Management Report

for

City of Arden Hills, Minnesota

December 31, 2017

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

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

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

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

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

Minneapolis, Minnesota
June 7, 2018

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AUDIT SUMMARY

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

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

We have audited the financial statements of the governmental activities, the business-type activities, each major fund, and the aggregate remaining fund information of the City as of and for the year ended December 31, 2017, and the related notes to the financial statements. Professional standards require that we provide you with information about our responsibilities under auditing standards generally accepted in the United States of America and *Government Auditing Standards*, as well as certain information related to the planned scope and timing of our audit. We have communicated such information to you verbally and in our audit engagement letter. Professional standards also require that we communicate the following information related to our audit.

PLANNED SCOPE AND TIMING OF THE AUDIT

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

AUDIT OPINION AND FINDINGS

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

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

- We reported one matter involving the City's internal control over financial reporting that we consider to be a material weakness as detailed in the Special Purpose Audit Reports. Due to the limited size of the City's office staff, the City has limited segregation of duties in certain areas.

- The results of our testing disclosed no instances of noncompliance 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; Engineering Fund; Central Garage Fund; and Technology Fund had year-end deficit equity balances of $259,269, $29,516, $150,362, $7,020, $26,797, and $31,790, 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, 2017; however, the City implemented the following governmental accounting standards during the fiscal year:

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

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

ACCOUNTING ESTIMATES AND MANAGEMENT JUDGMENTS

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

- **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 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, a disagreement with management is a financial accounting, reporting, or auditing matter, whether or not resolved to our satisfaction, that could be significant to the financial statements or the auditor's report. We are pleased to report that no such disagreements arose during the course of our audit.

MANAGEMENT REPRESENTATIONS

We have requested certain representations from management that are included in the management representation letter dated June 7, 2018.

MANAGEMENT CONSULTATIONS WITH OTHER INDEPENDENT ACCOUNTANTS

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

OTHER AUDIT FINDINGS OR ISSUES

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

OTHER MATTERS

We applied certain limited procedures to the management's discussion and analysis (MD&A) 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.

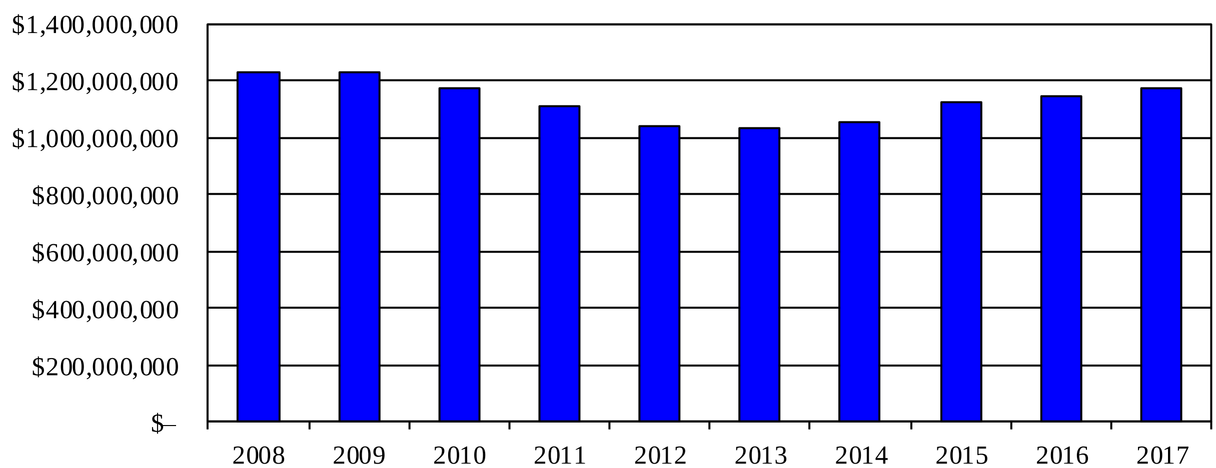
PROPERTY TAXES

Minnesota cities rely heavily on local property tax levies to support their governmental fund activities. For the 2016 fiscal year, local ad valorem property tax levies provided 39.8 percent of the total governmental fund revenues for cities over 2,500 in population, and 36.4 percent for cities under 2,500 in population.

