Management Report

for

City of Arden Hills, Minnesota

December 31, 2018

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

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

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

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

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

Minneapolis, Minnesota
May 2, 2019

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

PLANNED SCOPE AND TIMING OF THE AUDIT

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

AUDIT OPINION AND FINDINGS

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

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

- 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 Parks Fund; Public Safety Capital Equipment Fund; and TCAAP Fund; had year-end deficit equity balances of $5,816, $19,456, and $164,132, 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, 2018; however, the City implemented the following governmental accounting standards during the fiscal year:

- Governmental Accounting Standards Board (GASB) Statement No. 85, *Omnibus 2017*, which addresses issues that have been identified during implementation and application of certain GASB statements.

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

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

ACCOUNTING ESTIMATES AND MANAGEMENT JUDGMENTS

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

- **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. There were no misstatements detected as a result of audit procedures that were material, either individually or in the aggregate, to each opinion unit's financial statements taken as a whole.

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 May 2, 2019.

MANAGEMENT CONSULTATIONS WITH OTHER INDEPENDENT ACCOUNTANTS

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

OTHER AUDIT FINDINGS OR ISSUES

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

OTHER MATTERS

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

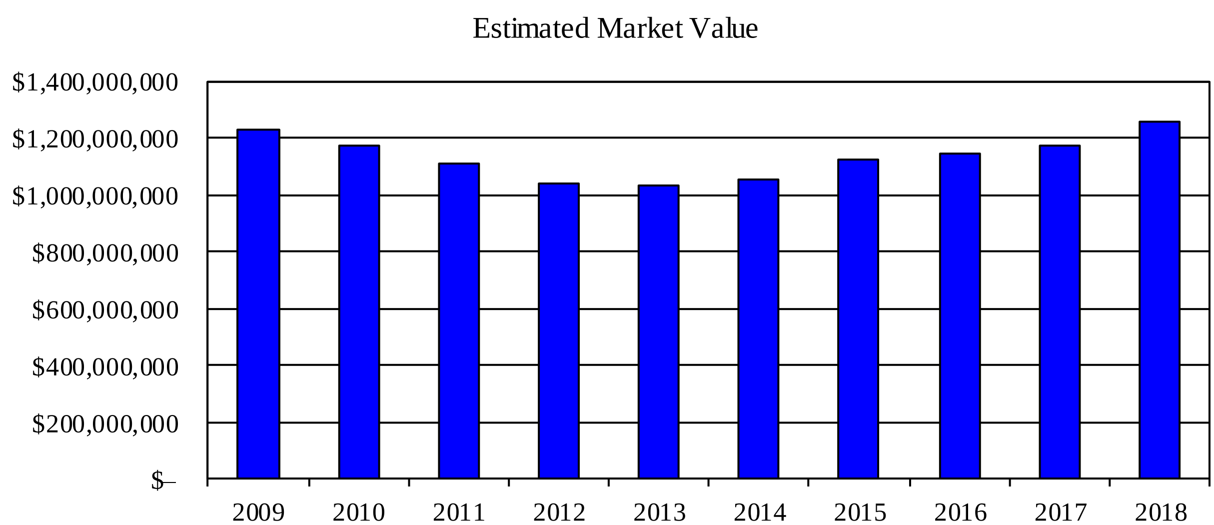
This section of the report provides you with an overview of the financial trends and activities of the City's governmental funds, which includes the General, special revenue, debt service, and capital project funds. These funds are used to account for the basic services the City provides to all of its 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 2017 fiscal year, local ad valorem property tax levies provided 41.1 percent of the total governmental fund revenues for cities over 2,500 in population, and 37.4 percent for cities under 2,500 in population. Total property taxes levied by all Minnesota cities for taxes payable in 2018 increased 6.2 percent from the prior year, and total certified levies payable in 2019 are projected to increase by 5.6 percent.

