

Management Report
for
City of Farmington, Minnesota
December 31, 2017

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PRINCIPALS

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To the City Council and Management
City of Farmington, Minnesota

We have prepared this management report in conjunction with our audit of the City of Farmington, Minnesota's (the City) financial statements for the year ended December 31, 2017. We have organized this report into the following sections:

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

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

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

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

Minneapolis, Minnesota
May 14, 2018

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AUDIT SUMMARY

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

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

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

PLANNED SCOPE AND TIMING OF THE AUDIT

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

AUDIT OPINION AND FINDINGS

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

- We have issued an unmodified opinion on the City's basic financial statements.
- We reported one matter involving the City's internal control over financial reporting that we consider to be a material weakness. 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 that are required to be reported under *Governmental Auditing Standards*.
- We reported no findings based on our testing of the City's compliance with Minnesota laws and regulations.

SIGNIFICANT ACCOUNTING POLICIES

Management is responsible for the selection and use of appropriate accounting policies. The significant accounting policies used by the City are described in Note 1 of the notes to basic financial statements.

No new accounting policies were adopted and the application of existing policies was not changed during the year ended December 31, 2017; however, the City implemented the following governmental accounting standards during the fiscal year:

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

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

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:

- **Net Other Post-Employment Benefit (OPEB) and Pension Liabilities** – The City has recorded liabilities and activity for other post-employment benefits (OPEB) and pension benefits. These obligations are calculated using actuarial methodologies described in GASB Statement Nos. 45 and 68. These actuarial calculations include significant assumptions, including projected changes, healthcare insurance costs, investment returns, retirement ages, proportionate share, and employee turnover.
- **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, compensated absence balances, and the likelihood that sick leave will ultimately be paid at termination.

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.

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 14, 2018.

MANAGEMENT CONSULTATIONS WITH OTHER INDEPENDENT ACCOUNTANTS

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

OTHER AUDIT FINDINGS OR ISSUES

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

OTHER MATTERS

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

GOVERNMENTAL FUNDS OVERVIEW

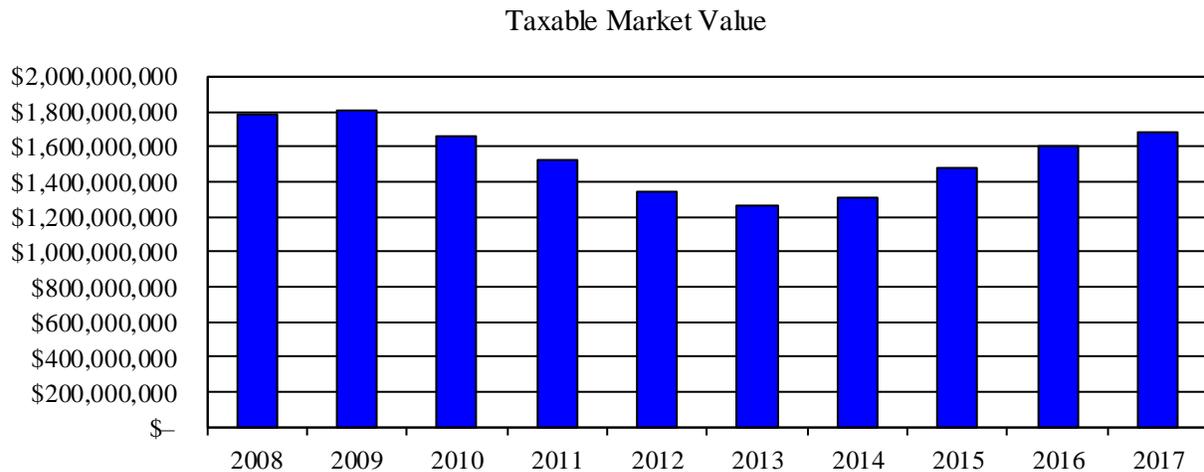
This section of the report provides you with an overview of the financial trends and activities of the City's governmental funds, which includes the General, special revenue, debt service, and capital project funds. These funds are used to account for the basic services the City provides to all of its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

PROPERTY TAXES

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

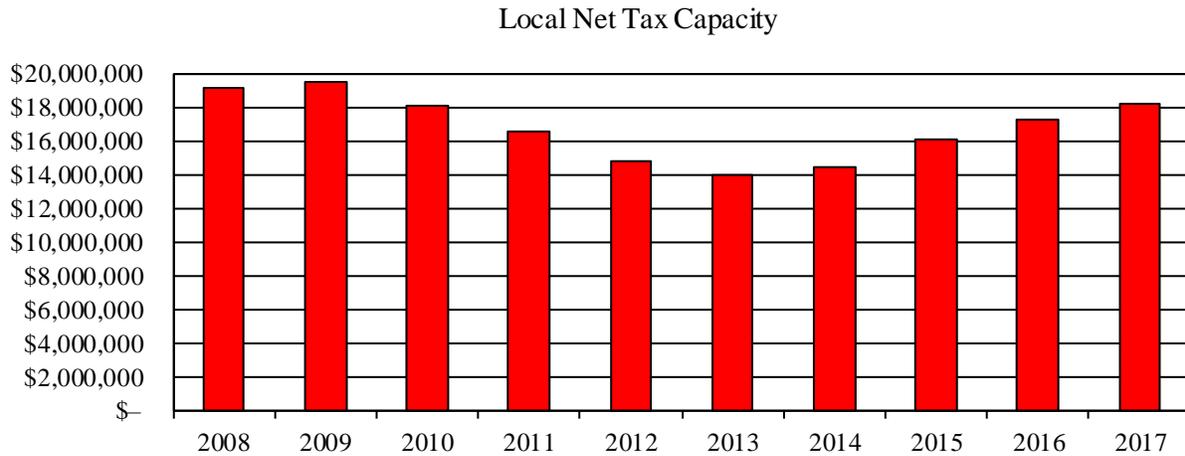
The total market value of property in Minnesota cities increased about 5.6 percent for the 2017 levy year, which followed an increase of 5.7 percent for levy year 2016. The market values used for levying property taxes are based on the previous fiscal year (e.g., market values for taxes levied in 2017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

The City's taxable market value increased 8.5 percent for taxes payable in 2016 and 5.2 percent for taxes payable in 2017. 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 its 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 7.9 percent for taxes payable in 2016 and 5.0 percent for taxes payable in 2017.

