Management Report

for

City of Arden Hills
Ramsey County, Minnesota

December 31, 2013

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MMKR
CERTIFIED PUBLIC
ACCOUNTANTS

PRINCIPALS
Thomas M. Montague, CPA
Thomas A. Karnowski, CPA
Paul A. Radosevich, CPA
William J. Lauer, CPA
James H. Eichten, CPA
Aaron J. Nielsen, CPA
Victoria L. Holinka, CPA

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, 2013. The purpose of this report is to provide comments resulting from our audit process and to communicate information relevant to city finances in Minnesota. We have organized this report into the following sections:

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

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

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

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

Minneapolis, Minnesota
June 19, 2014

Malloy, Montague, Karnowski, Radosevich & Co., P.A.
5353 Wayzata Boulevard • Suite 410 • Minneapolis, MN 55416 • Telephone: 952-545-0424 • Telefax: 952-545-0569 • www.mmkr.com

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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, 2013, 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, 2013:

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

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

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

- The results of our testing disclosed no instances of noncompliance required to be reported under *Government Auditing Standards*.

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

FUND BALANCE DEFICITS

As reported in the City's comprehensive annual financial report (CAFR), the Equipment, Building, and Replacement Fund; Economic Development Authority (EDA) TIF District No. 4 Fund; Parks Fund; and Central Garage Internal Service Fund had year-end deficit equity balances of $62,854, $2,969, $68,493, and $18,744, 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. For the fiscal year ended December 31, 2013, the City implemented Governmental Accounting Standards Board (GASB) Statement No. 65, *Items Previously Reported as Assets and Liabilities*, which identifies specific items previously presented as assets that will now be presented as either deferred outflows of resources or outflows (expenses/expenditures), and items previously reported as liabilities that will now be presented as deferred inflows of resources or inflows (revenues). No other new accounting policies were adopted, and the application of remaining policies was not changed during the year.

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

CORRECTED AND UNCORRECTED MISSTATEMENTS

Professional standards require us to accumulate all known and likely misstatements identified during the audit, other than those that are trivial, and communicate them to the appropriate level of management. Where applicable, management has corrected all such misstatements. In addition, none of the misstatements detected as a result of audit procedures and corrected by management, when applicable, were material, either individually or in the aggregate, to each opinion unit's financial statements taken as a whole.

ACCOUNTING ESTIMATES AND MANAGEMENT JUDGMENTS

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

- **Depreciation** – Management's estimates of depreciation expense are based on the estimated useful lives of the assets.

- **Compensated Absences** – Management's estimate is based on current rates of pay and unused compensated absence balances.

Management expects any differences between estimates and actual amounts of these estimates to be insignificant. We evaluated the key factors and assumptions used to develop these accounting 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.

DIFFICULTIES ENCOUNTERED IN PERFORMING THE AUDIT

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

DISAGREEMENTS WITH MANAGEMENT

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

MANAGEMENT REPRESENTATIONS

We have requested certain representations from management that are included in the management representation letter dated June 19, 2014.

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 INFORMATION IN DOCUMENTS CONTAINING AUDITED FINANCIAL STATEMENTS

With respect to supplemental information accompanying the financial statements, 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 basic financial statements. We compared and reconciled the supplemental information to the underlying accounting records used to prepare the basic financial statements or to the basic financial statements themselves.

With respect to the introductory section and the statistical section accompanying the basic financial statements, our procedures were limited to reading this other information and, in doing so, we did not identify any material inconsistencies with the audited financial statements.

GOVERNMENTAL FUNDS OVERVIEW

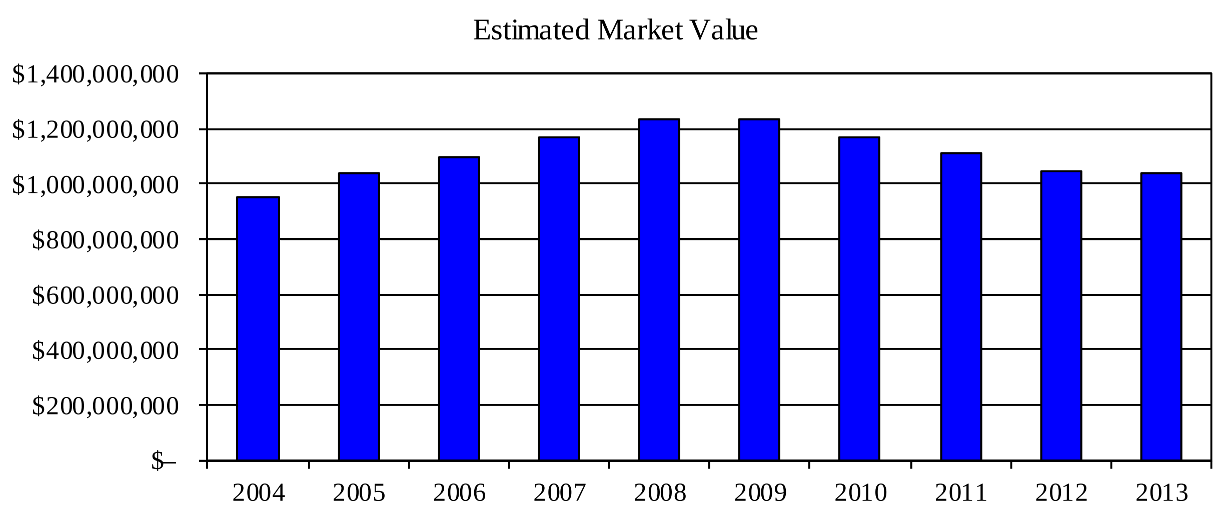
This section of the report provides you with an overview of the financial trends and activities of the City's governmental funds, which includes the General Fund, special revenue, debt service, and capital project funds. These funds are used to account for the basic services the City provides to all 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. In recent years this dependence has been heightened, as economic conditions have resulted in reductions to other revenue sources such as state aids and fees generated from property development or redevelopment. Despite these conditions, property taxes levied by Minnesota cities increased a record low 0.9 percent state-wide for 2012, and 2.27 percent for 2013. Almost one-third of Minnesota cities kept their 2013 levy at the same level as the previous year, while another 13 percent reduced their levies for 2013.

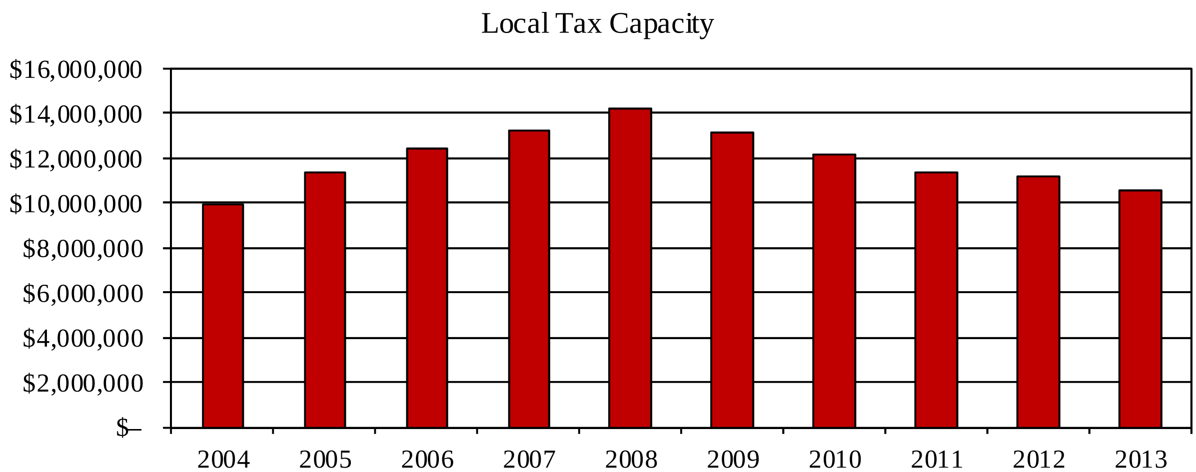
Economic conditions have also had a profound effect on the tax base of Minnesota cities with state-wide taxable market values declining each of the last four levy years, including average decreases of 8.8 percent and 4.5 percent for taxes payable in 2012 and 2013, respectively. There is optimism that this trend is reversing, as the market value decline for the 2013 levy year was the smallest of the past four years. However, since the assessed valuation used for levying property taxes is based on values from the previous fiscal year (e.g. the market value for taxes payable in 2013 is based on estimated values as of January 1, 2012), taxable market value improvement has lagged behind recent upturns in the housing market and the economy in general.

