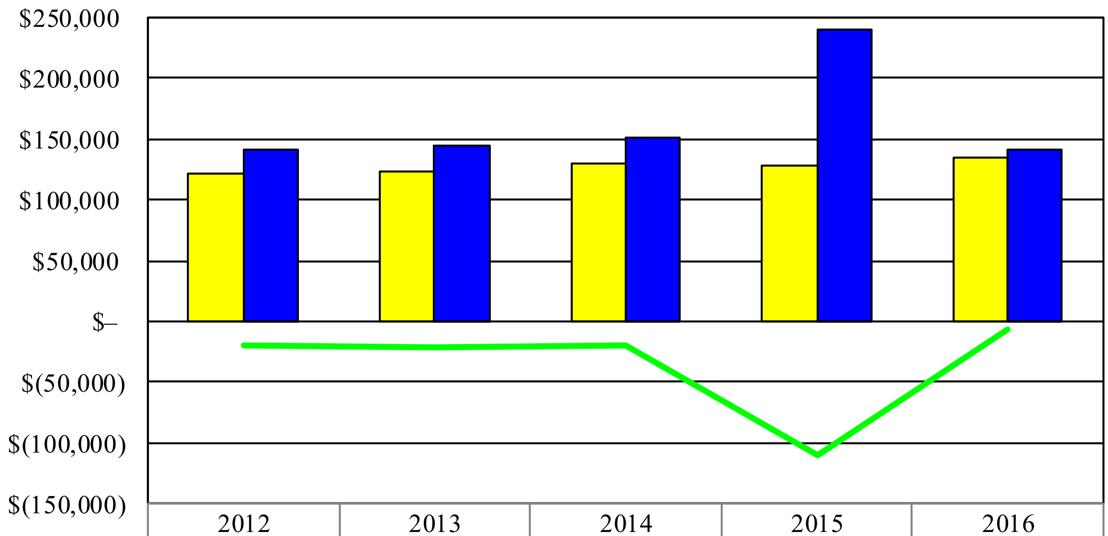
The Surface Water Management Fund ended 2016 with a net position of $3,877,304, an increase of $282,212 from the prior year. Of this, $3,603,477 represents the investment in capital assets, leaving $273,827 of unrestricted net position.

Surface Water Management Fund operating revenues for 2016 were $812,044, an increase of $29,543 from last year. Operating expenses for 2016 (excluding depreciation of $78,030) were $390,935, or $26,010, less than the prior year, due primarily to a decrease in other services and charges to this utility operation.

RECYCLING FUND

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

Recycling Fund
Year Ended December 31,



	2012	2013	2014	2015	2016
Oper Rev	$121,688	$122,666	$130,369	$129,030	$134,739
Oper Exp	$142,114	$144,541	$150,417	$239,727	$141,190
Oper Inc (Loss)	$(20,426)	$(21,875)	$(20,048)	$(110,697)	$(6,451)

The Recycling Fund ended 2016 with an unrestricted net position of $102,413, an increase of $18,646 from the prior year.

Recycling Fund operating revenues for 2016 were $134,739, an increase of $5,709 from the prior year. Operating expenses for 2016 were $141,190, a decrease of $98,537 from the prior year.

The Recycling Fund also received $23,439 of nonoperating intergovernmental revenues that are available for the operation of the City's Recycling Program.

In 2015, intergovernmental revenues included $100,000 received from Ramsey County as a grant to upgrade city residents' recycling receptacles. This intergovernmental revenue is not reflected in the graph above; however, the expenses related to this grant are included in the operating results presented by the graph above. This one-time grant accounts for the increase in operating expenses in the 2015 fiscal year.

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.