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

The City's estimated market value increased by 1.9 percent for 2016 and increased 2.5 percent for taxes payable in 2017. The following graph shows the City's changes in estimated market value over the past 10 years:

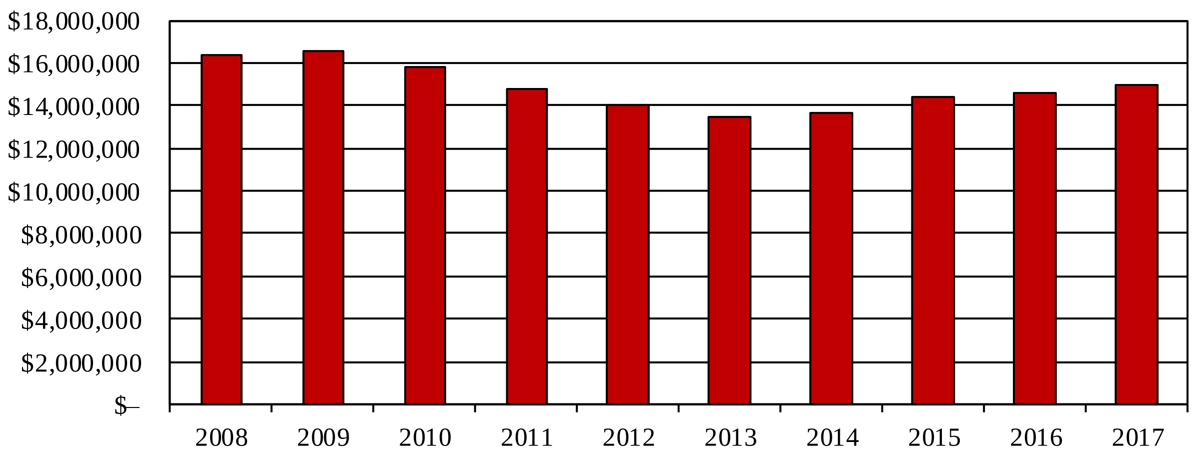
Estimated Market Value



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 1.5 percent for taxes payable in 2016, and increased 2.3 percent for taxes payable in 2017.

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

Local Tax Capacity



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

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	2017
Average tax rate							
City	46.9	46.5	43.4	43.0	27.3	26.5	27.2
County	44.7	44.1	42.9	42.3	58.9	58.9	55.9
School	27.1	27.5	28.3	28.6	27.4	26.2	25.3
Special taxing	6.9	6.9	8.8	8.7	9.2	9.1	8.6
Total	125.6	125.0	123.4	122.6	122.8	120.7	117.0

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

There are a number of reasons contributing to the change in the average total tax rate. The City's portion of the tax capacity rates for its 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, 2017, presented both by fund balance classification and by fund:

Governmental Fund Change in Fund Balance

	Fund Balance as of December 31,		Increase
	2017	2016	(Decrease)
Fund balances of governmental funds			
Total by classification			
Nonspendable	$ 289,183	$ 26,485	$ 262,698
Restricted	898,739	786,678	112,061
Committed	471,996	450,433	21,563
Assigned	6,423,941	4,130,709	2,293,232
Unassigned	2,626,103	2,443,164	182,939
Total governmental funds	$ 10,709,962	$ 7,837,469	$ 2,872,493
Total by fund			
General	$ 3,639,317	$ 2,944,813	$ 694,504
EDA Operating	303,058	283,647	19,411
Equipment, Building, and Replacement	(259,269)	(37,102)	(222,167)
Permanent Improvement Revolving	6,080,457	3,739,379	2,341,078
Other governmental funds	946,399	906,732	39,667
Total governmental funds	$ 10,709,962	$ 7,837,469	$ 2,872,493

In total, the fund balances of the City's governmental funds increased by $2,872,493 during the year ended December 31, 2017. The majority of the increase was in assigned fund balance in the Permanent Improvement Revolving Fund, due to a one-time reimbursement from the county for its share of a joint street project.

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 MD&A. 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, 2016			2015	2016	2017
Population	2,500–10,000	10,000–20,000	20,000–100,000	9,847	9,966	10,066
Property taxes	$ 460	$ 432	$ 455	$ 325	$ 327	$ 352
Tax increments	26	26	42	71	24	29
Franchise and other taxes	35	43	45	7	13	11
Special assessments	59	44	59	92	37	31
Licenses and permits	35	33	42	53	60	72
Intergovernmental revenues	313	275	152	142	40	211
Charges for services	110	92	103	50	58	59
Other	91	57	54	71	40	45
Total revenue	$ 1,129	$ 1,002	$ 952	$ 811	$ 599	$ 810

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 $8,155,546 of total revenue in its governmental funds in 2017, an increase of $2,175,696 (36.4 percent) from the prior year. The City's per capita governmental fund revenues for 2017 were $810, an increase of $211 (35.2 percent) per capita from the prior year. Intergovernmental revenues increased $171 per capita, due to a one-time reimbursement from the county for its share of a joint street project, as previously discussed. Property tax revenues increased $25 per capita, due to the increased general property tax levy.