The City's taxable market value decreased 5.9 percent and 0.8 percent for 2012 and 2013, respectively. The following graph shows the City's changes in taxable market value over the past 10 years:



Tax capacity is considered the actual base available for taxation. It is calculated by applying the state's property classification system to each property's market value. Each property classification, such as commercial or residential, has a different calculation and uses different rates. Consequently, a city's total tax capacity will change at a different rate than its total market value, as tax capacity is affected by the proportion of the City's tax base that is in each property classification from year-to-year, as well as legislative changes to tax rates. The City's tax capacity decreased 1.7 percent and 4.9 percent for taxes payable in 2012 and 2013, respectively.

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



The following table presents the average tax rates applied to city residents for each of the last two levy years, along with comparative state-wide and metro area rates. The general increase in rates reflects both the increased reliance of local governments on property taxes and the recent decline in tax capacities.

Rates expressed as a percentage of net tax capacity

	All Cities State-Wide		Seven-County Metro Area		**City of Arden Hills**	
	2012	2013	2012	2013	**2012**	**2013**
Average tax rate						
City	46.3	48.8	43.4	46.1	**25.5**	**27.9**
County	46.8	48.5	45.0	47.1	**61.3**	**65.2**
School	27.3	28.5	28.5	30.3	**28.6**	**29.4**
Special taxing	6.8	7.2	8.7	9.4	**10.0**	**10.2**
Total	127.2	133.0	125.6	132.9	**125.4**	**132.7**

There are a number of reasons contributing to the change in the average total tax rate. The City's portion of the tax capacity rates for the City's residents has historically been well below the average for Minnesota cities state-wide and for cities in the seven-county metro area because of the City's high property values and strong commercial tax base. The City does not have any outstanding debt levy requirement, which also contributes to the lower than average city tax rate.

GOVERNMENTAL FUND BALANCES

The following table summarizes the changes in the fund balances of the City's governmental funds during the year ended December 31, 2013, presented both by fund balance classification and by fund:

Governmental Fund Change in Fund Balance

	Fund Balance as of December 31, 2013	Fund Balance as of December 31, 2012	Increase (Decrease)
Fund balances of governmental funds			
Total by classification			
Nonspendable	$ 23,664	$ 22,954	$ 710
Restricted	888,707	1,799,380	(910,673)
Committed	421,989	452,496	(30,507)
Assigned	7,230,650	6,989,249	241,401
Unassigned	2,089,196	1,899,120	190,076
Total governmental funds	$ 10,654,206	$ 11,163,199	$ (508,993)
Total by fund			
General	$ 2,365,706	$ 2,350,919	$ 14,787
EDA Operating	268,408	297,475	(29,067)
Tax Increment Bonds	2,123	2,167	(44)
Equipment, Building, and Replacement	(62,854)	(232,240)	169,386
Permanent Improvement Revolving	6,610,900	6,502,758	108,142
Other governmental funds	1,469,923	2,242,120	(772,197)
Total governmental funds	$ 10,654,206	$ 11,163,199	$ (508,993)

In total, the fund balances of the City's governmental funds decreased by $508,993 during the year ended December 31, 2013. The decrease was primarily due to capital spending for the 2013 street project. The decrease in restricted fund balance was due to the approved transfer of unrestricted resources from the EDA TIF District No. 2 Fund to the Permanent Improvement Revolving Fund.

GOVERNMENTAL FUND REVENUES

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

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

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

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

	State-Wide			**City of Arden Hills**		
Year	December 31, 2012			**2011**	**2012**	**2013**
Population	2,500–10,000	10,000–20,000	20,000–100,000	**9,552**	**9,642**	**9,750**
Property taxes	$ 414	$ 382	$ 416	**$ 305**	**$ 320**	**$ 317**
Tax increments	32	44	46	**36**	**45**	**48**
Franchise and other taxes	29	36	30	**9**	**10**	**10**
Special assessments	60	54	62	**59**	**26**	**39**
Licenses and permits	24	24	35	**45**	**43**	**39**
Intergovernmental revenues	278	279	138	**26**	**15**	**32**
Charges for services	104	81	83	**44**	**47**	**42**
Other	66	58	50	**80**	**45**	**(1)**
Total revenue	$ 1,007	$ 958	$ 860	**$ 604**	**$ 551**	**$ 526**

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

The City generated $5,129,294 of total revenue in its governmental funds in 2013, a decrease of $183,111 (3.4 percent) from the prior year. The City's per capita governmental funds revenues for 2013 were $526, a decrease of $25 (4.5 percent) per capita from the prior year. Special assessments revenue increased $13 per capita due to collections on assessments for the 2013 street project. Intergovernmental revenues increased by $17 per capita due to an increase in MSA funds received for the 2013 street project. The $46 decrease in the "other" category was caused primarily by the unrealized loss on marking investments to market at year-end in accordance with GASB standards.

GOVERNMENTAL FUND EXPENDITURES

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

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

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

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

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

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

	State-Wide			**City of Arden Hills**		
Year	December 31, 2012			**2011**	**2012**	**2013**
Population	2,500–10,000	10,000–20,000	20,000–100,000	**9,552**	**9,642**	**9,750**
Current						
General government	$ 127	$ 101	$ 84	**$ 111**	**$ 109**	**$ 108**
Public safety	234	229	241	**172**	**179**	**183**
Public works	114	105	92	**29**	**39**	**40**
Parks and recreation	82	95	86	**69**	**70**	**69**
All other	73	75	92	**1**	**6**	**9**
	$ 630	$ 605	$ 595	**$ 382**	**$ 403**	**$ 409**
Capital outlay and construction	$ 315	$ 313	$ 221	**$ 199**	**$ 70**	**$ 164**
Debt service						
Principal	$ 187	$ 135	$ 103	**$ 26**	**$ 26**	**$ 27**
Interest and fiscal	58	46	39	**4**	**3**	**2**
	$ 245	$ 181	$ 142	**$ 30**	**$ 29**	**$ 29**

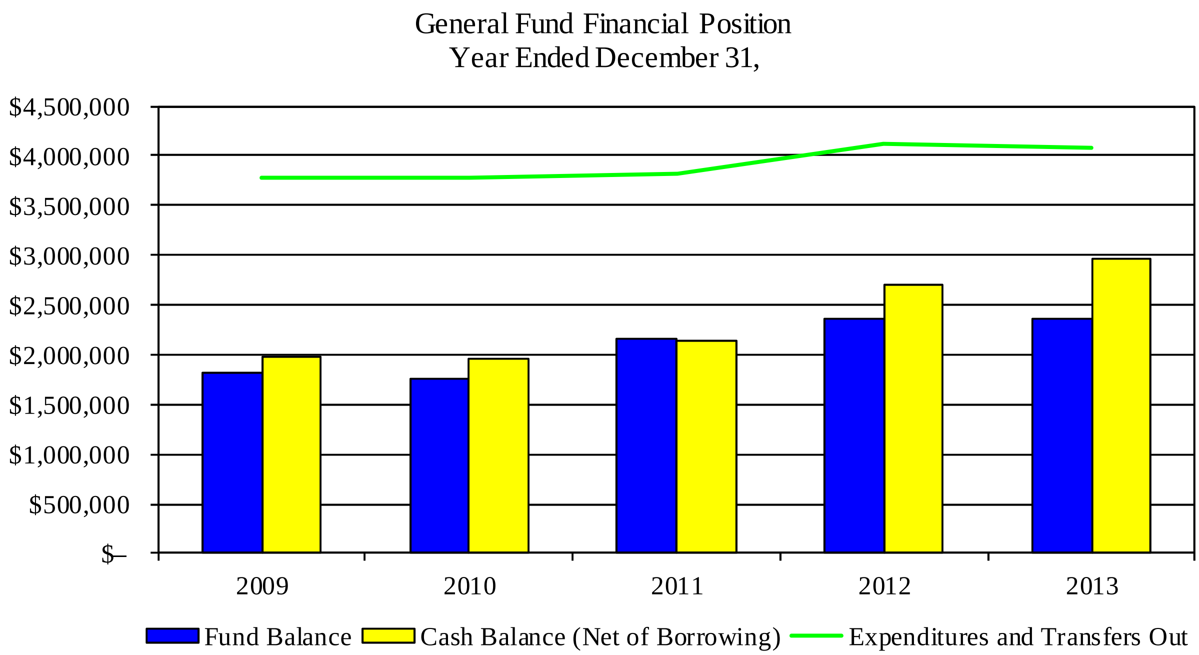
As the above table reflects, the City's expenditures per capita have also been below the state-wide average. A significant reason for this difference is in capital outlay and debt service, which is reasonable for a city that is not in the middle of a major development or redevelopment period.