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, along with comparative state-wide and metro area average rates from the two most recent years for which the information is available:

Rates Expressed as a Percentage of Net Tax Capacity							
	<u>All Cities State-Wide</u>		<u>Seven-County Metro Area</u>		<u>City of Farmington</u>		
	2015	2016	2015	2016	2015	2016	2017
Average tax rate							
City	46.9	46.5	43.4	43.0	61.5	59.2	58.8
County	44.7	44.1	42.9	42.3	29.6	28.6	28.0
School	27.1	27.5	28.3	28.6	53.5	57.6	54.2
Special taxing	<u>6.9</u>	<u>6.9</u>	<u>8.8</u>	<u>8.7</u>	<u>3.7</u>	<u>3.8</u>	<u>3.7</u>
Total	<u><u>125.6</u></u>	<u><u>125.0</u></u>	<u><u>123.4</u></u>	<u><u>122.6</u></u>	<u><u>148.3</u></u>	<u><u>149.2</u></u>	<u><u>144.7</u></u>

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

The City’s portion of the tax rate is higher than the average Minnesota city. The City has historically received more of its governmental fund revenue from property taxes than the average Minnesota city, due to the lower than average amount of aid it typically receives from the state.

GOVERNMENTAL FUND BALANCES

The following table summarizes the changes in the fund balances of the City's governmental funds during the year ended December 31, 2017, presented both by fund balance classification and by fund:

Governmental Funds Change in Fund Balance			
	Fund Balance as of December 31,		Increase (Decrease)
	<u>2017</u>	<u>2016</u>	
Fund balances of governmental funds			
Total by classification			
Nonspendable	\$ 34,529	\$ 33,872	\$ 657
Restricted	4,071,837	16,959,150	(12,887,313)
Committed	6,373,022	5,158,828	1,214,194
Unassigned	<u>5,666,183</u>	<u>5,031,529</u>	<u>634,654</u>
Total – governmental funds	<u>\$ 16,145,571</u>	<u>\$ 27,183,379</u>	<u>\$ (11,037,808)</u>
Total by fund			
General	\$ 5,700,712	\$ 5,065,291	\$ 635,421
Debt Service	3,731,347	16,663,140	(12,931,793)
State Aid Construction Capital Projects	283,919	396,538	(112,619)
Storm Water Trunk Capital Projects	2,856,025	2,603,763	252,262
Permanent Improvement Revolving Capital Projects	165,526	151,184	14,342
Maintenance Capital Projects	903,238	136,382	766,856
Nonmajor	<u>2,504,804</u>	<u>2,167,081</u>	<u>337,723</u>
Total – governmental funds	<u>\$ 16,145,571</u>	<u>\$ 27,183,379</u>	<u>\$ (11,037,808)</u>

In total, the fund balances of the City's governmental funds decreased by \$11,037,808 during the year ended December 31, 2017.

The decrease in restricted fund balances of \$12,887,313 relates primarily to the refunding or early call of several outstanding debt issues. The City retired \$10.0 million of debt principal using refunding bond proceeds in addition to \$6.4 million in debt principal paid from available resources.

Committed fund balance increased \$1,214,194, with the majority of the increase in resources committed for future capital improvements in the Storm Water Trunk and Maintenance Capital Projects Funds.

Unassigned fund balance increased \$634,654 due primarily to positive operating results in the General Fund.

GOVERNMENTAL FUNDS REVENUE AND EXPENDITURES

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

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

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

Governmental Funds Revenue per Capita					
With State-Wide Averages by Population Class					
Year	State-Wide		City of Farmington		
	December 31, 2016		2015	2016	2017
Population	10,000–20,000	20,000–100,000	22,451	22,343	22,343
Property taxes	\$ 432	\$ 455	\$ 511	\$ 530	\$ 545
Tax increments	26	42	–	–	–
Franchise and other taxes	43	45	12	12	12
Special assessments	44	59	29	24	24
Licenses and permits	33	42	17	29	19
Intergovernmental revenues	275	152	93	73	73
Charges for services	92	103	37	48	42
Other	57	54	17	24	19
Total revenue	\$ 1,002	\$ 952	\$ 716	\$ 740	\$ 734

The City's governmental fund revenues for 2017 were \$16,393,012, a decrease of \$182,120 (1.1 percent), or \$6 per capita, from the prior year. Revenue from property taxes was \$15 per capita higher than the prior year due to a 3.5 percent increase in the City's adopted levy. Licenses and permits were \$10 per capita lower than last year, mainly as a result of a decrease in building permits. Charges for services declined \$6 per capita from last year, mainly due to lower revenues from storm water and sanitary sewer trunk fees.

The City has historically received more of its governmental fund revenue from property taxes than the average Minnesota city, due to the lower than average amount of aid it typically receives from the state and the debt levies for the City's capital improvement bonds.

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:

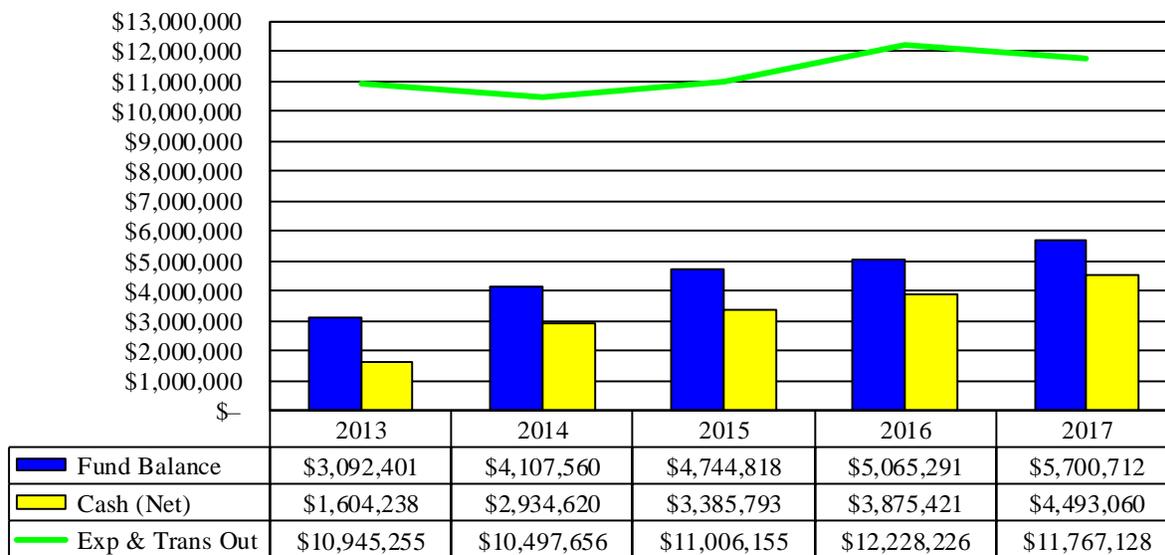
Governmental Funds Expenditures per Capita With State-Wide Averages by Population Class					
Year	State-Wide		City of Farmington		
	December 31, 2016		2015	2016	2017
Population	10,000–20,000	20,000–100,000	22,451	22,343	22,343
Current					
General government	\$ 114	\$ 97	\$ 87	\$ 89	\$ 92
Public safety	250	273	229	237	248
Streets and highways	123	95	88	90	107
Culture and recreation	109	95	69	68	71
All other	77	91	4	2	2
	<u>673</u>	<u>651</u>	<u>477</u>	<u>486</u>	<u>520</u>
Capital outlay and construction	370	301	209	123	26
Debt service					
Principal	163	115	129	197	286
Interest and fiscal charges	38	34	46	49	37
	<u>201</u>	<u>149</u>	<u>175</u>	<u>246</u>	<u>323</u>
Total expenditures	<u>\$ 1,244</u>	<u>\$ 1,101</u>	<u>\$ 861</u>	<u>\$ 855</u>	<u>\$ 869</u>