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, 2016			2015	2016	2017
Population	2,500–10,000	10,000–20,000	20,000–100,000	9,847	9,966	10,066
Current						
General government	$ 145	$ 114	$ 97	$ 116	$ 120	$ 118
Public safety	263	250	273	195	199	204
Public works	126	123	95	34	48	44
Parks and recreation	93	109	95	58	62	61
All other	74	77	91	25	23	26
	701	673	651	428	452	453
Capital outlay and construction	381	370	301	686	99	117
Debt service						
Principal	196	163	115	28	–	–
Interest and fiscal	48	38	34	–	–	–
	244	201	149	28	–	–
Total expenditures	$ 1,326	$ 1,244	$ 1,101	$ 1,142	$ 551	$ 570

Total expenditures in the City's governmental funds for 2017 were $5,754,643, an increase of $261,165 (4.8 percent). The City's per capita governmental funds current expenditures for 2017 were $453, consistent with the $452 per capita in the prior year.

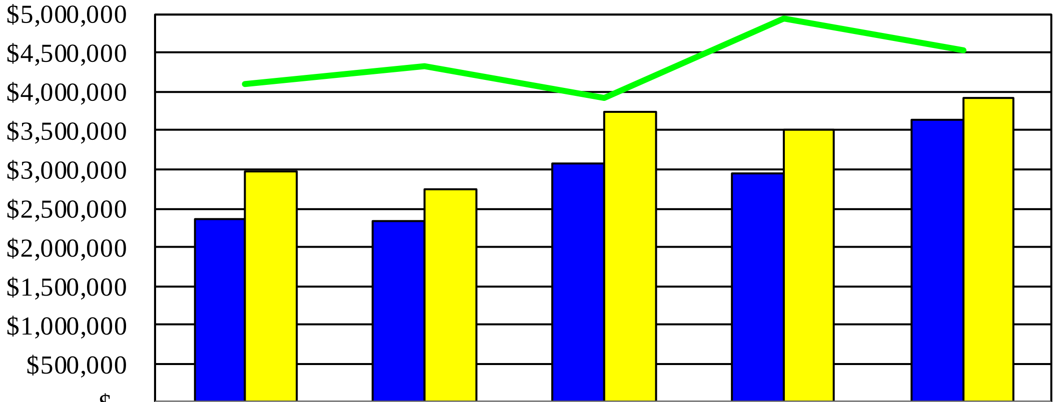
Capital outlay and construction increased by $18 per capita, with increased activity in the City's Equipment, Building, and Replacement Fund.

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,



	2013	2014	2015	2016	2017
Fund Bal	$2,365,706	$2,345,942	$3,082,410	$2,944,813	$3,639,317
Cash Bal	$2,960,646	$2,734,366	$3,752,294	$3,506,967	$3,906,088
Exp & Trans Out	$4,086,640	$4,324,507	$3,926,100	$4,940,586	$4,536,636

The City's General Fund cash and investments balance at December 31, 2017 was $3,906,088 (net of borrowing), an increase of $399,121 from the previous year. Total fund balance at December 31, 2017 was $3,639,317, an increase of $694,504 from the prior year. This fund balance level represents approximately 87 percent of the City's annual General Fund expenditures, based on 2017 expenditure levels, which compares to a prior year fund balance level of 71 percent. The overall impact of operations on fund balance was $890,459 better than anticipated in the final budget.