Total expenditures in the City's governmental funds for 2013 were $5,869,052, an increase of $1,014,170 (20.9 percent). The City's per capita governmental funds current expenditures for 2013 were $409, an increase of $6 (1.5 percent) per capita from the prior year. Increases in public safety for police and fire contract service fees and in public works in the current year contributed to the overall increase in current expenditures. Capital outlay and construction experienced an increase from the prior year due to the 2013 street project in the current year. The City did not have a major street project in the prior year. Debt service expenditures were similar to the prior year as planned with scheduled debt payments.

GENERAL FUND

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

The graph below illustrates the change in the General Fund financial position over the last five years. We have also included a line representing annual expenditures and transfers out to reflect the change in the size of the General Fund operation over the same period.

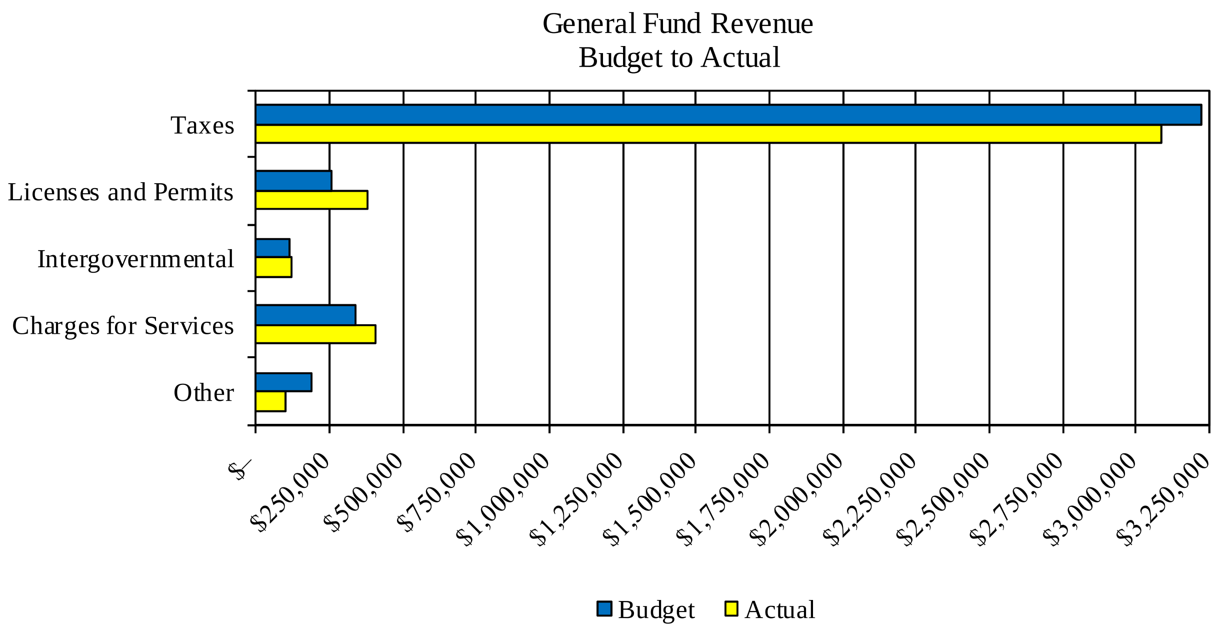


The City's General Fund cash and investments balance at December 31, 2013 was $2,960,646 (net of borrowing), an increase of $252,862 from the previous year. Total fund balance at December 31, 2013 was $2,365,706, an increase of $14,787 from the prior year. This fund balance level represents approximately 62 percent of the City's annual General Fund expenditures, based on 2013 expenditure levels, which compares to a prior year fund balance level of 63 percent. The overall impact of operations on fund balance was $60,887 better than anticipated in the final budget.

As the graph illustrates, the City has generally been able to maintain stable cash and fund balance levels as the volume of financial activity has fluctuated. This is an important factor because a government, like any organization, requires a certain amount of equity to operate. A healthy financial position allows the City to avoid volatility in tax rates; helps minimize the impact of state funding changes; allows for the adequate and consistent funding of services, repairs, and unexpected costs; and is a factor in determining the City's bond rating and resulting interest costs. Maintaining an adequate fund balance has become increasingly important given the fluctuations in state funding for cities in recent years.

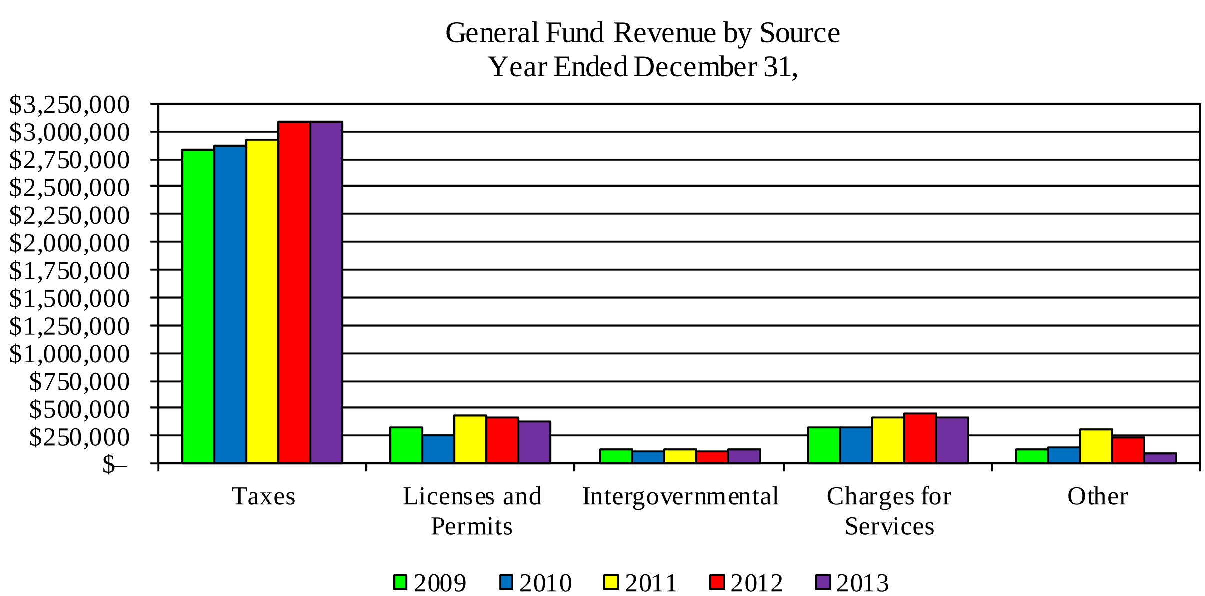
A trend that is typical to Minnesota local governments, especially the General Fund of cities, is the unusual cash flow experienced throughout the year. The City's General Fund cash disbursements are made fairly evenly during the year other than the impact of seasonal services such as snowplowing, street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

The following graph reflects the City’s General Fund revenues, budget and actual, for 2013:



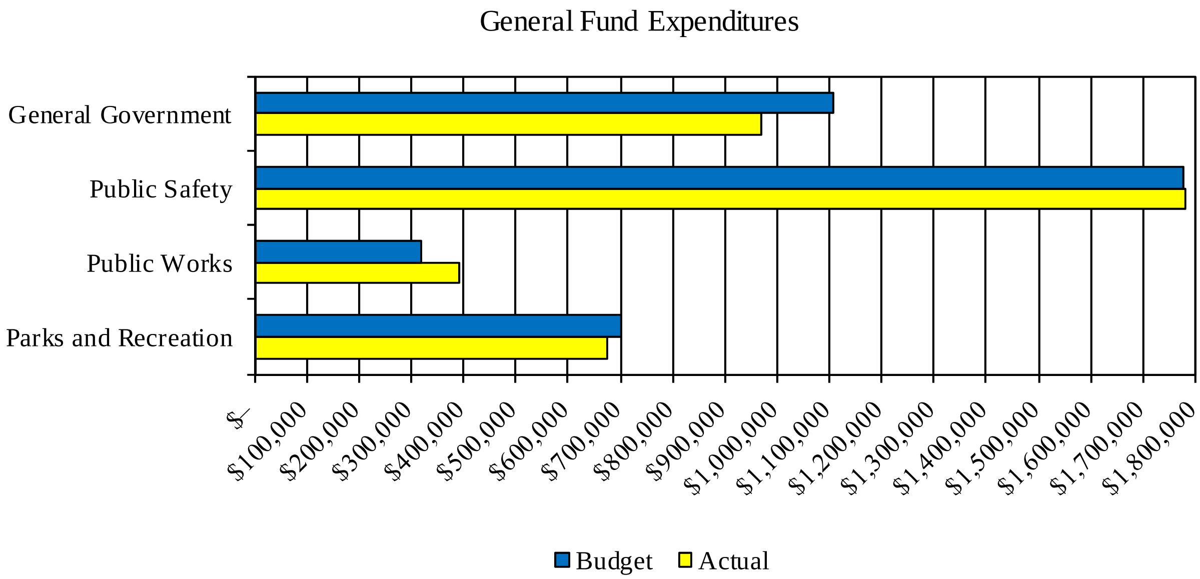
Total General Fund revenues for 2013 were $4,101,427, which was $28,980 (0.7 percent) under the final budget. The largest variance occurred in general property taxes, which were $134,727 below anticipated levels. The impact of building permit fees related to new construction was an offset to this variance. Charges for services were also over budget by $70,000 due to plan check fees related to the new construction. Other sources were less than anticipated with the market value adjustment on investments as previously discussed.

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



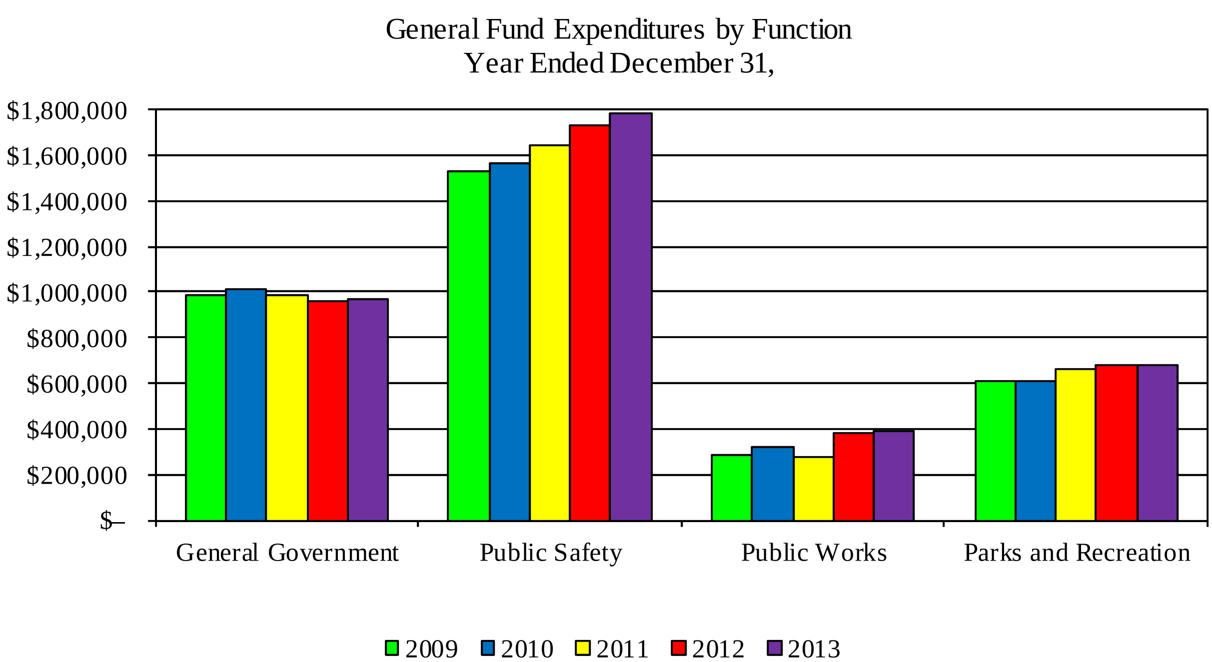
Total General Fund revenue for 2013 was $208,200 (4.8 percent) lower than last year. Licenses and permits and charges for services decreased $33,031 and $39,594, respectively due to greater levels of building activity in the prior year. Other revenues decreased as a result of decreased park dedication fees, decreased fees received on conduit debt issued, and decreased investment earnings due to a large negative market value adjustment at year-end for the down market.

The following graph reflects the City's General Fund expenditures, budget and actual, for 2013:



Total General Fund expenditures for 2013 were $3,816,640, which was $89,867 (2.3 percent) under the final budget. As presented in the budgetary comparison schedule (within the City's CAFR), expenditure variances were both over and under within various functions and departments while remaining within total appropriations approved by the City Council. The general government function was $136,671 under budget, mainly in the planning and zoning ($54,104) and administration ($43,061) departments. Parks and recreation was $27,202 under budget, mainly for the appropriation for celebrating Arden Hills, which was not held in 2013. These favorable variances were partially offset by the public safety and public works functions being over budget $1,129 and $72,877, respectively.

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



Overall, General Fund expenditures increased $71,552 (1.9 percent) from the prior year. The largest change occurred in public safety, which increased $50,880 due to increased contract fees for police and fire services.

ENTERPRISE FUNDS OVERVIEW

The City maintains a number of 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 significantly 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, 2013, presented both by classification and by fund:

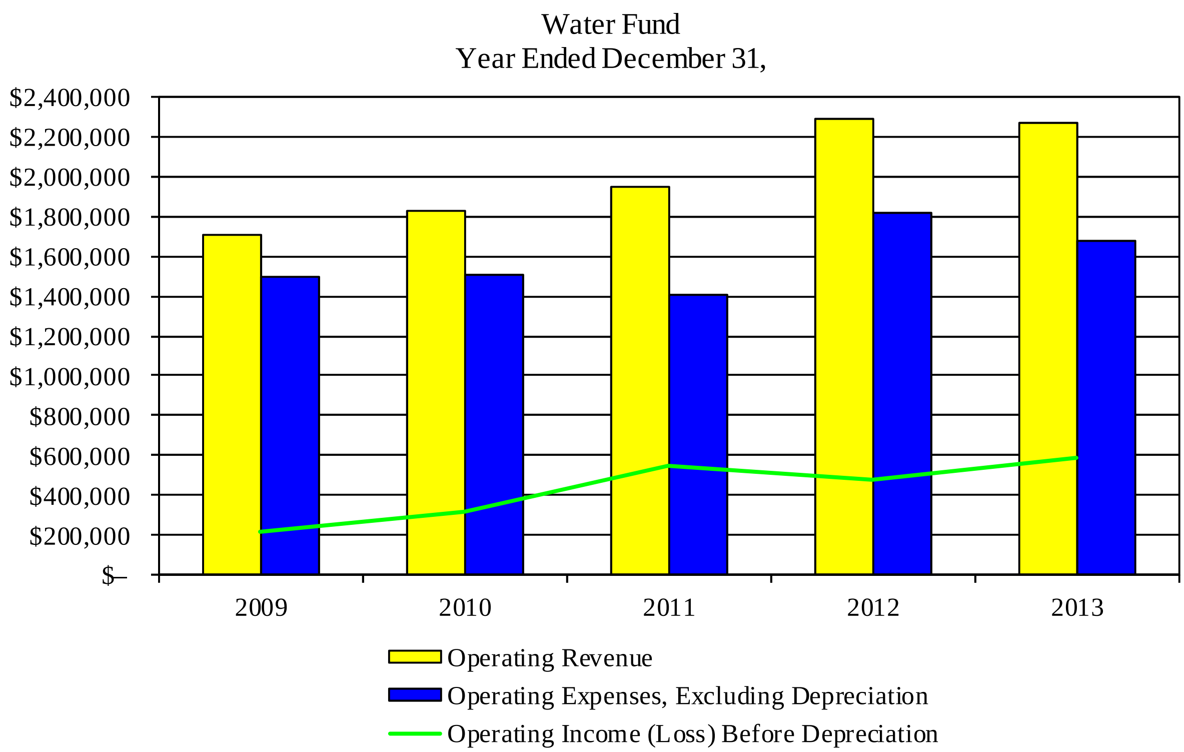
Enterprise Funds Change in Financial Position