Total expenditures in the City’s governmental funds for 2017 were \$19,396,070, an increase of \$275,738 (1.4 percent), or \$14 per capita, from the previous year. Current governmental expenditures for 2017 were \$34 per capita higher than last year, mainly in the areas of public safety (\$11 per capita) and streets and highways (\$17 per capita). Capital outlay and construction expenditures were \$97 per capita lower than last year, primarily due to a reduction in street improvement project activity. This was partially offset by a \$77 per capita increase in debt service, due to the City electing to refund or exercise early call provisions on several debt issues, financed in part with available internal resources.

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, streets and highway 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,



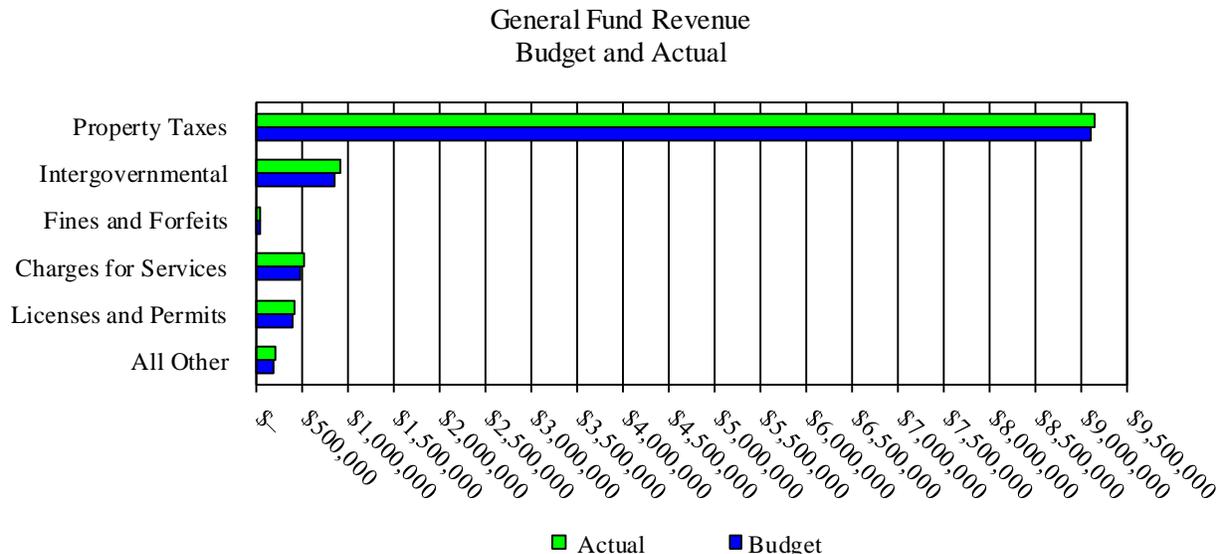
The City's General Fund cash and investments, net of interfund borrowing at December 31, 2017 was \$617,639 higher than at the previous year-end. Total fund balance at December 31, 2017 of \$5,700,712 represented an increase of \$635,421 from the prior year, as compared to a breakeven budget.

As the graph illustrates, the City has generally been able to maintain healthy cash and fund balance levels as the volume of financial activity has grown. 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 about 81.3 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.

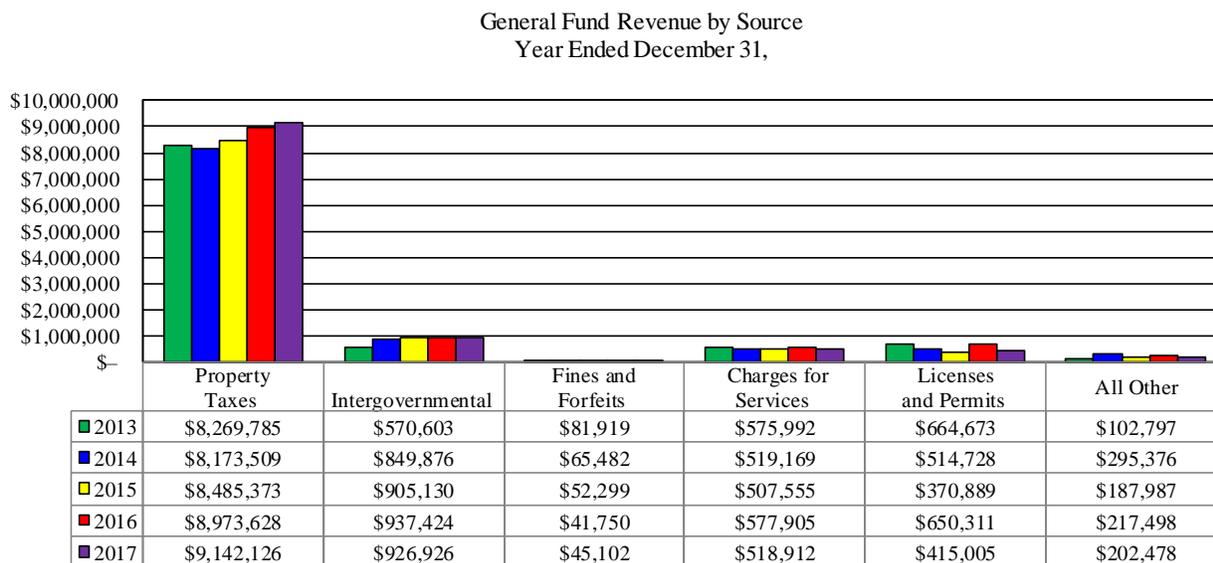
The City's unassigned General Fund balance of \$5,666,183 at the end of the 2017 fiscal year represented approximately 44.9 percent of budgeted expenditures and transfers out for 2018. This is within the City's policy that calls for maintaining an unassigned fund balance of between 40.0–50.0 percent of the subsequent year's budgeted expenditures and transfers out.