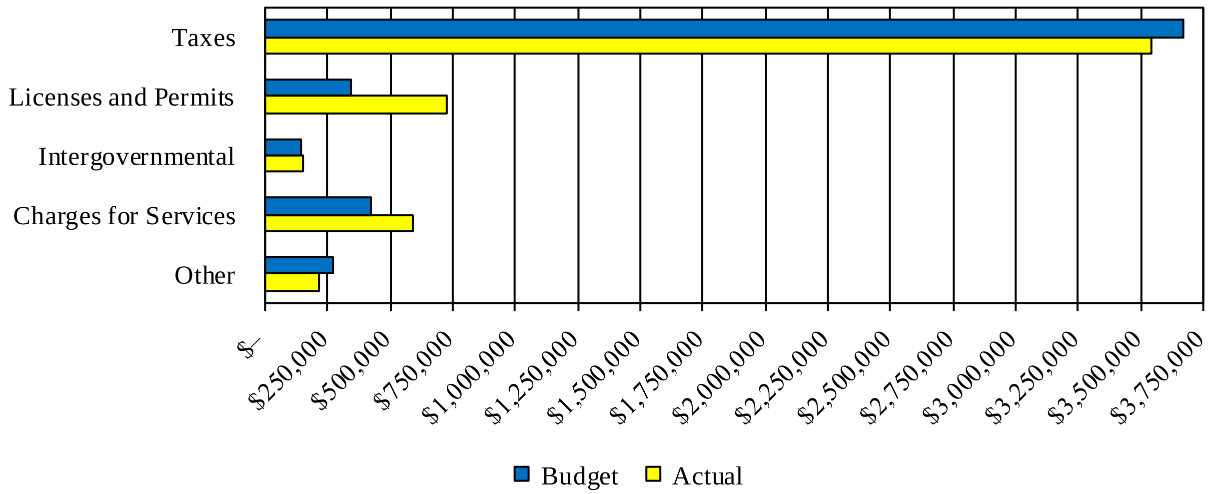
As the graph illustrates, the City has generally been able to maintain stable cash and fund balance levels as the volume of financial activity has fluctuated. This is an important factor because a government, like any organization, requires a certain amount of equity to operate. A healthy financial position 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 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 2017:

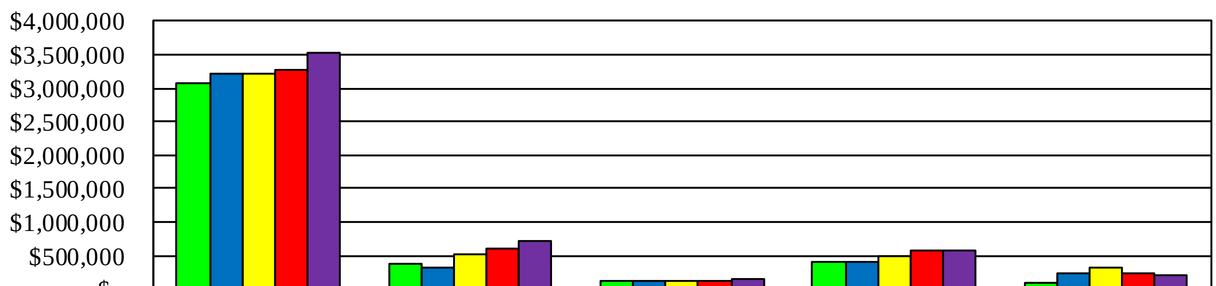
General Fund Revenue
Budget to Actual



Total General Fund revenues for 2017 were $5,231,140, which was $370,843 (7.6 percent) over the final budget. Licenses and permits ($381,867) and charges for services ($167,276) were over budget, related to increased development, building activity, and conservative budgeting for these sources. Taxes were $129,685 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:

General Fund Revenue by Source
Year Ended December 31,



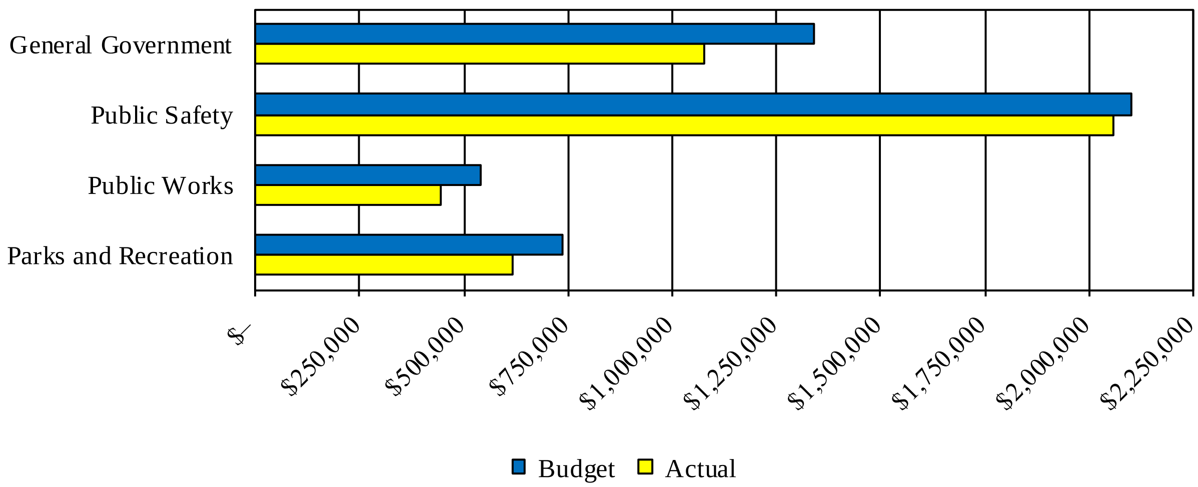
	Taxes	Licenses and Permits	Intergovernmental	Charges for Services	Other
2013	$3,086,064	$382,039	$120,811	$410,995	$101,518
2014	$3,210,025	$327,727	$136,249	$400,224	$230,518
2015	$3,203,004	$518,846	$130,023	$496,908	$313,787
2016	$3,260,537	$598,686	$131,914	$577,041	$234,811
2017	$3,541,705	$729,197	$151,425	$590,141	$218,672