	Net Position as of December 31, 2013	Net Position as of December 31, 2012	Increase (Decrease)
Net position of enterprise funds			
Total by classification			
Net investment in capital assets	$ 14,356,782	$ 12,360,674	$ 1,996,108
Unrestricted	1,158,470	2,403,645	(1,245,175)
Total enterprise funds	$ 15,515,252	$ 14,764,319	$ 750,933
Total by fund			
Water	$ 7,049,873	$ 6,705,284	$ 344,589
Sewer	5,183,180	4,884,862	298,318
Surface Water Management	3,215,300	3,103,395	111,905
Nonmajor Recycling	66,899	70,778	(3,879)
Total enterprise funds	$ 15,515,252	$ 14,764,319	$ 750,933

In total, the net position of the City's enterprise funds increased by $750,933 during the year ended December 31, 2013. The shift between net investment in capital assets and unrestricted net position is due to the City's increased investment in utility infrastructure. This investment in infrastructure has reduced overall cash balances and unrestricted net position.

WATER FUND

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



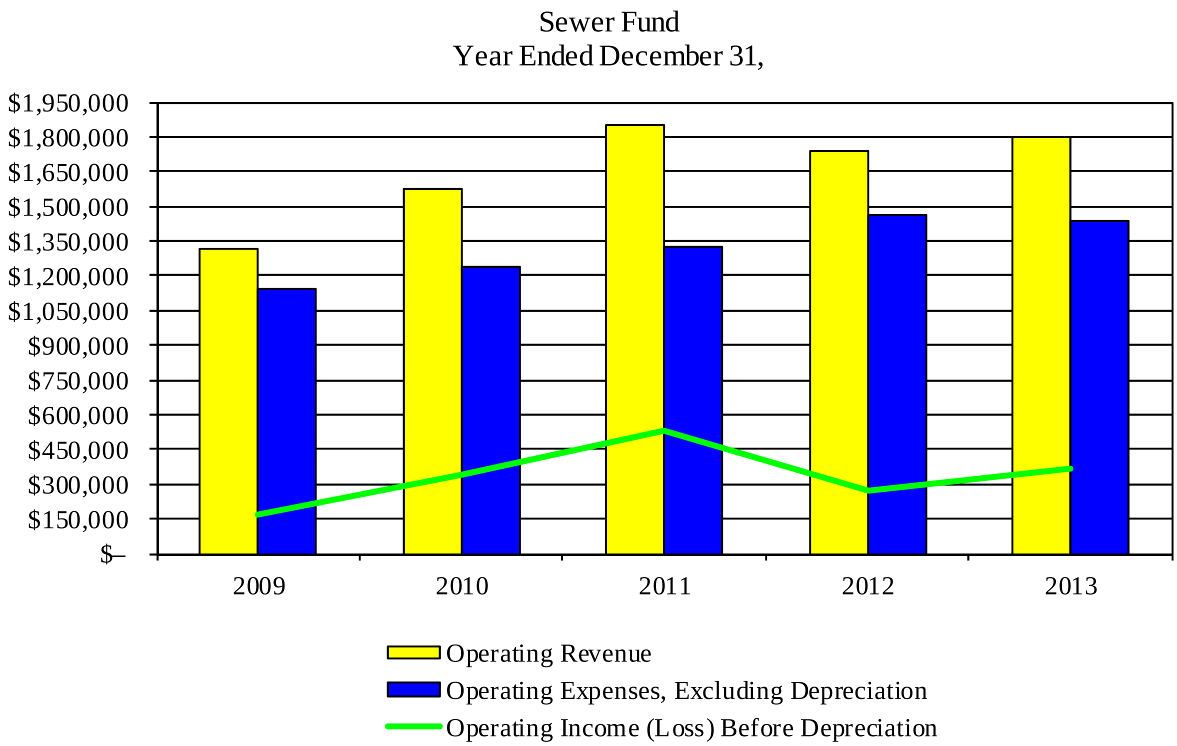
The Water Fund ended 2013 with a net position of $7,049,873, an increase of $344,589 from the prior year. Of this, $6,205,951 represents the net investment in capital assets, leaving $843,922 of unrestricted net position.

Water Fund operating revenues were $2,271,072 for 2013, a decrease of $14,089. This decrease was primarily due to decreased consumption as a result of an unusually dry season in the prior year. Operating expenses (excluding depreciation of $164,275) were $1,679,255, which represents a decrease of $132,646 (7.3 percent). This decrease was largely due to a decrease in water purchased from the City of Roseville and decreased services and charges and purchased services due to decreased maintenance costs.

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

SEWER FUND

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

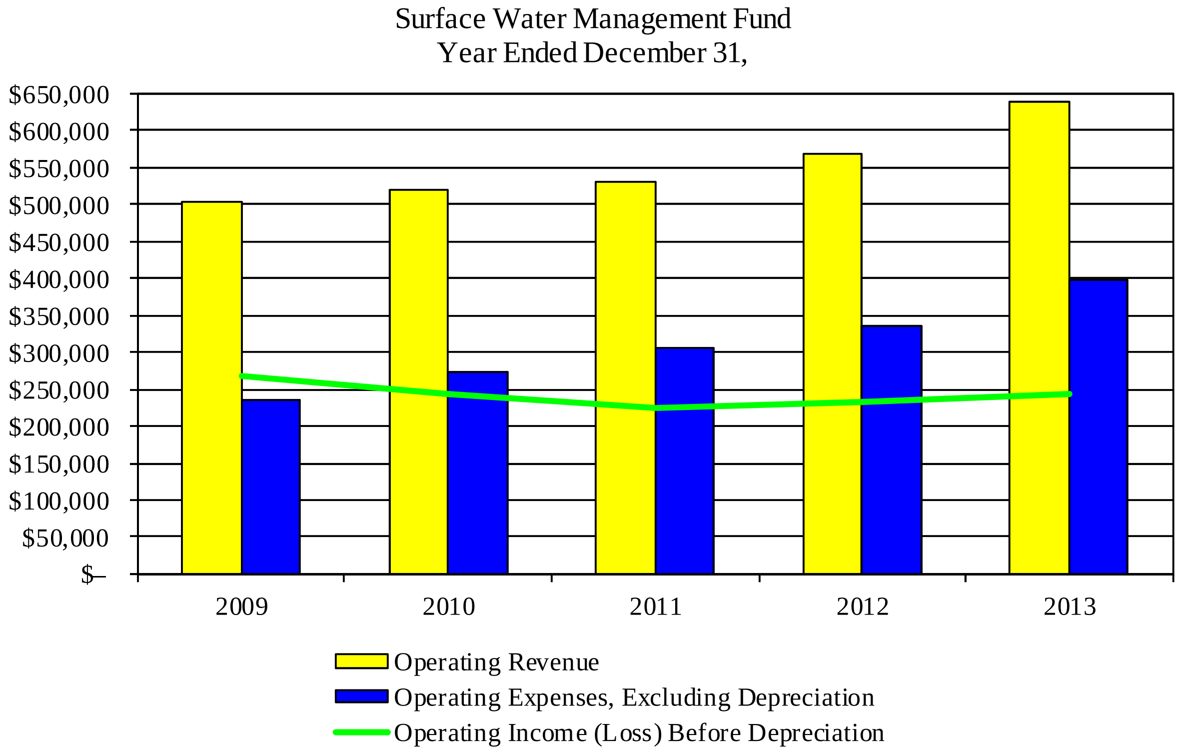


The Sewer Fund ended 2013 with a net position of $5,183,180, an increase of $298,318 from the prior year. Of this, $5,394,227 represents the net investment in capital assets, leaving a deficit in unrestricted net position of $211,047.