The following graph reflects the City's General Fund revenue sources for 2017 compared to budget:



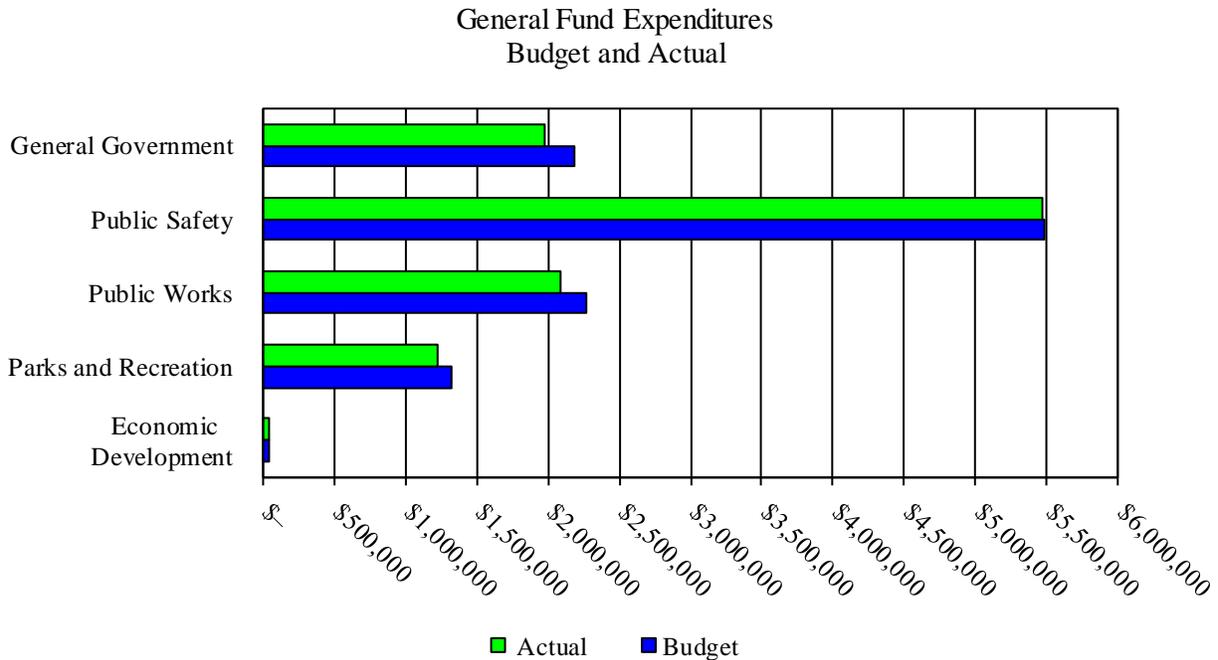
General Fund revenue for 2017 was \$11,250,549, which was \$197,409 (1.8 percent) more than budget. Property tax revenues were \$46,373 over budget, mainly due to the City not budgeting for collections of prior year delinquent taxes. Intergovernmental revenue exceeded budget by \$79,494, as fire pension and training aid, police aid, and miscellaneous state grants were higher than projected. Charges for services exceeded budget by \$36,962, mainly due to fire charges exceeding expectations. Revenue from licenses and permits were \$17,390 more than budget, as plumbing and heating permits were higher than anticipated. Finally, revenue in the all other category was \$12,088 more than budget.

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



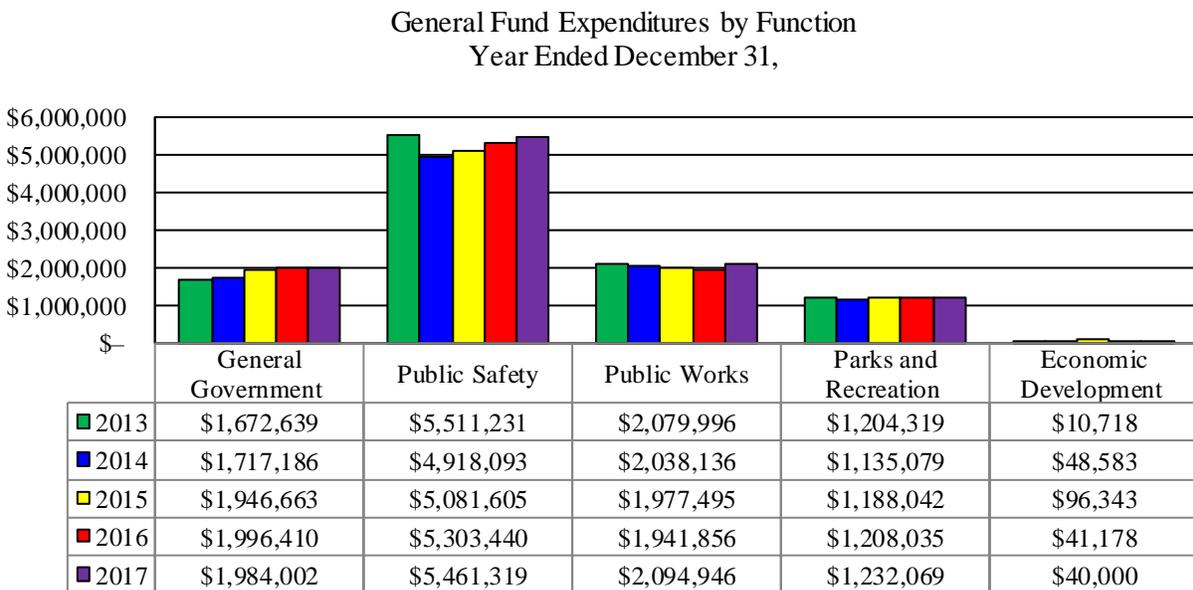
Total General Fund revenue for 2017 was \$147,967 (1.3 percent) lower than last year. Property taxes were \$168,498 higher than last year, due to the increased tax levy. Licenses and permits revenues decreased \$235,306 from last year, due to a decrease in building permits. Charges for services decreased \$58,993, mainly as a result of decreased fire charges.

The following graph illustrates the components of General Fund spending for 2017 compared to budget:



General Fund expenditures for 2017 were \$10,812,336, which was \$478,812 (4.2 percent) under budget. Expenditures were under budget due to milder weather, lower fuel prices, and conservative spending, with the largest savings in general government (\$198,189) and public works (\$173,601).

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



Total General Fund expenditures for 2017 were \$321,417 (3.1 percent) higher than the previous year. The largest increase was in public safety expenditures and public works expenditures, which were \$157,879 and \$153,090 higher than last year.