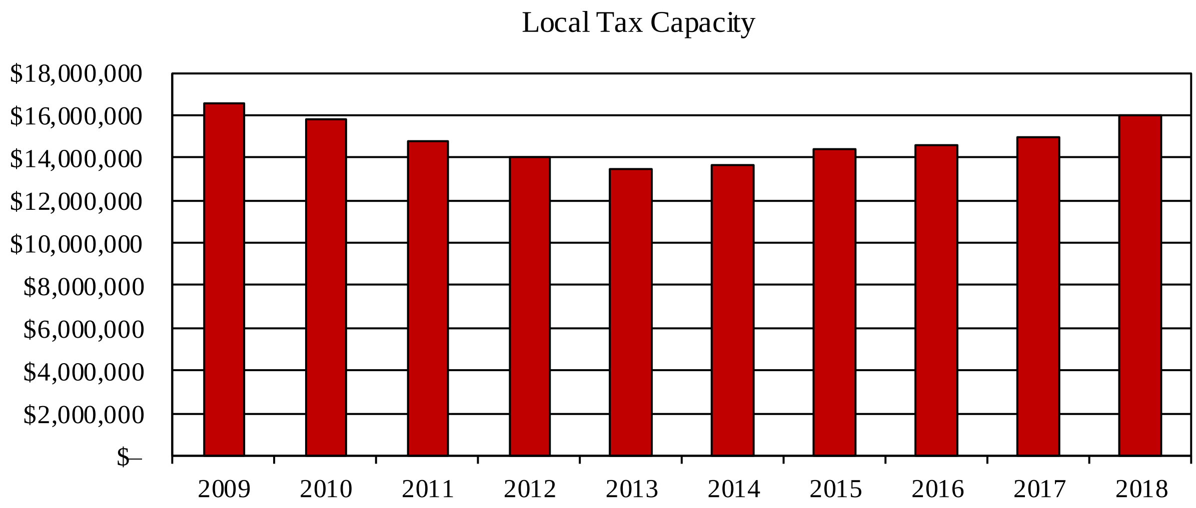
The total market value of property in Minnesota cities increased about 5.6 percent for the 2017 levy year (state-wide market value information for the 2018 levy year was not available at the time this report was issued). The market values used for levying property taxes are based on the previous fiscal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

The City's estimated market value increased by 2.5 percent for 2017 and increased 7.4 percent for taxes payable in 2018. 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 2.3 percent for taxes payable in 2017, and increased 7.3 percent for taxes payable in 2018.

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



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

Rates Expressed as a Percentage of Net Tax Capacity

	City of Arden Hills		
	2016	2017	2018
Average tax rate			
City	26.5	27.2	25.5
County	58.9	55.9	54.0
School	26.2	25.3	28.5
Special taxing	9.1	8.6	8.2
Total	120.7	117.0	116.2

The total average tax rate was consistent with the prior year. An increase in the school portion was offset by decreases in the other taxing authority rates.

GOVERNMENTAL FUND BALANCES

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

Governmental Fund Change in Fund Balance

	Fund Balance as of December 31, 2018	Fund Balance as of December 31, 2017	Increase (Decrease)
Fund balances of governmental funds			
Total by classification			
Nonspendable	$ 25,696	$ 289,183	$ (263,487)
Restricted	1,010,521	898,739	111,782
Committed	508,241	471,996	36,245
Assigned	3,136,684	6,423,941	(3,287,257)
Unassigned	2,862,678	2,626,103	236,575
Total governmental funds	$ 7,543,820	$ 10,709,962	$ (3,166,142)
Total by fund			
General	$ 3,340,369	$ 3,639,317	$ (298,948)
EDA Operating	508,241	303,058	205,183
Equipment, Building, and Replacement	216,902	(259,269)	476,171
Permanent Improvement Revolving	2,656,977	6,080,457	(3,423,480)
Other governmental funds	821,331	946,399	(125,068)
Total governmental funds	$ 7,543,820	$ 10,709,962	$ (3,166,142)

In total, the fund balances of the City's governmental funds decreased by $3,166,142 during the year ended December 31, 2018. The majority of the decrease was in assigned fund balance in the Permanent Improvement Revolving Fund, due to spending for street and trail projects in the current year.

GOVERNMENTAL FUND REVENUES

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

We have included the most recent comparative state-wide averages available from the Office of the State Auditor to provide a benchmark for interpreting the City's data. The amounts received from the typical major sources of governmental fund revenue will naturally vary between cities based on factors such as a city's stage of development, location, size and density of its population, property values, services it provides, and other attributes. It will also differ from year-to-year, due to the effect of inflation and changes in its operation. Also, certain data 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, 2017			2016	2017	2018
Population	2,500–10,000	10,000–20,000	20,000–100,000	9,966	9,969	10,069
Property taxes	$ 474	$ 451	$ 475	$ 327	$ 355	$ 355
Tax increments	26	27	38	24	30	35
Franchise and other taxes	38	43	48	13	11	10
Special assessments	57	48	59	37	31	73
Licenses and permits	39	34	49	60	73	52
Intergovernmental revenues	322	276	147	40	213	100
Charges for services	108	103	103	58	59	42
Other	68	53	48	40	46	49
Total revenue	$ 1,132	$ 1,035	$ 967	$ 599	$ 818	$ 716

The City's governmental funds have generated significantly less revenue per capita in total than other Minnesota cities in its population class. A city's stage of development, along with the way a city finances various capital projects, will impact the mix of revenue sources it receives.

