

Management Report  
for  
City of Plymouth, Minnesota  
December 31, 2018

THIS PAGE INTENTIONALLY LEFT BLANK



PRINCIPALS

Thomas A. Karnowski, CPA  
Paul A. Radosevich, CPA  
William J. Lauer, CPA  
James H. Eichten, CPA  
Aaron J. Nielsen, CPA  
Victoria L. Holinka, CPA/CMA  
Jaclyn M. Huegel, CPA

To the City Council and Management  
City of Plymouth, Minnesota

We have prepared this management report in conjunction with our audit of the City of Plymouth, Minnesota's (the City) financial statements for the year ended December 31, 2018. We have organized this report into the following sections:

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

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

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

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

Minneapolis, Minnesota  
June 10, 2019

THIS PAGE INTENTIONALLY LEFT BLANK

## 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, *GOVERNMENT AUDITING STANDARDS*, AND TITLE 2 U.S. CODE OF FEDERAL REGULATIONS (CFR) PART 200, *UNIFORM ADMINISTRATIVE REQUIREMENTS, COST PRINCIPLES, AND AUDIT REQUIREMENTS FOR FEDERAL AWARDS (UNIFORM GUIDANCE)***

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

### **PLANNED SCOPE AND TIMING OF THE AUDIT**

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

### **AUDIT OPINION AND FINDINGS**

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

- We have issued an unmodified opinion on the City's basic financial statements. Our report included a paragraph emphasizing the City's implementation of Governmental Accounting Standards Board (GASB) Statement No. 75, *Accounting and Financial Reporting for Postemployment Benefits Other Than Pensions* during the year ended December 31, 2018. Our opinion was not modified with respect to this matter.
- 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 that the Schedule of Expenditures of Federal Awards is fairly stated, in all material respects, in relation to the basic financial statements.
- The results of our tests indicate that the City has complied, in all material respects, with the types of compliance requirements that could have a direct and material effect on each of its major federal programs.

- We reported no deficiencies in the City’s internal controls over compliance that we considered to be material weaknesses with the types of compliance requirements that could have a direct and material effect on each of its major federal programs.
- 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, 2018; however, the City implemented the following governmental accounting standards during the fiscal year:

- GASB Statement No. 75, *Accounting and Financial Reporting for Postemployment Benefits Other Than Pensions*, which established new accounting and financial reporting requirements for governments whose employees are provided with other post-employment benefits (OPEB).
- GASB Statement No. 85, *Omnibus 2017*, which addressed issues that have been identified during implementation and application of certain GASB statements.

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

## **ACCOUNTING ESTIMATES AND MANAGEMENT JUDGMENTS**

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

- **Depreciation** – Management’s estimates of depreciation expense are based on the estimated useful lives of the assets.
- **Total OPEB and Net Pension Liabilities** – The City has recorded liabilities and activity for OPEB and pension benefits. These obligations are calculated using actuarial methodologies described in the GASB Statement Nos. 68 and 75. These actuarial calculations include significant assumptions, including projected changes, healthcare insurance costs, investment returns, retirement ages, proportionate share, and employee turnover.
- **Compensated Absences** – Management’s estimate is based on current rates of pay and sick leave balances.
- **Self-Insurance Reserves** – Management’s estimates of self-insurance reserves are based on the estimated liability for incurred but not reported claims.

We evaluated the key factors and assumptions used by management to develop these estimates in determining that they are reasonable in relation to the basic financial statements taken as a whole.

The financial statement disclosures are neutral, consistent, and clear.

## **CORRECTED AND UNCORRECTED MISSTATEMENTS**

Professional standards require us to accumulate all known and likely misstatements identified during the audit, other than those that are clearly trivial, and communicate them to the appropriate level of management. There were no misstatements detected as a result of audit procedures that were material, either individually or in the aggregate, to each opinion unit's financial statements taken as a whole.

## **DIFFICULTIES ENCOUNTERED IN PERFORMING THE AUDIT**

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

## **DISAGREEMENTS WITH MANAGEMENT**

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

## **MANAGEMENT REPRESENTATIONS**

We have requested certain representations from management that are included in the management representation letter dated June 10, 2019.