ENTERPRISE FUNDS OVERVIEW

The City maintains several enterprise funds to account for services the City provides that are financed primarily through fees charged to those utilizing the service. This section of the report provides you with an overview of the financial trends and activities of the City's enterprise funds, which includes the Liquor Operations, Sewer Operations, Solid Waste, Storm Water, Water, and Street Light funds.

ENTERPRISE FUNDS FINANCIAL POSITION

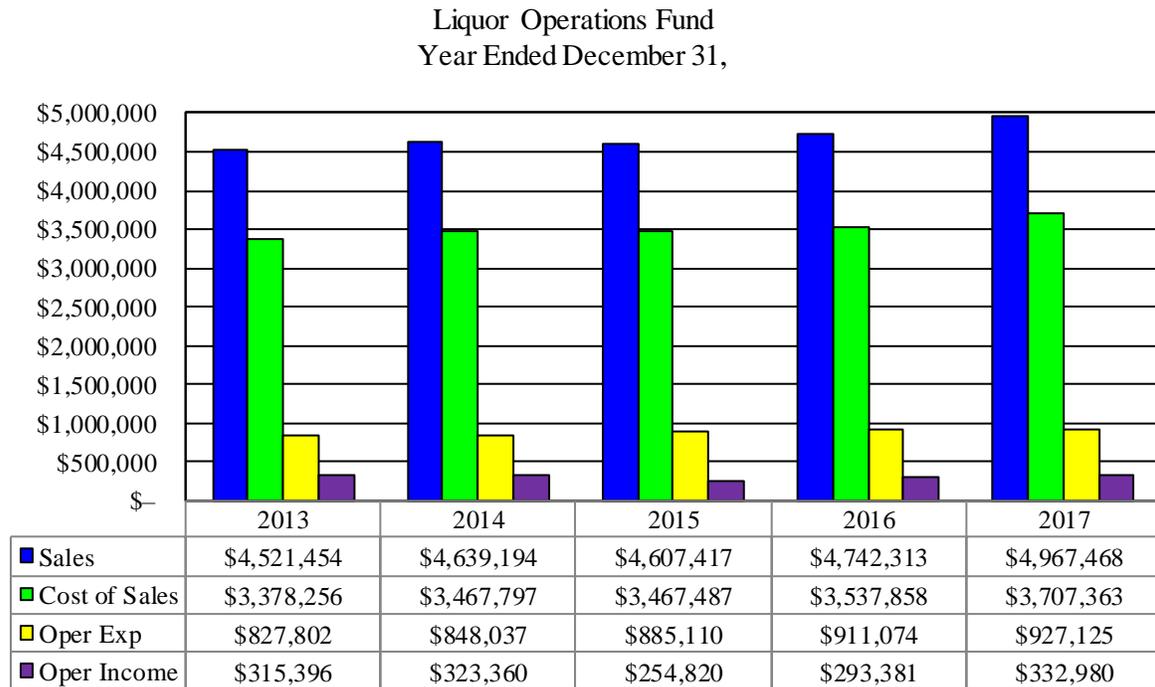
The following table summarizes the changes in the financial position of the City's enterprise funds during the year ended December 31, 2017, presented both by classification and by fund:

Enterprise Funds Change in Financial Position			
	Net Position as of December 31,		Increase (Decrease)
	<u>2017</u>	<u>2016</u>	
Net position of enterprise funds			
Total by classification			
Net investment in capital assets	\$ 51,464,649	\$ 53,225,787	\$ (1,761,138)
Restricted – future drinking water treatment plant	2,238,206	2,231,966	6,240
Unrestricted	<u>13,508,485</u>	<u>12,575,526</u>	<u>932,959</u>
Total – enterprise funds	<u>\$ 67,211,340</u>	<u>\$ 68,033,279</u>	<u>\$ (821,939)</u>
Total by fund			
Liquor Operations	\$ 1,151,713	\$ 1,057,545	\$ 94,168
Sewer Operations	20,703,287	21,148,014	(444,727)
Solid Waste	1,484,225	1,545,800	(61,575)
Storm Water	14,332,928	14,684,236	(351,308)
Water	29,443,667	29,531,419	(87,752)
Street Light	<u>95,520</u>	<u>66,265</u>	<u>29,255</u>
Total – enterprise funds	<u>\$ 67,211,340</u>	<u>\$ 68,033,279</u>	<u>\$ (821,939)</u>

In total, the net position of the City's enterprise funds decreased by \$821,939 during the year ended December 31, 2017. The City's net investment in capital assets decreased \$1,761,138 during the year, due to depreciation. Unrestricted net position increased by \$932,959, as most of the City's enterprise operations had positive operating results prior to transfers out. The enterprise funds transferred a total of \$1,939,974 to the governmental and internal service funds during the year to support the General Fund, help pay for capital improvements, and for debt service.

LIQUOR OPERATIONS FUND

The following graph presents five years of comparative operating results for the City's Liquor Operations Fund:



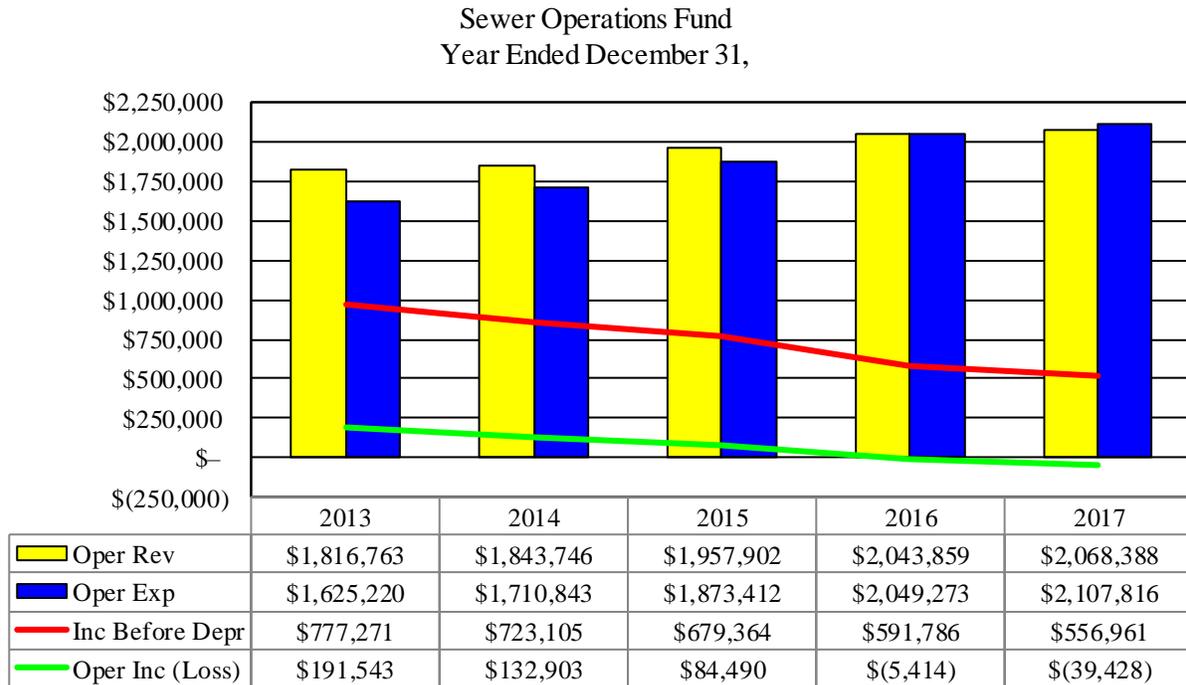
The City's Liquor Operations Fund ended 2017 with an unrestricted net position of \$1,151,713, an increase of \$94,168 from the prior year.