Sewer Fund operating revenues for 2013 were $1,798,889, an increase of $59,766 from last year. This increase was a result of an approved rate increase and sewer access and availability charges being up from the prior year. Operating expenses for 2013 (excluding depreciation of $126,525) were $1,434,271, down $29,906 from the prior year, or 2 percent.

SURFACE WATER MANAGEMENT FUND

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

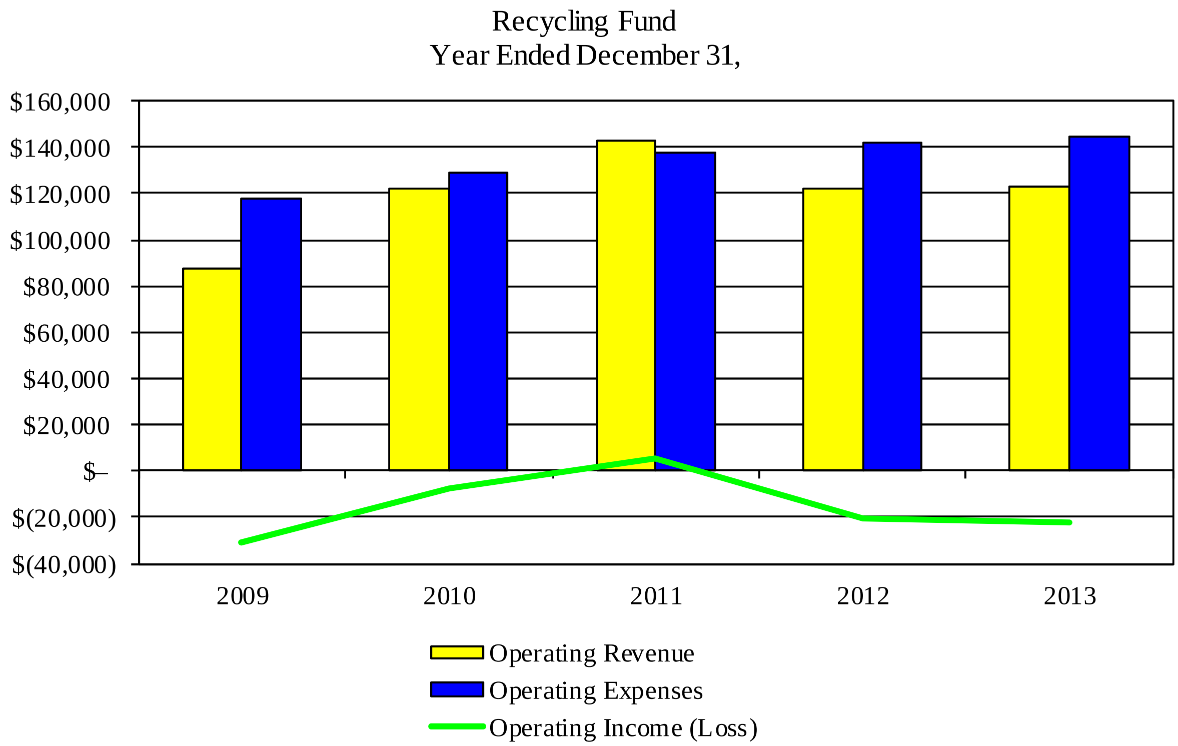


The Surface Water Management Fund ended 2013 with a net position of $3,215,300, an increase of $111,905 from the prior year. Of this, $2,756,604 represents the net investment in capital assets, leaving $458,696 of unrestricted net position.

Surface Water Management Fund operating revenues for 2013 were $639,747, an increase of $72,386 from last year. This increase is consistent with the utility rate increase approved for 2013. Operating expenses for 2013 (excluding depreciation of $56,487) were $397,240, or $61,982, more than the prior year due primarily to an increase in other services and charges to this utility operation.

RECYCLING FUND

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



The Recycling Fund ended 2013 with an unrestricted net position of $66,899, a decrease of $3,879 from the prior year.

Recycling Fund operating revenues for 2013 were $122,666, an increase of $978 from last year, due to a 4.8 percent rate increase offset by the change in recyclable materials markets reducing the City's share in this source. Operating expenses for 2013 were $144,541, an increase of $2,427 from the prior year. The Recycling Fund also received $19,694 of intergovernmental revenues which are not reflected in the graph above that are available for the operation of the City's recycling program.

GOVERNMENT-WIDE FINANCIAL STATEMENTS

In addition to fund-based information, the current reporting model for governmental entities also requires the inclusion of two government-wide financial statements designed to present a clear picture of the City as a single, unified entity. These government-wide financial statements provide information on the total cost of delivering services, including capital assets and long-term liabilities.

STATEMENT OF NET POSITION

The Statement of Net Position essentially tells you what your city owns and owes at a given point in time, the last day of the fiscal year. Theoretically, net position represents the resources the City has leftover to use for providing services after its debts are settled. However, those resources are not always in spendable form, or there may be restrictions on how some of those resources can be used. Therefore, net position is divided into three components: net investment capital assets, restricted, and unrestricted.

- **Net Investment in Capital Assets** – The portion of net position reflecting equity in capital assets (i.e. capital assets minus related debt).
- **Restricted Net Position** – The portion of net position equal to resources whose use is legally restricted minus any noncapital-related liabilities payable from those same resources.
- **Unrestricted Net Position** – The residual balance of net position after the elimination of *net investment in capital assets* and *restricted net position.*

The following table presents the components of the City's net position as of December 31, 2013 and 2012 for governmental activities and business-type activities (utility fund operations):

	As of December 31,		Increase
	2013	2012	(Decrease)
Net position			
Governmental activities			
Net investment in capital assets	$ 17,435,976	$ 17,167,531	$ 268,445
Restricted	896,106	1,788,007	(891,901)
Unrestricted	10,274,835	9,738,832	536,003
Total governmental activities	28,606,917	28,694,370	(87,453)
Business-type activities			
Net investment in capital assets	14,356,782	12,360,674	1,996,108
Unrestricted	1,158,470	2,403,645	(1,245,175)
Total business-type activities	15,515,252	14,764,319	750,933
Total net position	$ 44,122,169	$ 43,458,689	$ 663,480

The City ended 2013 with combined total net position of $44,122,169, an increase of $663,480 from the prior year. At the end of the current fiscal year, the City is able to present positive balances in all three categories of net position, both for the government as a whole, as well as for its separate governmental and business-type activities. The same situation held true for the prior fiscal year.

STATEMENT OF ACTIVITIES

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

The following table presents the change in the net position of the City for the years ended December 31, 2013 and 2012:

	2013			2012
	Expenses	Program Revenues	Net Change	Net Change
Net (expense) revenue				
Governmental activities				
General government	$ 1,133,379	$ 433,770	$ (699,609)	$ (681,779)
Public safety	1,956,260	443,150	(1,513,110)	(1,409,948)
Public works	944,104	380,778	(563,326)	(753,777)
Parks and recreation	807,363	113,524	(693,839)	(680,687)
Economic development	403,143	91,511	(311,632)	(56,720)
Interest on long-term debt	25,767	–	(25,767)	(31,287)
Business-type activities				
Water	1,843,530	2,271,072	427,542	301,961
Sewer	1,560,796	1,955,474	394,678	169,250
Surface water management	453,727	639,747	186,020	178,955
Recycling	144,541	142,360	(2,181)	(624)
Total net (expense) revenue	$ 9,272,610	$ 6,471,386	(2,801,224)	(2,964,656)
General revenues				
Property taxes			3,094,036	3,095,488
Tax increment collections			466,280	431,060
Franchise taxes			96,820	94,532
Unrestricted investment earnings			(192,432)	265,907
Total general revenues			3,464,704	3,886,987
Change in net position			$ 663,480	$ 922,331

One of the goals of this statement is to provide a side-by-side comparison to illustrate the difference in the way the City's governmental and business-type operations are financed. The table clearly illustrates the dependence of the City's governmental operations on general revenues, such as property taxes and unrestricted grants. It also shows that, for the most part, the City's business-type activities are generating sufficient program revenues (service charges and program-specific grants) to cover expenses. This is critical given the current downward pressures on the general revenue sources.