## **MANAGEMENT CONSULTATIONS WITH OTHER INDEPENDENT ACCOUNTANTS**

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

## **OTHER AUDIT FINDINGS OR ISSUES**

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

## **OTHER MATTERS**

We applied certain limited procedures to the management's discussion and analysis 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 supplementary information accompanying the financial statements and the separately issued Schedule of Expenditures of Federal Awards, which are not RSI. With respect to this 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 supplementary information and Schedule of Expenditures of Federal Awards 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 section and the statistical section, which accompany the financial statements, but are not RSI. Such information has not been subjected to the auditing procedures applied in the audit of the basic financial statements and, accordingly, we do not express an opinion or provide any assurance on it.



## GOVERNMENTAL FUNDS OVERVIEW

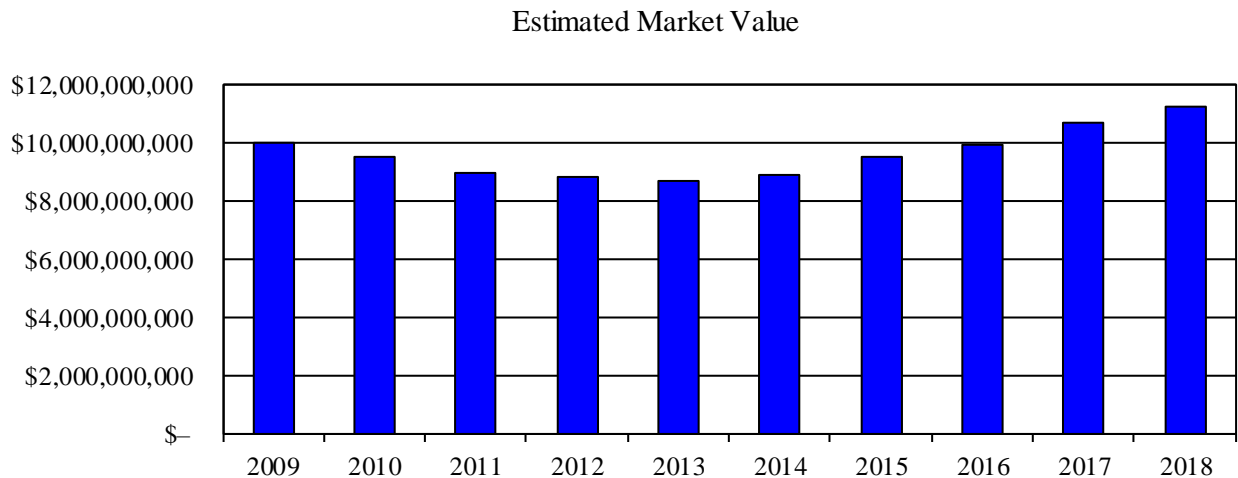
This section of the report provides you with an overview of the financial trends and activities of the City's governmental funds, which includes the General, special revenue, debt service, and capital project funds. These funds are used to account for the basic services the City provides to all of its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

### PROPERTY TAXES

Minnesota cities rely heavily on local property tax levies to support their governmental fund activities. For the 2017 fiscal year, local ad valorem property tax levies provided 41.1 percent of the total governmental fund revenues for cities over 2,500 in population, and 37.4 percent for cities under 2,500 in population. Total certified levies for taxes payable in 2018 by all Minnesota cities increased 6.2 percent from the prior year, and total certified levies for taxes payable in 2019 are projected to increase by 5.6 percent.