The Liquor Operations Fund had gross sales of \$4,967,468 in 2017, an increase of \$225,155 (4.8 percent) from the previous year. Gross profit was \$1,260,105, about 25.4 percent of sales, which is consistent with the prior year.

Operating expenses for 2017 increased \$16,051 (1.8 percent) from the previous year, mainly due to an increase in professional services.

SEWER OPERATIONS FUND

The following graph presents five years of comparative operating results for the City's Sewer Operations Fund:



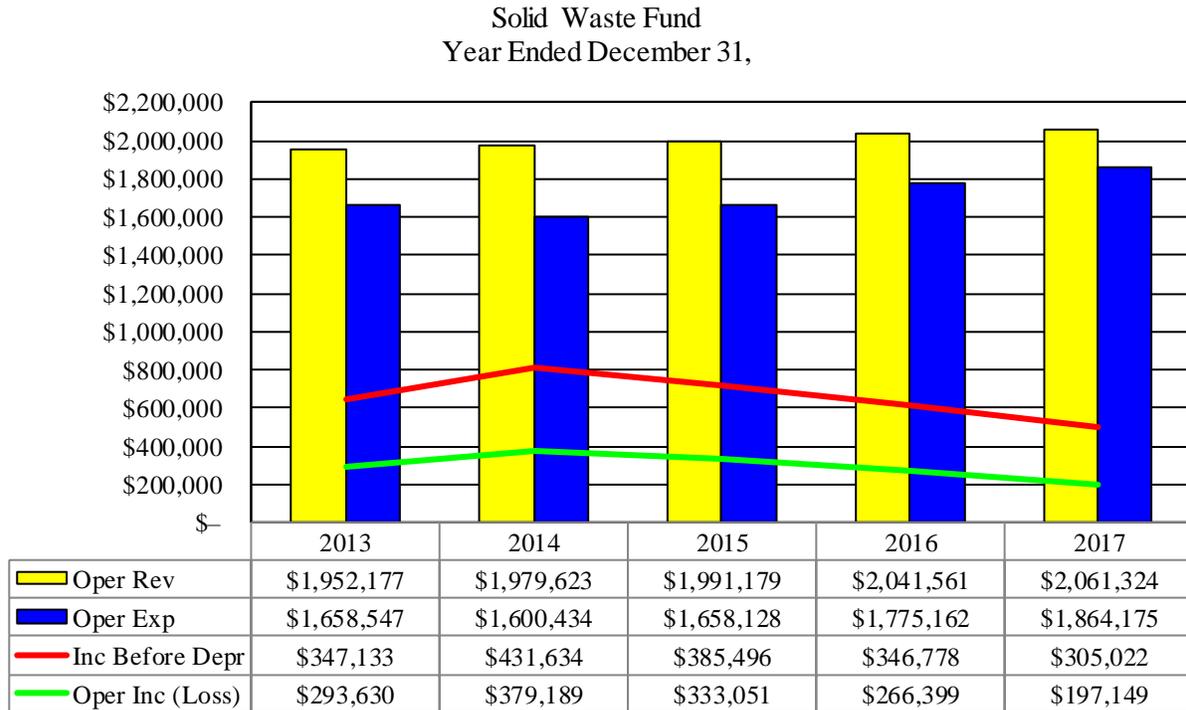
The Sewer Operations Fund ended 2017 with a total net position of \$20,703,287, a decrease of \$444,727 from the prior year due to charges for services not being sufficient to cover depreciation expense. Of this, \$17,371,645 represents the investment in sewer collection system capital assets, leaving an unrestricted net position of \$3,331,642.

Operating revenue in the Sewer Operations Fund increased \$24,529 (1.2 percent) from the prior year, due to an increase in rates and more customers on the system.

Operating expenses for 2017 were \$58,543 (2.9 percent) higher than the previous year. The largest factor contributing to the change was an increase of approximately \$56,000 in disposal fees paid to Metropolitan Council Environmental Services.

SOLID WASTE FUND

The following graph presents five years of comparative operating results for the City's Solid Waste Fund:



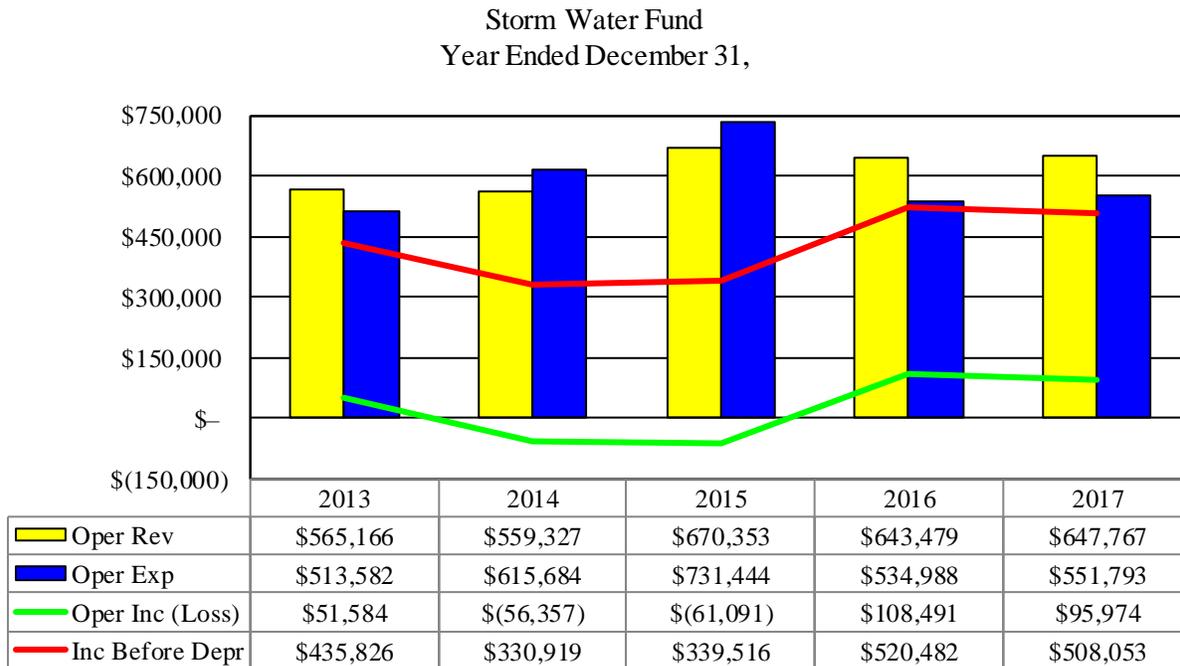
The Solid Waste Fund ended 2017 with a total net position of \$1,484,225, a decrease of \$61,575 from the prior year. Of this, \$219,928 represents the investment in solid waste operation capital assets, leaving an unrestricted net position of \$1,264,297.