Total General Fund revenues for 2017 were $428,151 (8.9 percent) more than prior year. Property tax revenue increased $281,168, due to the increased levy in the current year. Licenses and permits and charges for services increased $130,511 and $13,100, respectively, due to greater levels of building activity.

GENERAL FUND EXPENDITURES

The following graph reflects the City's General Fund expenditures, budget and actual, for 2017:

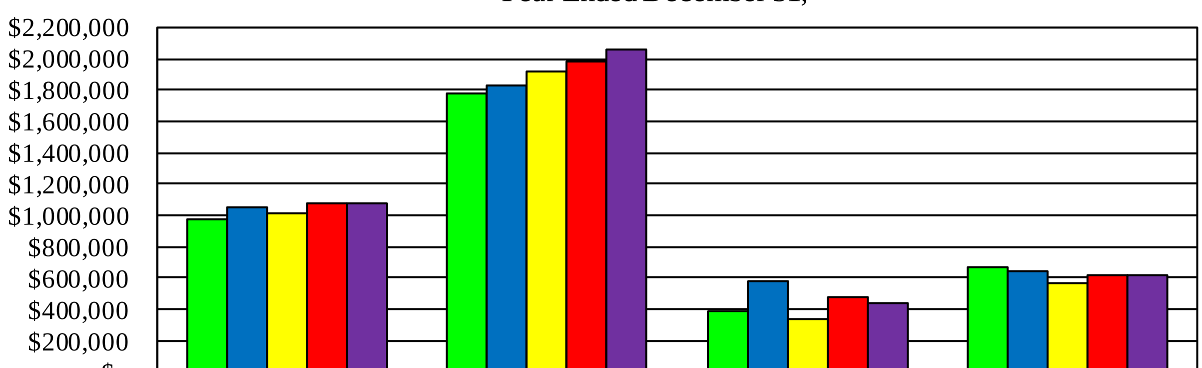
General Fund Expenditures



Total General Fund expenditures for 2017 were $4,196,636, which was $519,616 (11.0 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 $262,992 under budget, mainly in planning and zoning ($129,359) and TCAAP ($88,272) within personal services. The parks and recreation function was under budget by $119,165, mainly in personal services. Public works was under budget by $95,116.

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

General Fund Expenditures by Function
Year Ended December 31,



	General Government	Public Safety	Public Works	Parks and Recreation
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
2017	$1,076,352	$2,058,037	$443,633	$618,614

Overall, General Fund expenditures increased $31,171 (0.7 percent) from the prior year. The largest increase was in public safety ($76,531) offset by a decrease in public works ($36,181).

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, 2017, presented both by classification and by fund:

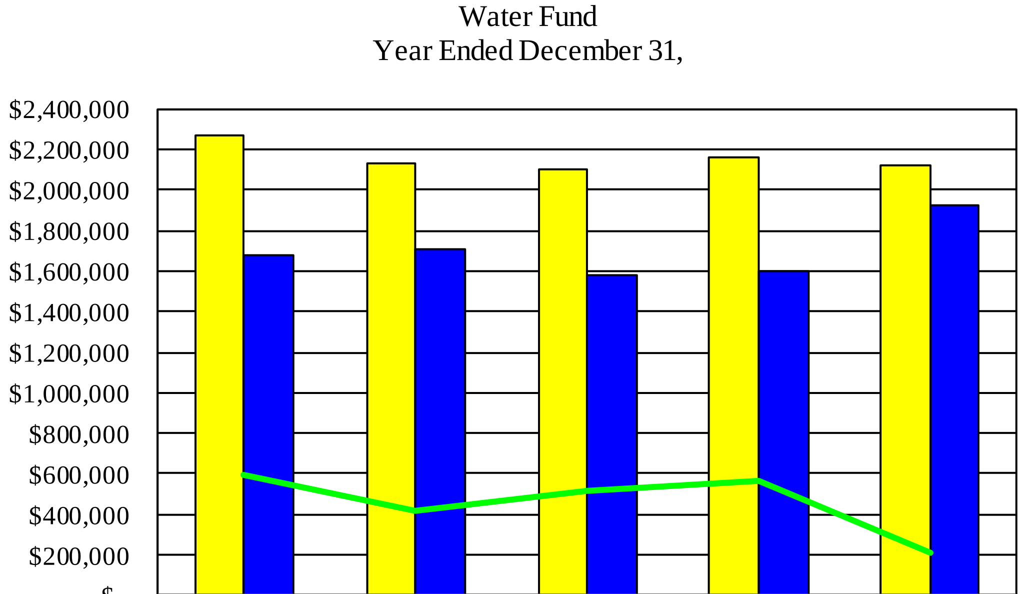
Enterprise Funds Change in Financial Position