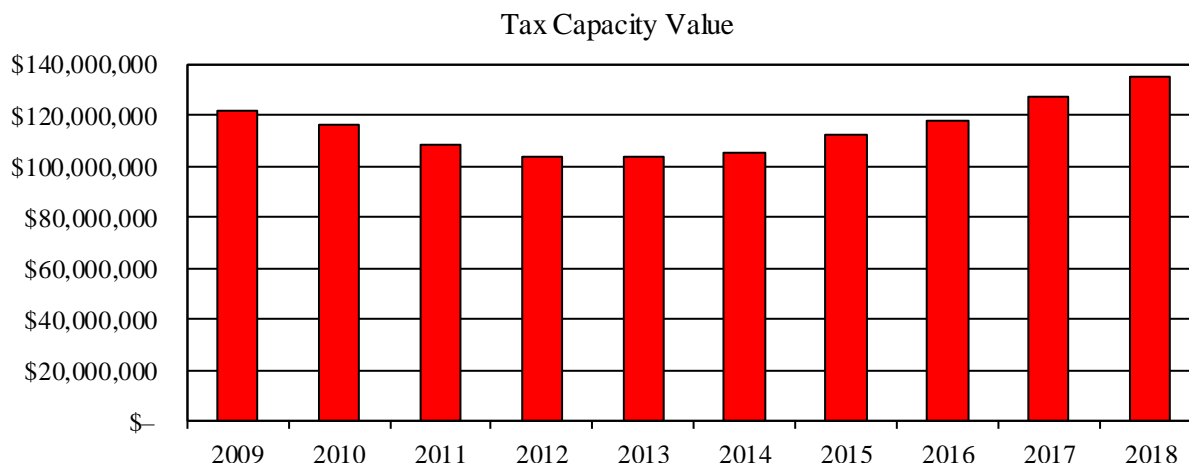
The total market value of property in Minnesota cities increased about 5.6 percent for the 2017 levy year (state-wide market value information for the 2018 levy year was not available at the time this report was issued). The market values used for levying property taxes are based on the previous fiscal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

The City's estimated market value increased 7.4 percent for taxes payable in 2017 and 5.1 percent for taxes payable in 2018. The following graph shows the City's changes in estimated market value over the past 10 years:



Tax capacity is considered the actual base available for taxation. It is calculated by applying the state’s property classification system to each property’s market value. Each property classification, such as commercial or residential, has a different calculation and uses different rates. Consequently, a city’s total tax capacity will change at a different rate than its total market value, as tax capacity is affected by the proportion of the 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 8.1 percent for 2017 and 5.9 percent for 2018.

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



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

<b>Rates Expressed as a Percentage of Net Tax Capacity</b>			
	City of Plymouth		
	2016	2017	2018
<b>Average tax rate</b>			
City	27.3	26.5	26.3
County	45.4	44.1	42.8
School	26.1	26.3	25.5
Special taxing	10.9	10.7	10.3
<b>Total</b>	<u>109.7</u>	<u>107.6</u>	<u>104.9</u>

Increasing property values contributed to the decrease in the total average tax rate as presented in the above table.

Note: The school tax rate is based on Wayzata School’s (District No. 284) tax rate and the special taxing rate uses the Bassett Creek Watershed (District No. 7) due to these two districts servicing the majority of the City.

## GOVERNMENTAL FUND BALANCES

The following table summarizes the changes in the fund balances of the City's governmental funds during the years ended December 31, 2018 and 2017, presented both by fund balance classification and by fund:

<b>Governmental Funds Change in Fund Balance</b>			
	Fund Balance as of December 31,		Increase (Decrease)
	<u>2018</u>	<u>2017</u>	
Fund balances of governmental funds			
Total by classification			
Nonspendable	\$ 144,942	\$ 123,451	\$ 21,491
Restricted	20,047,533	17,821,796	2,225,737
Assigned	40,362,787	39,483,495	879,292
Unassigned	<u>16,509,324</u>	<u>15,709,966</u>	<u>799,358</u>
Total governmental funds	<u>\$ 77,064,586</u>	<u>\$ 73,138,708</u>	<u>\$ 3,925,878</u>
Total by fund			
General	\$ 16,686,422	\$ 15,835,810	\$ 850,612
Transit System	9,163,544	8,019,175	1,144,369
General Capital Projects	6,018,707	5,438,216	580,491
Improvement Projects	2,719,810	3,695,198	(975,388)
Street Replacement	17,705,092	16,343,354	1,361,738
Nonmajor funds	<u>24,771,011</u>	<u>23,806,955</u>	<u>964,056</u>
Total governmental funds	<u>\$ 77,064,586</u>	<u>\$ 73,138,708</u>	<u>\$ 3,925,878</u>

In total, the fund balances of the City's governmental funds increased \$3,925,878 during the year ended December 31, 2018.

The increase in the current year was primarily in the Transit System Fund, with an increase in amounts restricted for the Transit System Fund and the Street Replacement Fund, with an increase in amounts assigned for infrastructure improvements.