Operating revenue in the Solid Waste Fund increased \$19,763 (1.0 percent) from the prior year, due to increases in both tonnage collected and the number of customers.

Operating expenses for 2017 were \$89,013 (5.0 percent) higher than the previous year, mainly due to an increase in tipping fees charged to the City for solid waste disposal.

STORM WATER FUND

The following graph presents five years of comparative operating results for the City's Storm Water Fund:



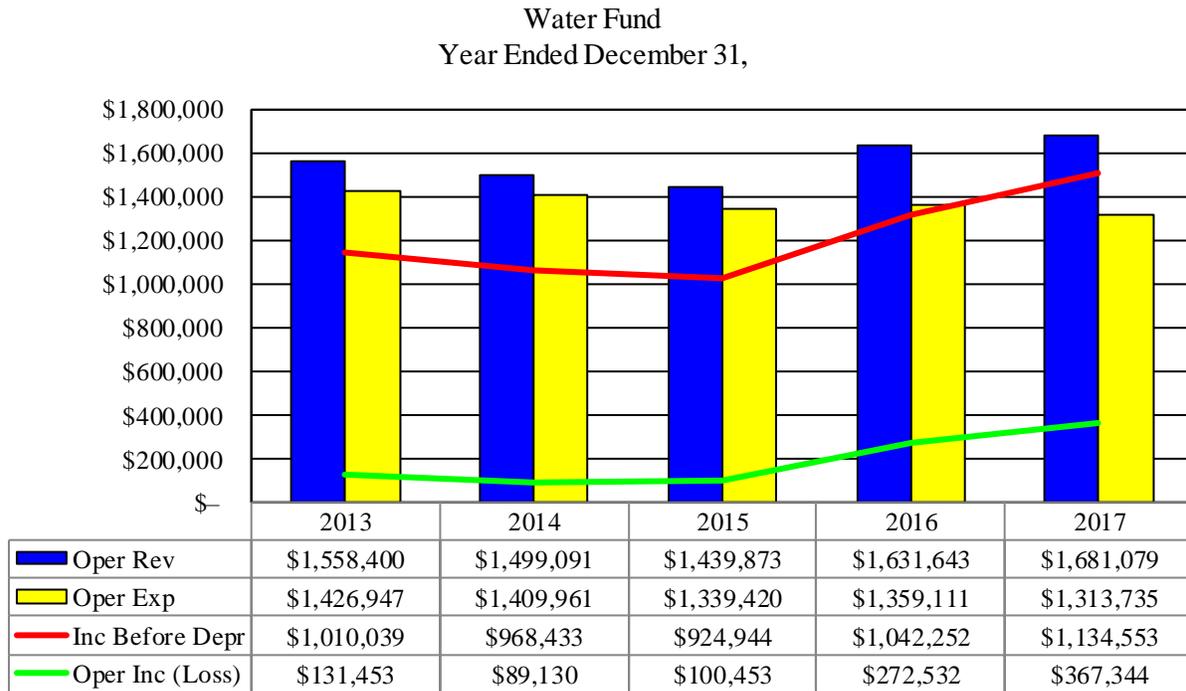
The Storm Water Fund ended 2017 with a total net position of \$14,332,928, a decrease of \$351,308 from the prior year due to charges for services not being sufficient to cover depreciation expense. Of this, \$13,229,318 represents the investment in storm water operation capital assets, leaving an unrestricted net position of \$1,103,610.

Operating revenue in the Storm Water Fund increased \$4,288 (0.7 percent) from the prior year.

Operating expenses for 2017 were \$16,805 (3.1 percent) higher than the previous year, mainly due to an increase in professional services.

WATER FUND

The following graph presents five years of comparative operating results for the City's Water Fund:



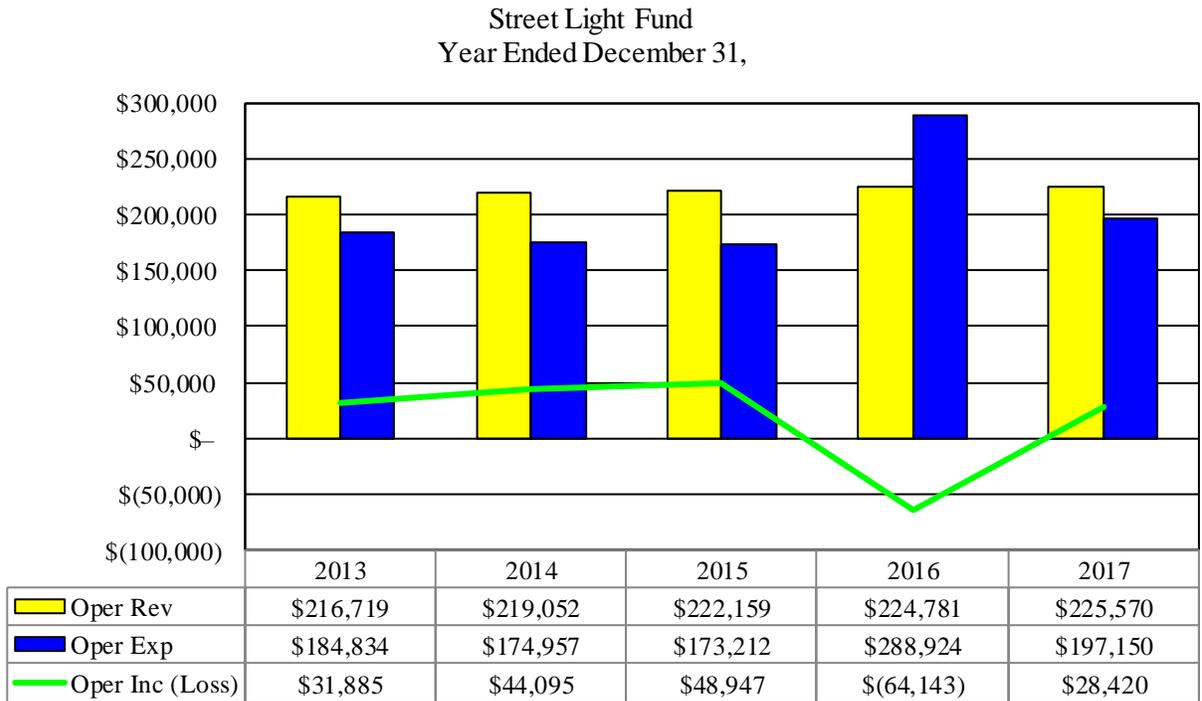
The Water Fund ended 2017 with a total net position of \$29,443,667, a decrease of \$87,752 from the prior year due to charges for services not being sufficient to cover depreciation expense. Of this, \$20,643,758 represents the investment in water distribution system capital assets, \$2,238,206 is restricted for a future drinking water treatment plant, and unrestricted net position is \$6,561,703.