	Net Position as of December 31, 2017	Net Position as of December 31, 2016	Increase (Decrease)
Net position of enterprise funds			
Total by classification			
Investment in capital assets	$ 16,292,000	$ 16,306,381	$ (14,381)
Unrestricted	1,298,744	1,116,957	181,787
Total enterprise funds	$ 17,590,744	$ 17,423,338	$ 167,406
Total by fund			
Water	$ 7,519,127	$ 7,597,937	$ (78,810)
Sewer	5,765,055	5,845,684	(80,629)
Surface Water Management	4,175,003	3,877,304	297,699
Nonmajor Recycling	131,559	102,413	29,146
Total enterprise funds	$ 17,590,744	$ 17,423,338	$ 167,406

In total, the net position of the City's enterprise funds increased by $167,406 during the year ended December 31, 2017. This increase was mainly in unrestricted net position, which increased $181,787, due to positive operating results in the enterprise funds.

WATER FUND

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



	2013	2014	2015	2016	2017
Oper Rev	$2,271,072	$2,132,191	$2,099,242	$2,165,773	$2,127,452
Oper Exp, Excl Dep	$1,679,255	$1,711,191	$1,579,215	$1,601,171	$1,921,138
Oper Inc Before Dep	$591,817	$421,000	$520,027	$564,602	$206,314

The Water Fund ended 2017 with a net position of $7,519,127, a decrease of $78,810 from the prior year. Of total net position, $6,719,621 represents the investment in capital assets, leaving $799,506 of unrestricted net position.

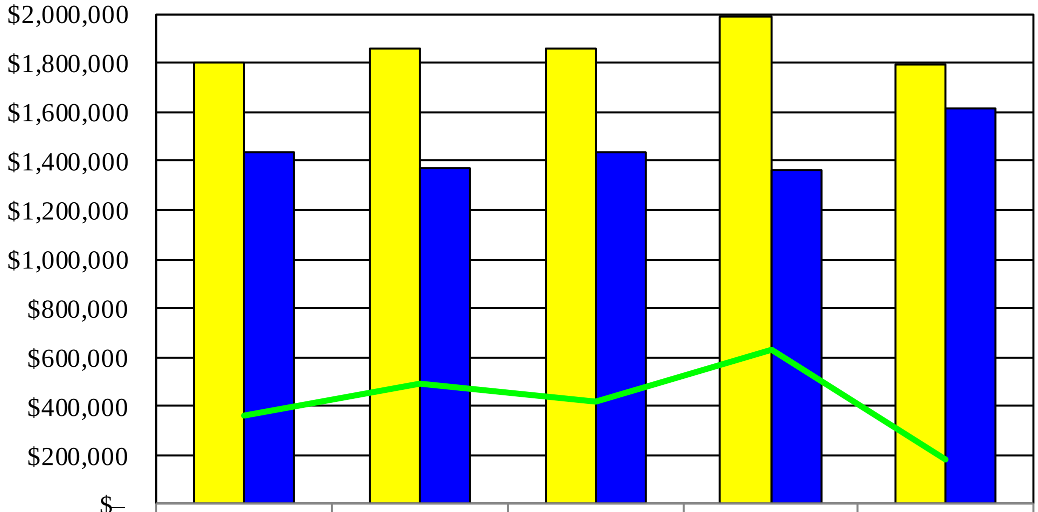
Water Fund operating revenues were $2,127,452 for 2017, a decrease of $38,321. Operating expenses (excluding depreciation of $238,736) were $1,921,138, which represents an increase of $319,967. Expenses were up largely due to an increase in other services and charges and additional supplies and maintenance.