LEGISLATIVE UPDATES

Despite an improving economy, the 2013 Legislature faced the familiar prospect of having to address a significant projected deficit in order to adopt a balanced budget for the next biennium. The November 2012 financial forecast projected a deficit of $1.1 billion in the state General Fund for the 2014–2015 biennium, which was revised down to a $627 million deficit in the February 2013 forecast. Even with this challenge, there was an expectation that with one political party holding the Governor's office and majorities in both the House and Senate, this biennial budget agreement would be reached more quickly and easily than the previous one, which featured numerous vetoes, a special session, and the longest shutdown of non-essential state government services in Minnesota history. While in the end there was no special session or government shutdown, the 2013 session still stretched until the final day allowable under the state constitution, with the last bill passed at midnight.

The following is a summary of recent legislative activity affecting the finances of Minnesota cities in 2013 and into the future:

Local Government Aid (LGA) – The state-wide LGA appropriation for fiscal 2013 was set to increase about 2.8 percent to $426.4 million. However, the 2012 Legislature froze 2013 LGA payments at 2012 levels for cities with a population of 5,000 or more. For cities with populations below 5,000, 2013 LGA was the greater of their 2012 aid or the amount they would have received for 2013 under existing law.

The 2013 Legislature completely overhauled the LGA formula for fiscal year 2014 and thereafter, creating a three-tiered formula that includes separate "need factor" calculations for cities with populations under 2,500, between 2,500 and 10,000, or over 10,000. The new formula simplifies the LGA calculation, and is designed to reduce the volatility of the LGA distribution by limiting the amount it may decline in a given year. Under the new formula, each city's LGA distribution for 2014 will be no less than their 2013 LGA. Beginning in 2015, any reduction to a city's LGA distribution will be limited to the lesser of $10 per capita, or 5 percent of their previous year net tax levy. For cities that gain under the new formula, the increases will be distributed proportionate to their unmet need, as determined by the new "need factor" calculations. The state-wide LGA appropriation is $507.6 million for fiscal 2014, $509.1 million for 2015, and $511.6 million for fiscal 2016 and thereafter.

Levy Limits – A levy limit for city property tax levies payable in 2014 was established for all cities with populations exceeding 2,500. The levy limit base is the certified levy (excluding special levies) plus the certified LGA for taxes payable in fiscal 2012 or 2013, whichever is greater, increased by 3 percent. The levy limit is equal to the base, less the city's certified LGA for fiscal 2014. Levies for special purposes such as debt service, abatements, or voter-approved purposes, are not subject to this limitation.

Market Value Definitions – A number of levy, tax, spending, debt, and similar limits that had previously been computed based on "market value" or "taxable market value" must now be computed based on "estimated market value." This change was enacted to eliminate the effects of the homestead market value exclusion established in 2011.

Levy Authority for Watershed Management Plan – Cities are granted the authority to levy taxes to provide funding for the implementation of a comprehensive watershed management plan.

Tax Status of Leased Tax-Exempt Property – Tax-exempt property owned by a political subdivision and held under a lease for a term of at least one year, or under a contract for the purchase thereof, is considered to be the property of the person holding it for all purposes of taxation. This change makes the tax treatment of leased property owned by local governments consistent with leased property owned by the federal government.

Tax Increment Financing (TIF) – A number of changes and clarifications were made to rules governing the use of TIF, including:

- The prohibition on using tax increments for improvements or equipment primarily of a decorative or aesthetic nature, or with costs twice as high due to the selection of materials or designs compared to more commonly used improvements or equipment, is eliminated.
- The four-year rule originally applying to TIF Districts certified between January 1, 2005 and April 20, 2009 is extended through December 31, 2016.
- Development authorities may elect to reduce the original net tax capacity of qualifying TIF districts for the effects of the homestead market value exclusion that replaced the homestead tax credit program.
- Taxes paid by captured tax capacity of TIF districts that are attributable to the new general education levy authorized by the 2013 Legislature, will be paid to the school district that imposes the levy.

Park Dedication Fees – A clarification was made to define the basis on which a city calculates a park dedication fee charged to a developer in lieu of dedicating land for park usage. The fee must be calculated on the fair market value of the land as annually determined by the city based on tax valuation or other relevant data. The new law also provides a method for resolving valuation disputes through negotiation or the use of independent appraisals of land in the same land use category.

Host Community Economic Development Grants – A new program was created that will provide grants for the acquisition and improvement of publicly owned capital assets for metro-area cities that host waste disposal facilities. No local matching funds are required.

Change to Small Cities Development Block Grants – The Minnesota Department of Employment and Economic Development is now allowed to provide a forgivable loan through the Small Cities Development Block Grant Program directly to a private enterprise. The city in which the private enterprise is located is no longer required to submit an application, only a resolution of support.

Wastewater and Stormwater Funding – Several changes were made to wastewater and stormwater grant and loan programs administered by the Public Facilities Authority. The changes include expanded eligibility for some programs, and increased grant or loan ceilings for others.

Sales Tax Exemption – Cities are exempted from paying sales tax on qualifying purchases, effective for purchases made on or after January 1, 2014. This exemption does not include purchases of goods or services to be used as inputs to goods or services cities provide to the public that are generally provided by a private business, such as liquor stores, golf courses, marinas, or fitness centers.

Cities with a population over 500 will be required to include a property tax savings report along with its proposed 2013 payable 2014 property tax levy certification, with the amount of sales or use taxes paid or estimated to have been paid in fiscal 2012. Cities must also discuss the savings resulting from the sales tax exemption at their fall truth-in-taxation public hearings.

Organized Solid Waste Collection – The process for imposing the city-organized collection of solid waste was streamlined and better defined. The previous 180-day process for cities to adopt organized collection of solid waste was eliminated. The process now begins with a 60-day period in which cities may negotiate with collectors currently operating in the city, thereby giving them the first opportunity to develop a proposal for organized collection. If the 60-day negotiation period ends without an agreement, a city may continue the process by passing a resolution to form a committee to study the methods of organizing collection and make recommendations. A city must provide public notice and hold at least one public hearing before deciding to implement organized collection.

Pensions – An omnibus pension bill was passed that made a number of changes to both state-wide pension plans and single employer relief associations, including:

- Changes to the Public Employees Retirement Association (PERA) General Plan:
    - The "average salary" for determining surviving spouse and dependent benefits was redefined.
    - A number of clarifications were made to what constitutes "salary" for plan purposes.
    - Changes were made to the level of annual post-retirement adjustments, which will vary based on the funding level of the plan.
- Changes to the PERA Police and Fire Plan:
    - Increases employee contribution rate from 9.6 percent of salary to 10.2 percent for fiscal 2014, and 10.8 percent for fiscal 2015 and thereafter.
    - Increases employer contribution rate from 14.4 percent of salary to 15.3 percent for fiscal 2014, and 16.2 percent for fiscal 2015 and thereafter.
    - A 20-year proportional vesting period was established for new hires beginning in 2014, under which the member becomes 50 percent vested after 10 years, and vests an additional 5 percent annually until fully vested at 20 years.
    - The retirement annuity formula calculation was changed to incorporate the effect of the new 20-year vesting period, and a new cap of 33 years on allowable service time included in the annuity calculation.
    - The early retirement reduction factor was increased from the current 2.4 percent per year to 5 percent, phased in over a 5-year period beginning July 1, 2014.
    - Changes were made to the level of annual post-retirement adjustments, which will vary based on the funding level of the plan.
- Changes to single employer relief associations:
    - The threshold of assets at which police relief associations and salaried or volunteer fire relief associations must prepare financial statements and have them audited by an independent auditor was raised from $200,000 to $500,000.
    - Volunteer firefighter relief associations are now required to pay a supplemental survivor benefit whenever it pays a survivor benefit, regardless of whether it is authorized in the association bylaws.
    - Any change to the interest rate paid during the deferral period of lump-sum service pensions must be approved by the governing body of the city or independent firefighting corporation to which the association is related.