The City generated $7,222,675 of total revenue in its governmental funds in 2018, a decrease of $932,871 (11.4 percent) from the prior year. The City's per capita governmental fund revenues for 2018 were $716, a decrease of $102 (12.5 percent) per capita from the prior year. Intergovernmental revenues decreased $113 per capita, due to a one-time reimbursement from the county for its share of a joint street project 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, 2017			2016	2017	2018
Population	2,500–10,000	10,000–20,000	20,000–100,000	9,966	9,969	10,069
Current						
General government	$ 147	$ 120	$ 101	$ 120	$ 119	$ 116
Public safety	270	259	287	199	206	207
Public works	128	127	101	48	45	58
Parks and recreation	96	112	99	62	62	65
All other	76	64	77	23	27	32
	717	682	665	452	459	478
Capital outlay and construction	403	319	263	99	118	591
Debt service						
Principal	228	147	121	–	–	–
Interest and fiscal	44	35	32	–	–	–
	272	182	153	–	–	–
Total expenditures	$ 1,392	$ 1,183	$ 1,081	$ 551	$ 577	$ 1,069

Total expenditures in the City's governmental funds for 2018 were $10,757,975, an increase of $5,003,332 (86.9 percent). The City's per capita governmental funds current expenditures for 2018 were $478, a slight increase from the $459 per capita expenditures in the prior year.

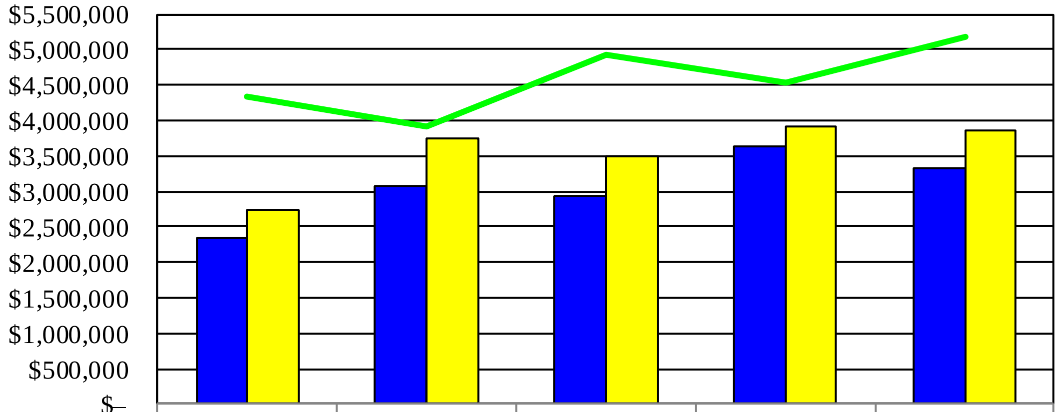
Capital outlay and construction increased by $473 per capita, with increased activity in the City's Permanent Improvement Revolving Fund, due to ongoing street and trail projects.

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,



	2014	2015	2016	2017	2018
Fund Bal	$2,345,942	$3,082,410	$2,944,813	$3,639,317	$3,340,369
Cash Bal	$2,734,366	$3,752,294	$3,506,967	$3,906,088	$3,850,270
Exp & Trans Out	$4,324,507	$3,926,100	$4,940,586	$4,536,636	$5,181,629

The City's General Fund cash and investments balance at December 31, 2018 was $3,850,270 (net of borrowing), a decrease of $55,818 from the previous year. Total fund balance at December 31, 2018 was $3,340,369, a decrease of $298,948 from the prior year. This fund balance level represents approximately 77 percent of the City's annual General Fund expenditures, based on 2018 expenditure levels, which compares to a prior year fund balance level of 87 percent. The overall impact of operations on fund balance was $338,277 better than anticipated in the final budget.