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

	As of December 31,		Increase
	2016	2015	(Decrease)
Net position			
Governmental activities			
Investment in capital assets	$ 25,178,721	$ 24,909,453	$ 269,268
Restricted	786,678	675,052	111,626
Unrestricted	8,249,560	8,765,793	(516,233)
Total governmental activities	34,214,959	34,350,298	(135,339)
Business-type activities			
Investment in capital assets	16,306,381	16,167,536	138,845
Unrestricted	1,116,957	238,381	878,576
Total business-type activities	17,423,338	16,405,917	1,017,421
Total net position	$ 51,638,297	$ 50,756,215	$ 882,082

Net position for governmental activities decreased by $135,339 in 2016, as presented above. The net investment in capital assets increased $269,268 this year. The change in this category of net position typically depends on the relationship of the rate at which the City is adding capital assets, the rate capital assets are being depreciated, and how the City finances the purchase and construction capital assets. The restricted portion of net position increased $111,626, due to increases in amounts restricted for tax increment purposes and cable television. The decrease in unrestricted net position is due to positive operating results in the current year offset by the prior period adjustment reported, reducing net position by $774,250. As previously discussed, the City reported a prior period adjustment to properly report deferred inflows of resources for advances on state entitlements that apply to future periods.

The change in net position for business-type activities is consistent with our earlier discussion for the utility operations, which are presented under the same, full accrual, basis of accounting.

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, 2016 (excluding the prior period adjustment discussed previously) and 2015:

	2016			2015
	Expenses	Program Revenues	Net Change	Net Change
Net (expense) revenue				
Governmental activities				
General government	$ 1,384,908	$ 441,433	$ (943,475)	$ (789,538)
Public safety	2,047,961	835,839	(1,212,122)	(1,242,456)
Public works	800,157	523,714	(276,443)	2,901,112
Parks and recreation	751,910	144,555	(607,355)	(539,658)
Economic development	361,029	–	(361,029)	(733,528)
Interest on long-term debt	–	–	–	(817)
Business-type activities				
Water	1,833,468	2,166,757	333,289	295,837
Sewer	1,513,219	2,049,444	536,225	267,994
Surface water management	468,965	812,814	343,849	293,124
Recycling	141,190	158,178	16,988	13,531
Total net (expense) revenue	$ 9,302,807	$ 7,132,734	(2,170,073)	465,601
General revenues				
Property taxes			3,278,287	3,191,426
Tax increment collections			242,544	697,898
Franchise taxes			132,548	72,837
Unrestricted investment earnings			173,026	281,397
Total general revenues			3,826,405	4,243,558
Change in net position (excluding prior period adjustment)			$ 1,656,332	$ 4,709,159

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

LEGISLATIVE UPDATES

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

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

Border-to-Border Broadband Grants – The 2016 supplemental budget act appropriated $35 million in fiscal 2017 for a Border-to-Border Broadband Grant Program. The grants, available through the Office of Broadband Development in the Department of Employment and Economic Development (DEED), provide funding to help communities meet state goals for the development of state-wide high-speed broadband access, focusing on areas currently considered to be underserved or with a high concentration of low-income households.

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

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

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

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

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

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

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

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

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

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

ACCOUNTING AND AUDITING UPDATES

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

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

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

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

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

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

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

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

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

This statement establishes standards for recognizing and measuring liabilities, deferred outflows of resources, deferred inflows of resources, and expense/expenditures. Similar to changes implemented for pensions, this statement requires the liability of employers and nonemployer contributing entities to employees for defined benefit OPEB (net OPEB liability) to be measured as the portion of the present value of projected benefit payments to be provided to current active and inactive employees that is attributed to those employees' past periods of service (total OPEB liability), less the amount of the OPEB plan's fiduciary net position. Note disclosure and RSI requirements about defined benefit OPEB also are addressed.

This statement is effective for fiscal years beginning after June 15, 2017. Earlier application is encouraged.

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

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

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

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

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

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

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

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

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

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

The requirements of this statement are effective for reporting periods beginning after June 15, 2016, except for the requirements of this statement for the selection of assumptions in a circumstance in which an employer's pension liability is measured as of a date other than the employer's most recent fiscal year-end. In that circumstance, the requirements for the selection of assumptions are effective for that employer in the first reporting period in which the measurement date of the pension liability is on or after June 15, 2017. Earlier application is encouraged.

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

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

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

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

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

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

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

GASB STATEMENT NO. 84, *FIDUCIARY ACTIVITIES*

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

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

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

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

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