## GOVERNMENTAL FUND REVENUES

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

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

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

<b>Governmental Funds Revenue per Capita</b>					
With State-Wide Averages by Population Class					
Year Population	State-Wide		City of Plymouth		
	2016 20,000-100,000	2017 20,000-100,000	2016 75,452	2017 76,882	2018 78,351
Property taxes	\$ 455	\$ 475	\$ 407	\$ 421	\$ 427
Tax increments	42	38	19	21	25
Franchise fees and other taxes	45	48	29	29	29
Special assessments	59	59	-	-	-
Licenses and permits	42	49	62	65	58
Intergovernmental revenues	152	147	201	153	138
Charges for services	103	103	82	68	74
Other	54	48	58	66	67
<b>Total revenue</b>	<b>\$ 952</b>	<b>\$ 967</b>	<b>\$ 858</b>	<b>\$ 823</b>	<b>\$ 818</b>

The City's governmental funds have typically generated 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. The City has less special assessment revenue than the state-wide average, which is due to the way the City finances certain capital projects and, therefore, is not included in the funds presented in the above table.

Total revenues for the City's governmental funds for 2018 were \$64,108,582, an increase of \$784,911 (1.2 percent) from the prior year. On a per capita basis, the City's governmental funds revenue for 2018 was \$818, a decrease of \$5 from the prior year, including the effect of a change in estimated population. The most significant change was in intergovernmental revenues, which were \$15 per capita less than the prior year. In 2017, the City recognized more intergovernmental revenues for joint street reconstruction projects. An increase in property taxes and tax increment sources partially offset the decrease in intergovernmental revenues.

## 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:

Year	State-Wide		City of Plymouth		
	2016	2017	2016	2017	2018
Population	20,000–100,000	20,000–100,000	75,452	76,882	78,351
<b>Current</b>					
General government	\$ 97	\$ 101	\$ 97	\$ 83	\$ 86
Public safety	273	287	236	246	256
Streets and highways	95	101	64	108	77
Culture and recreation	95	99	102	101	105
All other	91	77	70	94	80
	<u>651</u>	<u>665</u>	<u>569</u>	<u>632</u>	<u>604</u>
<b>Capital outlay and construction</b>	301	263	475	156	212
<b>Debt service</b>					
Principal	115	121	13	34	13
Interest and fiscal	34	32	5	5	4
	<u>149</u>	<u>153</u>	<u>18</u>	<u>39</u>	<u>17</u>
<b>Total expenditures</b>	<u>\$ 1,101</u>	<u>\$ 1,081</u>	<u>\$ 1,062</u>	<u>\$ 827</u>	<u>\$ 833</u>

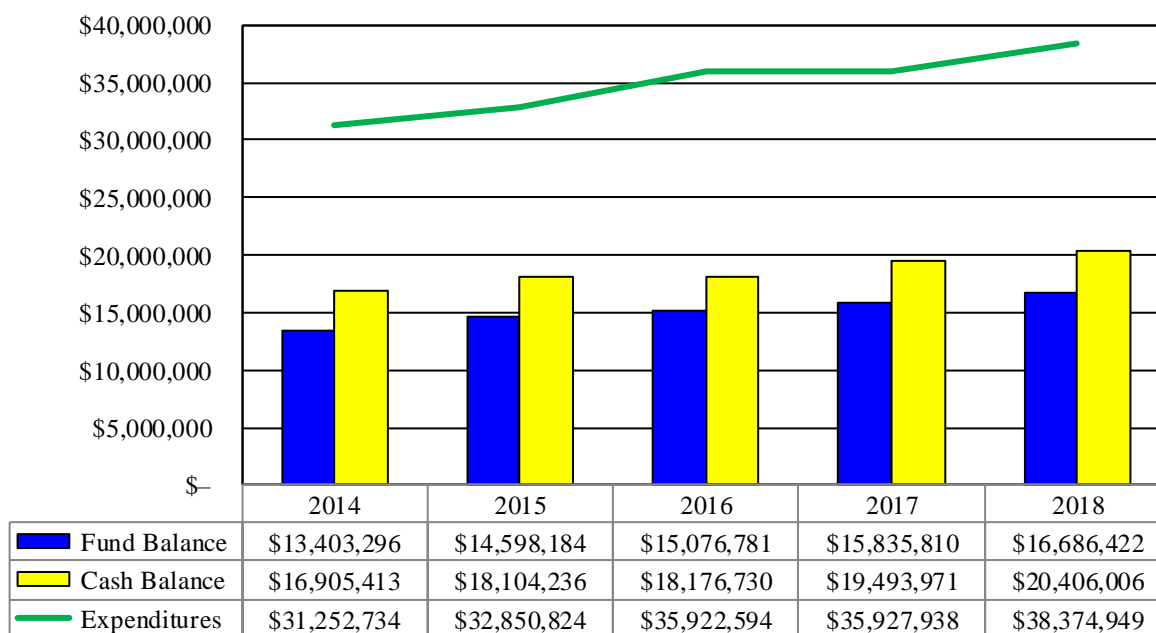
The City's governmental funds current per capita expenditures are lower than state-wide averages for cities in the same population class. The City's per capita expenditures for debt service are also much lower than state-wide averages.