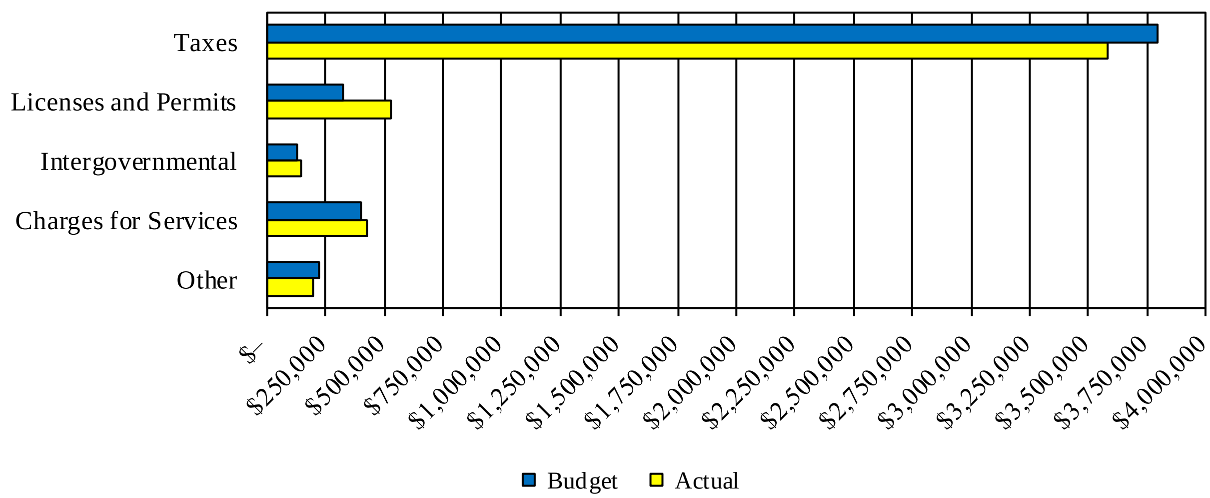
As the graph illustrates, the City has generally been able to maintain stable cash and fund balance levels as the volume of financial activity has fluctuated. This is an important factor because a government, like any organization, requires a certain amount of equity to operate. A healthy financial position 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 73 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 2018:

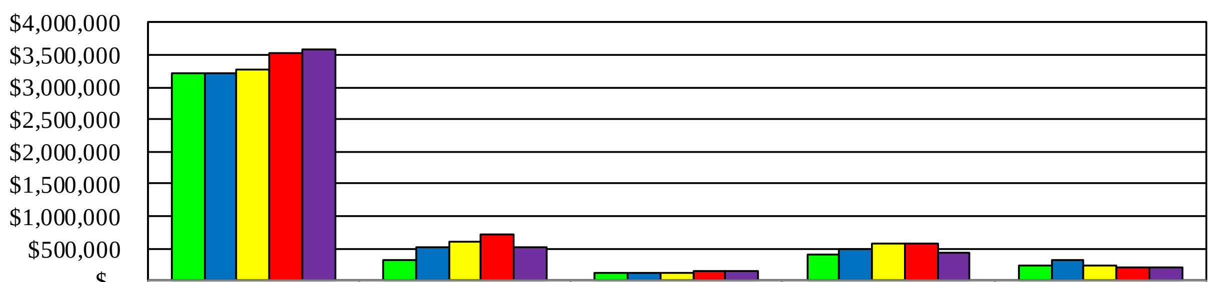
General Fund Revenue
Budget to Actual



Total General Fund revenues for 2018 were $4,882,681, which was $8,052 (0.2 percent) over the final budget. Licenses and permits ($201,844) and charges for services ($27,103) were over budget, due to conservative budgeting for these sources. Taxes were $216,414 below anticipated levels, due to abatements and adjustments on delinquent balances.

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:

General Fund Revenue by Source
Year Ended December 31,

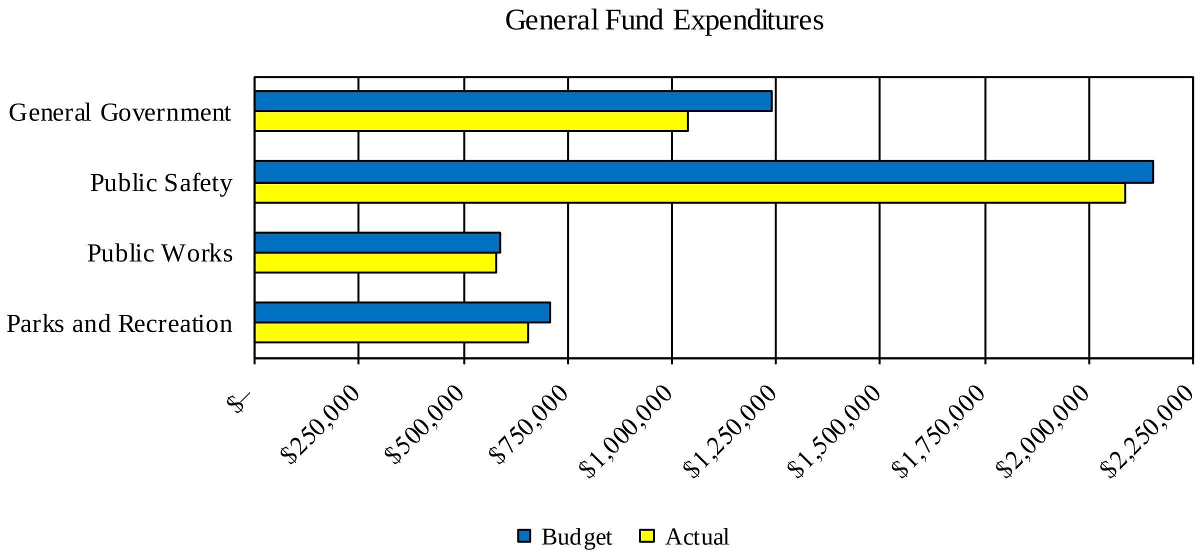


	Taxes	Licenses and Permits	Intergovernmental	Charges for Services	Other
2014	$3,210,025	$327,727	$136,249	$400,224	$230,518
2015	$3,203,004	$518,846	$130,023	$496,908	$313,787
2016	$3,260,537	$598,686	$131,914	$577,041	$234,811
2017	$3,541,705	$729,197	$151,425	$590,141	$218,672
2018	$3,578,628	$526,444	$149,097	$427,905	$200,607

Total General Fund revenues for 2018 were $348,459 (6.7 percent) less than prior year. Licenses and permits and charges for services decreased $202,753 and $162,236, respectively, due to decreased building activity in the current year.

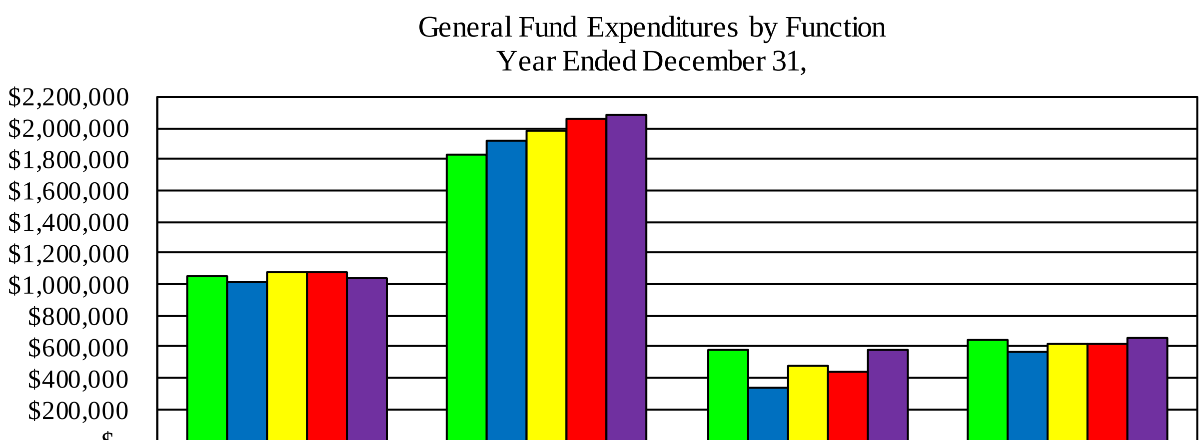
GENERAL FUND EXPENDITURES

The following graph reflects the City's General Fund expenditures, budget and actual, for 2018:



Total General Fund expenditures for 2018 were $4,361,629, which was $330,225 (7.0 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 $200,876 under budget, mainly in planning and zoning ($89,336) and general government buildings ($36,391) within other services and charges. The public safety function was under budget by $67,827, mainly in protective inspections ($33,033) and police and animal control ($32,819).

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
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
2018	$1,039,772	$2,088,345	$579,535	$653,977

Overall, General Fund expenditures increased $164,993 (3.9 percent) from the prior year, with the largest increase in public works ($135,902).

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, 2018, presented both by classification and by fund:

Enterprise Funds Change in Financial Position

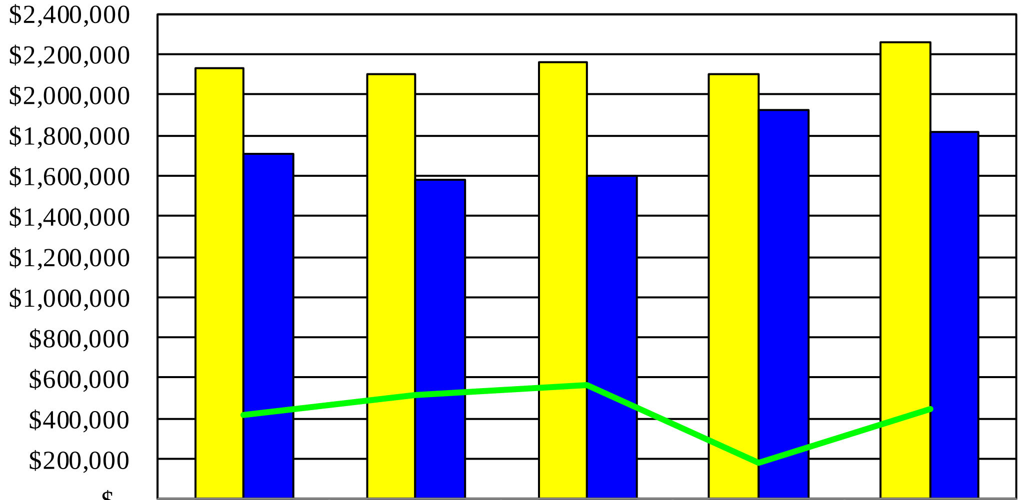
	Net Position as of December 31, 2018	Net Position as of December 31, 2017	Increase (Decrease)
Net position of enterprise funds			
Total by classification			
Net investment in capital assets	$ 17,295,916	$ 16,292,000	$ 1,003,916
Unrestricted	1,329,268	1,298,744	30,524
Total enterprise funds	$ 18,625,184	$ 17,590,744	$ 1,034,440
Total by fund			
Water	$ 8,179,034	$ 7,519,127	$ 659,907
Sewer	5,875,144	5,765,055	110,089
Surface Water Management	4,447,569	4,175,003	272,566
Nonmajor Recycling	123,437	131,559	(8,122)
Total enterprise funds	$ 18,625,184	$ 17,590,744	$ 1,034,440

In total, the net position of the City's enterprise funds increased by $1,034,440 during the year ended December 31, 2018. This increase was mainly in net investment in capital assets, which increased $1,003,916, due to continued investment in utility infrastructure and other capital assets.

WATER FUND

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

Water Fund
Year Ended December 31,



	2014	2015	2016	2017	2018
Oper Rev	$2,132,191	$2,099,242	$2,165,773	$2,104,639	$2,256,859
Oper Exp, Excl Dep	$1,711,191	$1,579,215	$1,601,171	$1,921,138	$1,812,772
Oper Inc Before Dep	$421,000	$520,027	$564,602	$183,501	$444,087

The Water Fund ended 2018 with a net position of $8,179,034, an increase of $659,907 from the prior year. Of total net position, $7,190,606 represents the net investment in capital assets, leaving $988,428 of unrestricted net position.

Water Fund operating revenues were $2,256,859 for 2018, an increase of $152,220 due to increased rates. Operating expenses (excluding depreciation of $260,017) were $1,812,772, which represents a decrease of $108,366. Expenses were down largely due to a decrease in other services and charges and supplies and maintenance.

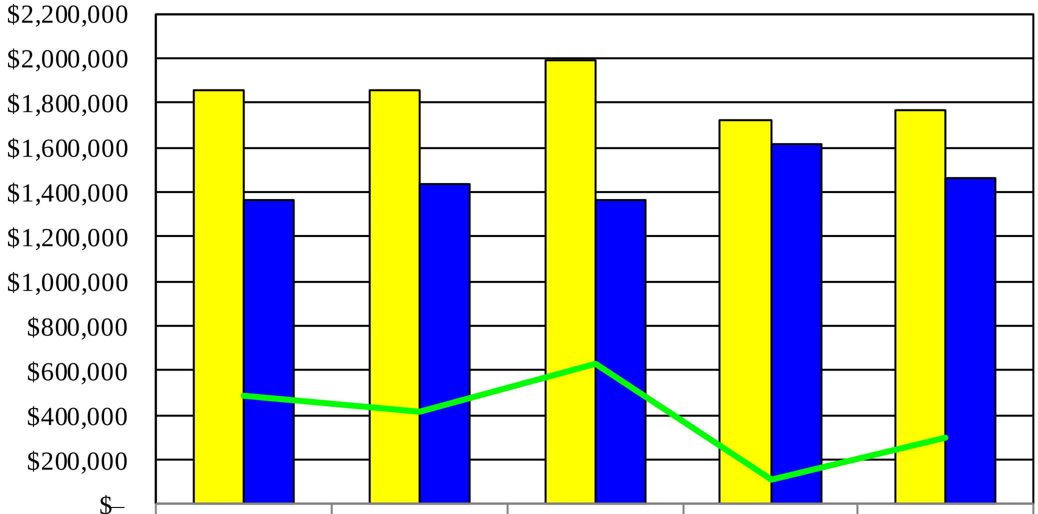
The Water Fund also received $500,000 in capital contributions in the current year for a watermain project.