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:

Sewer Fund
Year Ended December 31,



	2013	2014	2015	2016	2017
Oper Rev	$1,798,889	$1,857,272	$1,855,802	$1,989,066	$1,796,144
Oper Exp, Excl Dep	$1,434,271	$1,367,820	$1,438,589	$1,362,274	$1,615,427
Oper Inc Before Dep	$364,618	$489,452	$417,213	$626,792	$180,717

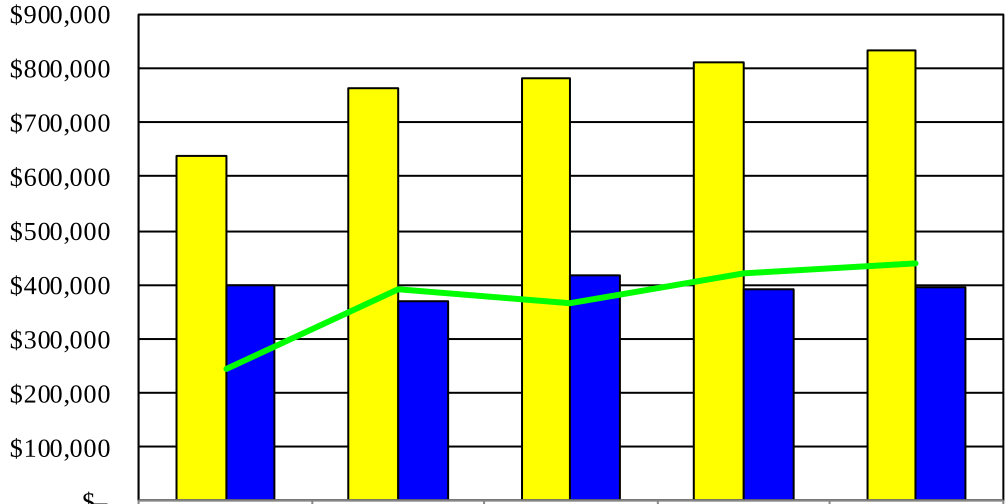
The Sewer Fund ended 2017 with a net position of $5,765,055, a decrease of $80,629 from the prior year. Of total net position, $5,859,306 represents the investment in capital assets, leaving a deficit $94,251 of unrestricted net position.

Sewer Fund operating revenues for 2017 were $1,796,144, a decrease of $192,922 compared to last year. Operating expenses for 2017 (excluding depreciation of $164,833) were $1,615,427, an increase of $253,153 from the prior year, with increases in sewer charges 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,



	2013	2014	2015	2016	2017
Oper Rev	$639,747	$762,884	$782,501	$812,044	$834,973
Oper Exp, Excl Dep	$397,240	$370,747	$416,945	$390,935	$395,715
Oper Inc Before Dep	$242,507	$392,137	$365,556	$421,109	$439,258

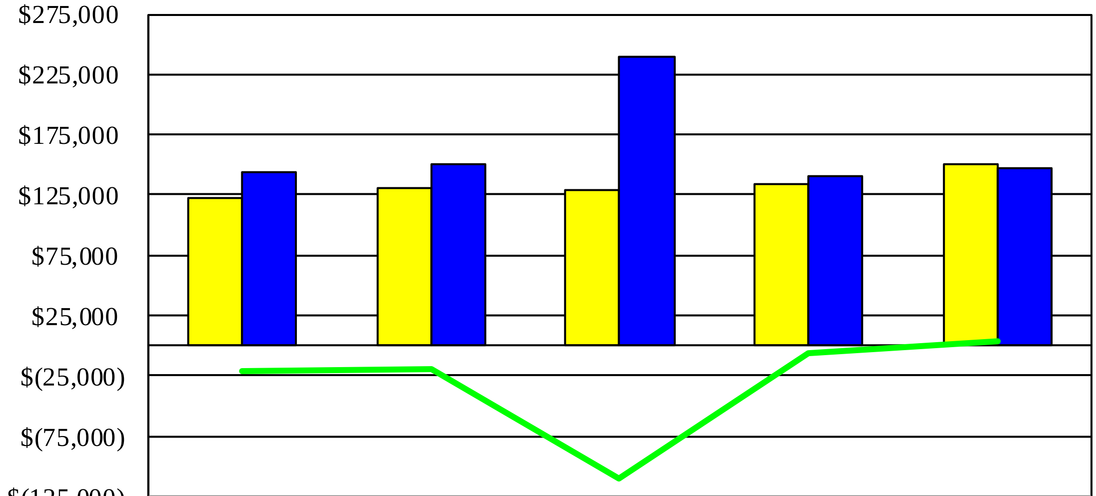
The Surface Water Management Fund ended 2017 with a net position of $4,175,003, an increase of $297,699 from the prior year. Of this, $3,713,073 represents the investment in capital assets, leaving $461,930 of unrestricted net position.