In addition, a new supplemental state aid was created to provide funding for pension plans. An annual allotment of $15.5 million will be distributed among the PERA Police and Fire Plan ($9 million), municipal volunteer firefighter associations ($5.5 million allocated based on proportionate share of fire state aid), and the Minnesota State Retirement System State Patrol Plan ($1 million).

Expansion of Debt Authority – Several changes were made to expand the allowable uses of certain types of debt, including:

- Home rule charter city or statutory city capital notes are allowed to be used for the purchase of application development services and training related to the use of computer hardware and software.
- Capital improvement program (CIP) bonds are allowed to be used for expenditures incurred before the adoption of the CIP, if the expenditures are included in the plan.
- Street reconstruction bonds are allowed to be used for bituminous overlay projects, which previously had not been included in the definition of reconstruction.

Authorized Investments – The list of authorized investments for cities was expanded to include: revenue obligations issued by local governments without levy authority that are rated AA or better; short-term (13 month maturity or less) obligation issued by a school district that is either rated in the highest credit rating category or covered by the State of Minnesota Credit Enhancement Program; and short-term (18 month maturity or less) guaranteed investment contracts when the issuer's or guarantor's short-term debt is rated in the highest rating category, even if their long-term debt is rated below the top two rating categories.

Elections – The Legislature passed an omnibus elections policy bill that made a number of changes and clarifications to election requirements, including:

- Establishing "no excuse" absentee balloting;
- Increasing the time for counting absentee ballots from 4 days prior to the election to 7;
- Reducing the number of people a voter may vouch for in a polling place from 15 to 8;
- Eliminating the requirement to have at least one telecommunications device for deaf voter registration in every city of the first, second, or third class;
- Requiring that the municipal clerk designated to administer absentee ballots also be responsible for the administration of a "ballot board";
- Reducing the number of election judges required in a precinct for elections other than a general election from 4 to 3, for precincts with more than 500 voters; and allowing the minimum number of three election judges for all elections including general elections for precincts with less than 500 registered voters;
- Modifying the vote differentials requiring publically funded recounts to 0.25 percent in elections where more than 50,000 votes are cast, and 0.5 percent for elections in which between 400 and 50,000 votes are cast;
- Amending the time period in which cities are prohibited from holding a special election from the first 40 days following a general election to the first 56 days;
- Increasing the number of days' notice a city clerk must provide to a county auditor before holding a municipal election from 67 to 74 days; and
- Establishing a pilot program and task force for the use of electronic rosters of voters.

Alternative Bid Publication for Projects Funded by Special Assessments – A technical change was made to eliminate duplicative publication requirements for projects funded with special assessments. The definition of "recognized industry trade journal" was broadened to include websites or electronic publications, thereby eliminating circumstances that were forcing cities utilizing an alternative electronic publication method to also publish written notice for certain projects.

Met Council Allocated Costs – A change was made to allow cities that are allocated costs by the Met Council to request the cost be deferred, or to be paid over time on a payment schedule with interest as agreed to by the Met Council.

Liquor Licensing – An omnibus liquor bill was passed that made several changes to liquor licensing and distribution. Among the changes are: authorizing cities with municipal liquor operations to issue brewer taproom licenses that allow consumption on the premises or adjacent to malt liquor breweries; authorizing cities to issue brewers a license for off-sale of malt liquor packaged by the brewer; providing for the sale of malt-liquor educator licenses that will allow malt liquor tastings and education to be conducted similar to wine tastings; and allowing micro-distilleries to provide product samples on site.

Tax-Exempt Holding Period for Development Property – The tax exempt holding period for city-owned land held for development is increased from 9 to 15 years for property acquired between January 1, 2000 and December 31, 2010, or for property located in a city outside of the metro area with a population under 20,000.

Citizen Contact Information Classified as Private Data – Citizen contact information submitted to cities in order to receive certain notifications or to subscribe to the city's electronic publications, such as phone numbers or email addresses, is now classified as private data. The names of people on such lists remain public information.

Criminal History and Background Checks – Cities are authorized to perform criminal history checks on applicants for: city employment, volunteer positions, or a license that does not otherwise subject the applicant to a criminal history check. Such criminal history checks may not be substituted for statutorily mandated background checks.

Background checks are now required for all fire department applicants, and are allowed for current fire department employees. The fire chief is also required to perform criminal history record checks of applicants.

ACCOUNTING AND AUDITING UPDATES

GASB STATEMENT NO. 67 – FINANCIAL REPORTING FOR PENSION PLANS – AN AMENDMENT OF GASB STATEMENT NOS. 25 AND 50

The primary objective of this statement is to improve financial reporting by state and local government pension plans. GASB Statement No. 67 replaces the requirements of GASB Statement Nos. 25 and 50 for pension plans that are administered through trusts or equivalent arrangements that meet the following criteria: contributions from employers and nonemployer contributing entities to the pension plan and earnings on those contributions are irrevocable; pension plan assets are dedicated to providing pensions to plan members in accordance with the benefit terms; and pension plan assets are legally protected from the creditors of employers, nonemployer contributing entities, and the pension plan administrator. If the plan is a defined benefit pension plan, plan assets also are legally protected from creditors of the plan members. The requirements of GASB Statement Nos. 25 and 50 remain applicable to pension plans that are not administered through trusts covered by the scope of this statement and to defined contribution plans that provide post-employment benefits other than pensions. The statement makes a number of changes in the financial statement presentation, measurement, and required disclosures relating to the reporting of these types of pension plans. This statement is effective for financial statements for fiscal years beginning after June 15, 2013. Earlier application is encouraged.

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

The primary objective of this statement is to improve accounting and financial reporting by state and local governments for pensions. This statement replaces the requirements of GASB Statement Nos. 27 and 50, as they relate to pensions that are provided through pension plans administered as trusts or equivalent arrangements that meet certain criteria (as described earlier for GASB Statement No. 67). The requirements of GASB Statement Nos. 27 and 50 remain applicable for pensions that are not covered by the scope of this statement.

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

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

GASB STATEMENT NO. 69 – GOVERNMENT COMBINATIONS AND DISPOSALS OF GOVERNMENT OPERATIONS

This statement provides accounting and financial reporting guidance, including disclosure requirements, for government combinations and disposals of government operations. Government combinations include mergers, acquisitions, and transfers of operations. Included within the scope of this statement are combinations of governmental entities, or combinations of governmental entities with nongovernmental entities (such as a nonprofit entity), as long as the new or continuing organization is a government. This statement does not apply to combinations in which a government acquires an organization that continues to exist as a separate entity, or acquires an equity interest in an organization that remains legally separate from the acquiring government. A disposal of operations occurs when a government either transfers or sells specific operations. The provisions of this statement are effective for financial statements for periods beginning after December 15, 2013. Earlier application is encouraged.

CHANGES TO REQUIREMENTS FOR FEDERAL GRANTS

In December 2013, the U.S. Office of Management and Budget (OMB) issued "Uniform Administrative Requirements, Cost Principles, and Audit Requirements for Federal Audits," which supersedes all or parts of eight OMB circulars; consolidating federal cost principles, administrative principles, and audit requirements in one document. The "Super Circular" includes a number of significant changes to the federal Single Audit process, including an increase in dollar threshold for requiring a Single Audit, changes to the thresholds and process used for determining major programs, a reduction in the percentage of expenditures required to be covered by a Single Audit, revised criteria for determining low-risk auditees, and an increase in the threshold for reporting questioned costs. The draft version of this guidance also included proposed reductions in the number of compliance requirements to be tested in a Single Audit, but final guidance on those changes will not be available until an updated compliance supplement is issued in 2014.

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