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,



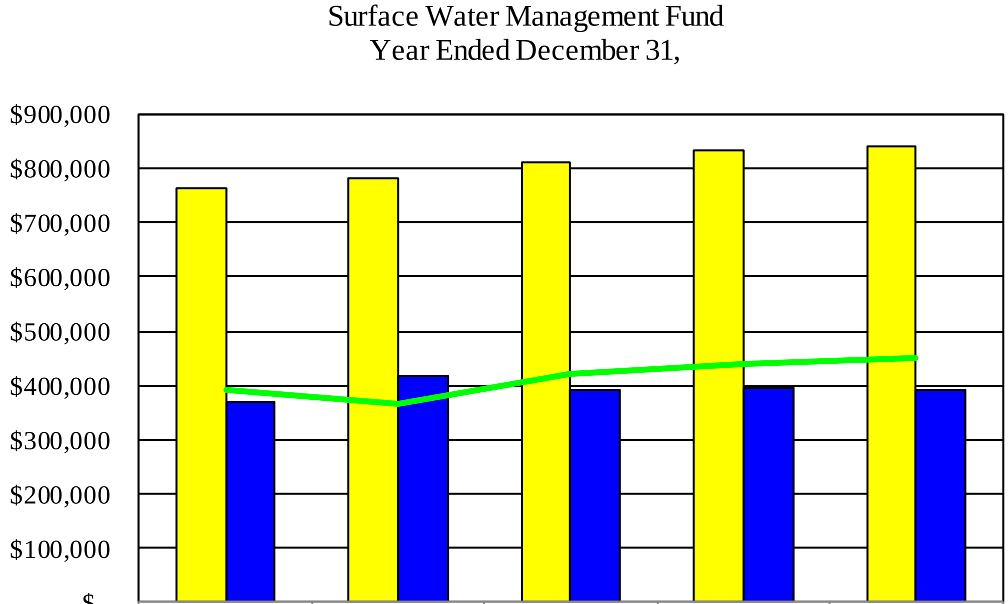
	2014	2015	2016	2017	2018
Oper Rev	$1,857,272	$1,855,802	$1,989,066	$1,723,699	$1,769,466
Oper Exp, Excl Dep	$1,367,820	$1,438,589	$1,362,274	$1,615,427	$1,467,028
Oper Inc Before Dep	$489,452	$417,213	$626,792	$108,272	$302,438

The Sewer Fund ended 2018 with a net position of $5,875,144, an increase of $110,089 from the prior year. Of total net position, $5,684,251 represents the net investment in capital assets, leaving $190,893 of unrestricted net position.

Sewer Fund operating revenues for 2018 were $1,769,466, an increase of $45,767 compared to last year. Operating expenses for 2018 (excluding depreciation of $175,456) were $1,467,028, a decrease of $148,399 from the prior year, due to a decrease in other services and charges.

SURFACE WATER MANAGEMENT FUND

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



	2014	2015	2016	2017	2018
Oper Rev	$762,884	$782,501	$812,044	$834,973	$839,499
Oper Exp, Excl Dep	$370,747	$416,945	$390,935	$395,715	$390,882
Oper Inc Before Dep	$392,137	$365,556	$421,109	$439,258	$448,617

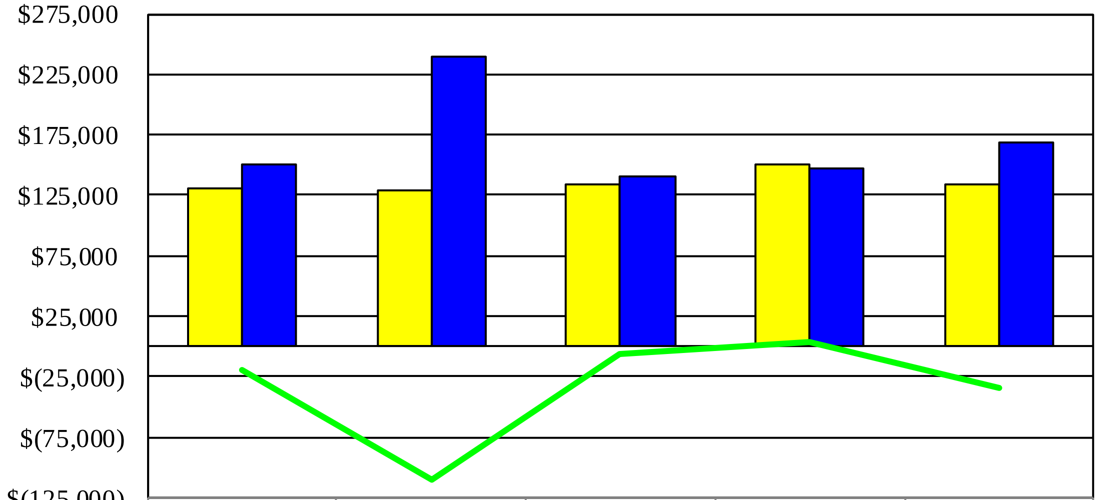
The Surface Water Management Fund ended 2018 with a net position of $4,447,569, an increase of $272,566 from the prior year. Of this, $4,421,059 represents the investment in capital assets, leaving $26,510 of unrestricted net position.