Operating revenue in the Water Fund for 2017 increased \$49,436 (3.0 percent) from the prior year, due to an increase in water rates, partially offset by a decrease in consumption.

Water Fund operating expenses for 2017 were \$45,376 (3.3 percent) lower than the previous year, mainly due to a decrease in professional services.

STREET LIGHT FUND

The following graph presents five years of comparative operating results for the City’s Street Light Fund:



Street Light Fund operating revenue for 2017 increased \$789 (0.4 percent) from the prior year.

Operating expenses were \$91,774 (31.8 percent) lower than the previous year, due to the cost of the City converting to LED lights, as well as the TH-3 Traffic Signal Change Project in the previous year.

Unrestricted net position increased \$29,255 in 2017, ending the year at \$95,520.

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 in capital assets, restricted, and unrestricted.

The following table presents the components of the City's net position as of December 31, 2017 and 2016, for governmental activities and business-type activities:

	As of December 31,		Increase (Decrease)
	2017	2016	
Net position			
Governmental activities			
Net investment in capital assets	\$ 28,820,307	\$ 23,684,773	\$ 5,135,534
Restricted	6,961,837	10,441,391	(3,479,554)
Unrestricted	6,576,959	5,142,435	1,434,524
Total governmental activities	<u>42,359,103</u>	<u>39,268,599</u>	<u>3,090,504</u>
Business-type activities			
Net investment in capital assets	51,464,649	53,225,787	(1,761,138)
Restricted	2,238,206	2,231,966	6,240
Unrestricted	13,508,485	12,575,526	932,959
Total business-type activities	<u>67,211,340</u>	<u>68,033,279</u>	<u>(821,939)</u>
Total net position	<u>\$ 109,570,443</u>	<u>\$ 107,301,878</u>	<u>\$ 2,268,565</u>

The City's total net position at December 31, 2017 was \$2,268,565 higher than the previous year-end. The City's net position increased \$3,090,504 from current year governmental activities and decreased \$821,939 from current year business-type activities.

The governmental activities net investment in capital assets increased \$5.1 million and the restricted portion of governmental net position decreased \$3.5 million in 2017, mainly due to the early repayment of several outstanding debt issues used to acquire the City's related capital assets. The \$1.4 million increase in governmental activities unrestricted net position was primarily related to increases in the unassigned fund balance of the General Fund and fund balances committed for various capital purposes.

The business-type activities net investment in capital assets decreased \$1.8 million in 2017, mainly due to depreciation. The unrestricted portion of the business-type activities net position increased \$932,959, due to the operating results of the City's enterprise operations as previously discussed.

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 positions. These amounts represent the full cost of providing services. The Statement of Activities provides a more comprehensive measure than just the amount of cash that changed hands, as reflected in the fund-based financial statements. This statement includes the cost of supplies used, depreciation of long-lived capital assets, and other accrual-based expenses.

The following table presents the change in the net position of the City for the years ended December 31, 2017 and 2016:

	2017		2016	
	Expenses	Program Revenues	Net Change	Net Change
Net (expense) revenue				
Governmental activities				
General government	\$ 2,178,067	\$ 467,783	\$ (1,710,284)	\$ (1,544,367)
Public safety	6,472,115	883,898	(5,588,217)	(6,055,818)
Public works	3,888,778	1,081,734	(2,807,044)	(4,311,896)
Parks and recreation	1,782,783	619,262	(1,163,521)	(1,199,878)
Economic development	40,000	15,000	(25,000)	(40,000)
Interest on long-term debt	549,075	–	(549,075)	(1,032,748)
Business-type activities				
Liquor	4,634,488	4,967,468	332,980	293,381
Sewer	2,105,901	2,068,388	(37,513)	(7,293)
Solid waste	1,864,175	2,085,324	221,149	311,399
Storm water	571,572	647,767	76,195	108,491
Water	1,313,482	1,681,079	367,597	272,428
Street light	197,150	225,570	28,420	(64,143)
Total net (expense) revenue	<u>\$ 25,597,586</u>	<u>\$ 14,743,273</u>	(10,854,313)	(13,270,444)
General revenues				
Property taxes			12,181,830	11,806,302
Franchise taxes			266,728	275,691
Unrestricted grants			289,854	287,252
Investment earnings			330,058	394,270
Gain on disposal of capital assets			54,408	–
Total general revenues			<u>13,122,878</u>	<u>12,763,515</u>
Change in net position			<u>\$ 2,268,565</u>	<u>\$ (506,929)</u>

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

The difference in the year-to-year net change in the public safety function was mainly due to a smaller increase in the City's proportionate share of the state-wide Public Employees Retirement Association pension plans. The difference in the year-to-year net change in the public works function resulted primarily from a significant uncapitalized street maintenance expense in 2016 attributable to the county's reconstruction of 195th Street.

LEGISLATIVE UPDATES

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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ACCOUNTING AND AUDITING UPDATES

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

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

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

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

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

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

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

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

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

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

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

GASB STATEMENT NO. 84, *FIDUCIARY ACTIVITIES*

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

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

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

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

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

GASB STATEMENT NO. 85, *OMNIBUS 2017*

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

GASB STATEMENT NO. 86, *CERTAIN DEBT EXTINGUISHMENT ISSUES*

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

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

GASB STATEMENT NO. 87, *LEASES*

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

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

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

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

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

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