Surface Water Management Fund operating revenues for 2017 were $834,973, an increase of $22,929 from last year. Operating expenses for 2017 (excluding depreciation of $85,311) were $395,715, or $4,780, more than the prior year.

RECYCLING FUND

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

Recycling Fund
Year Ended December 31,



	2013	2014	2015	2016	2017
Oper Rev	$122,666	$130,369	$129,030	$134,739	$151,272
Oper Exp	$144,541	$150,417	$239,727	$141,190	$147,919
Oper Inc (Loss)	$(21,875)	$(20,048)	$(110,697)	$(6,451)	$3,353

The Recycling Fund ended 2017 with an unrestricted net position of $131,559, an increase of $29,146 from the prior year.

Recycling Fund operating revenues for 2017 were $151,272, an increase of $16,533 from the prior year. Operating expenses for 2017 were $147,919, an increase of $6,729 from the prior year.

The Recycling Fund also received $24,441 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, 2017 and 2016 for governmental activities and business-type activities (utility fund operations):

	As of December 31,		Increase
	2017	2016	(Decrease)
Net position			
Governmental activities			
Investment in capital assets	$ 22,750,377	$ 25,178,721	$ (2,428,344)
Restricted	898,739	786,678	112,061
Unrestricted	10,678,219	8,249,560	2,428,659
Total governmental activities	34,327,335	34,214,959	112,376
Business-type activities			
Investment in capital assets	16,292,000	16,306,381	(14,381)
Unrestricted	1,298,744	1,116,957	181,787
Total business-type activities	17,590,744	17,423,338	167,406
Total net position	$ 51,918,079	$ 51,638,297	$ 279,782

Net position for governmental activities increased by $112,376 in 2017, as presented above. The investment in capital assets decreased $2,428,344 this year, mainly due to the contribution of capital assets to the county for a multi-year street project accumulated by the City. The remaining 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 of capital assets. The restricted portion of net position increased $112,061, due to increases in amounts restricted for tax increment purposes and cable television. The increase in unrestricted net position is due to positive operating results in the current year.

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, 2017 and 2016:

	2017			2016
	Expenses	Program Revenues	Net Change	Net Change
Net (expense) revenue				
Governmental activities				
General government	$ 1,322,106	$ 451,414	$ (870,692)	$ (943,475)
Public safety	2,158,835	1,034,424	(1,124,411)	(1,212,122)
Public works	3,512,218	2,190,730	(1,321,488)	(276,443)
Parks and recreation	759,737	164,228	(595,509)	(607,355)
Economic development	276,841	–	(276,841)	(361,029)
Business-type activities				
Water	2,159,874	2,127,525	(32,349)	333,289
Sewer	1,780,260	1,796,228	15,968	536,225
Surface water management	481,026	835,030	354,004	343,849
Recycling	147,919	175,713	27,794	16,988
Total net (expense) revenue	$ 12,598,816	$ 8,775,292	(3,823,524)	(2,170,073)
General revenues				
Property taxes			3,526,347	3,278,287
Tax increment collections			295,788	242,544
Franchise taxes			109,070	132,548
Unrestricted investment earnings			172,101	173,026
Total general revenues			4,103,306	3,826,405
Change in net position			$ 279,782	$ 1,656,332

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, for the most part, the City's business-type activities are generating sufficient program revenues (service charges and program-specific grants) to cover expenses. This is critical given the current downward pressures on the general revenue sources.

LEGISLATIVE UPDATES

The 2017 legislative session began with a full agenda, which included adopting a fiscal year 2018–2019 biennial state budget. The February 2017, state budget forecast projected that the state General Fund would end the 2016–2017 biennium with a surplus of $743 million, eliminating the need for budget cuts or transfers to balance the fund. However, the Legislature was expected to address several significant spending areas for which successful funding appropriations had not been passed in recent legislative sessions. The 2017 regular legislative session ended with four omnibus budget bills being vetoed, potentially leaving a number of these same areas without appropriations. After a three-day special session, the Governor and Legislature were able to agree on budget and appropriation bills addressing most of the state budgetary needs for the upcoming biennium, albeit not without several line item vetoes invoked by the Governor, including striking the appropriations for operating the House and Senate from the bills.

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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ACCOUNTING AND AUDITING UPDATES

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

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

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

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

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

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

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

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

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

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

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

GASB STATEMENT NO. 84, *FIDUCIARY ACTIVITIES*

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

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

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

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

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

GASB STATEMENT NO. 85, *OMNIBUS 2017*

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

GASB Statement No. 86, *Certain Debt Extinguishment Issues*

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

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

GASB Statement No. 87, *Leases*

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

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

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

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

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

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