Surface Water Management Fund operating revenues for 2018 were $839,499, an increase of $4,526 from last year. Operating expenses for 2018 (excluding depreciation of $108,167) were $390,882, or $4,833 less 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,



	2014	2015	2016	2017	2018
Oper Rev	$130,369	$129,030	$134,739	$151,272	$134,228
Oper Exp	$150,417	$239,727	$141,190	$147,919	$168,145
Oper Inc (Loss)	$(20,048)	$(110,697)	$(6,451)	$3,353	$(33,917)

The Recycling Fund ended 2018 with an unrestricted net position of $123,437, a decrease of $8,122 from the prior year.

Recycling Fund operating revenues for 2018 were $134,228, a decrease of $17,044 from the prior year. Operating expenses for 2018 were $168,145, an increase of $20,226 from the prior year.

The Recycling Fund also received $23,819 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, 2018 and 2017 for governmental activities and business-type activities (utility fund operations):

	As of December 31,		Increase
	2018	2017	(Decrease)
Net position			
Governmental activities			
Net investment in capital assets	$ 26,972,898	$ 22,750,377	$ 4,222,521
Restricted	1,010,521	898,739	111,782
Unrestricted	8,736,913	10,678,219	(1,941,306)
Total governmental activities	36,720,332	34,327,335	2,392,997
Business-type activities			
Net investment in capital assets	17,295,916	16,292,000	1,003,916
Unrestricted	1,329,268	1,298,744	30,524
Total business-type activities	18,625,184	17,590,744	1,034,440
Total net position	$ 55,345,516	$ 51,918,079	$ 3,427,437

Net position for governmental activities increased by $2,392,997 in 2018, as presented above. The investment in capital assets increased $4,222,521 this year, mainly due to the significant amount of construction activity in the current year. 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 $111,782, due to increases in amounts restricted for tax increment purposes. The decrease in unrestricted net position is due to the continued investment in infrastructure using unrestricted resources of the City.

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, 2018 and 2017:

	2018			2017
	Expenses	Program Revenues	Net Change	Net Change
Net (expense) revenue				
Governmental activities				
General government	$ 1,286,845	$ 285,055	$ (1,001,790)	$ (870,692)
Public safety	2,248,540	771,516	(1,477,024)	(1,124,411)
Public works	1,695,449	1,841,163	145,714	(1,321,488)
Parks and recreation	765,843	1,392,080	626,237	(595,509)
Economic development	391,156	–	(391,156)	(276,841)
Business-type activities				
Water	2,147,359	2,878,336	730,977	(32,349)
Sewer	1,654,079	1,885,874	231,795	15,968
Surface water management	499,049	840,444	341,395	354,004
Recycling	168,145	158,047	(10,098)	27,794
Total net (expense) revenue	$ 10,856,465	$ 10,052,515	(803,950)	(3,823,524)
General revenues				
Property taxes			3,578,894	3,526,347
Tax increment collections			351,569	295,788
Franchise taxes			101,237	109,070
Unrestricted investment earnings			199,687	172,101
Total general revenues			4,231,387	4,103,306
Change in net position			$ 3,427,437	$ 279,782

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

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

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

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

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

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

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

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

- Reforms impacting the PERA Public Employees Police and Fire Fund (PEPFF) plan included:

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

- Reforms impacting the volunteer firefighter relief associations plan included:

  - Added a requirement that the fire chief annually certify each firefighter's service credit to the relief association and the related municipality effective January 1, 2019.

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

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

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

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

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

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

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

GASB STATEMENT NO. 84, *FIDUCIARY ACTIVITIES*

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

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

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

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

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

GASB STATEMENT NO. 87, *LEASES*

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

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

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

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

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

GASB Statement No. 88, *Certain Disclosures Related to Debt, Including Direct Borrowings and Direct Placements*

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

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

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

GASB Statement No. 89, *Accounting for Interest Cost Incurred Before the End of a Construction Period*

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

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

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

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

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

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

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

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

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

UNIFORM GUIDANCE, MICRO-PURCHASE THRESHOLD

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