Total expenditures for the City's governmental funds for 2018 were \$65,274,435, an increase of \$1,701,809 (2.7 percent) from the prior year. The City's per capita governmental fund expenditures for 2018 were \$833, an increase of \$6 per capita from the prior year. Capital outlay and construction costs increased \$56 per capita, due to the timing of significant street and improvement projects, compared to the prior year's activity. The decrease in current spending was primarily in streets and highways, with less maintenance spending in the current year. Debt service decreased, due to the retirement of the 2007A Open Space Bonds in 2017.

## 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 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 balance at December 31, 2018 was \$20,406,006, an increase of \$912,035. Total fund balance at December 31, 2018 was \$16,686,422, which is an increase of \$850,612 from the prior year, after a year-end transfer of \$476,066 to the General Capital Projects Fund, in accordance with the fund balance policy of the City for the General Fund.

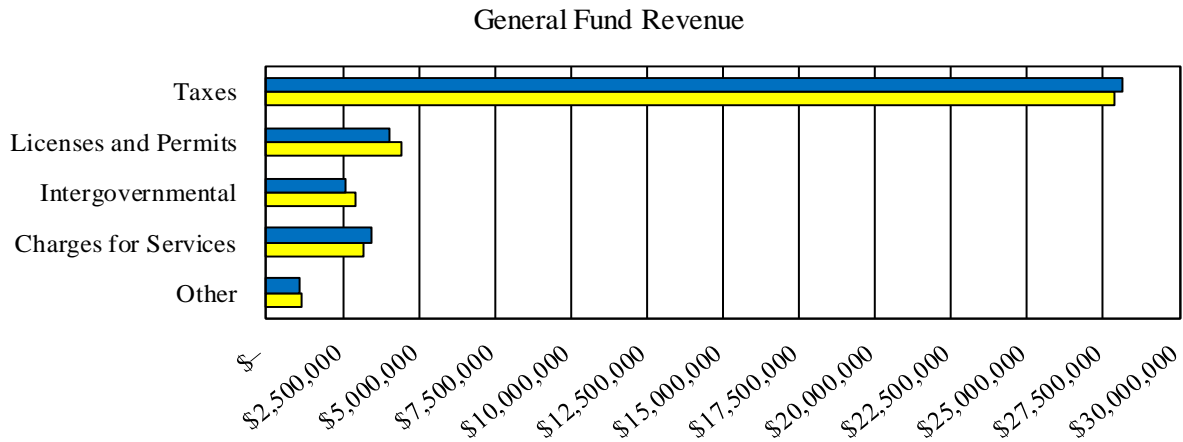
As the graph above illustrates, the City has generally been able to maintain healthy cash and fund balance levels as the volume of financial activity has grown. This is an important factor because a government, like any organization, requires a certain amount of equity to operate. A healthy financial 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. Taxes comprise about 70 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.

In accordance with the City's fund balance policy, the General Fund balance at the end of the 2018 fiscal year represents 40 percent of the subsequent year's budgeted expenditures and transfers out.

## GENERAL FUND REVENUES

The following graph illustrates the City's General Fund revenue sources for 2018 compared to budget:

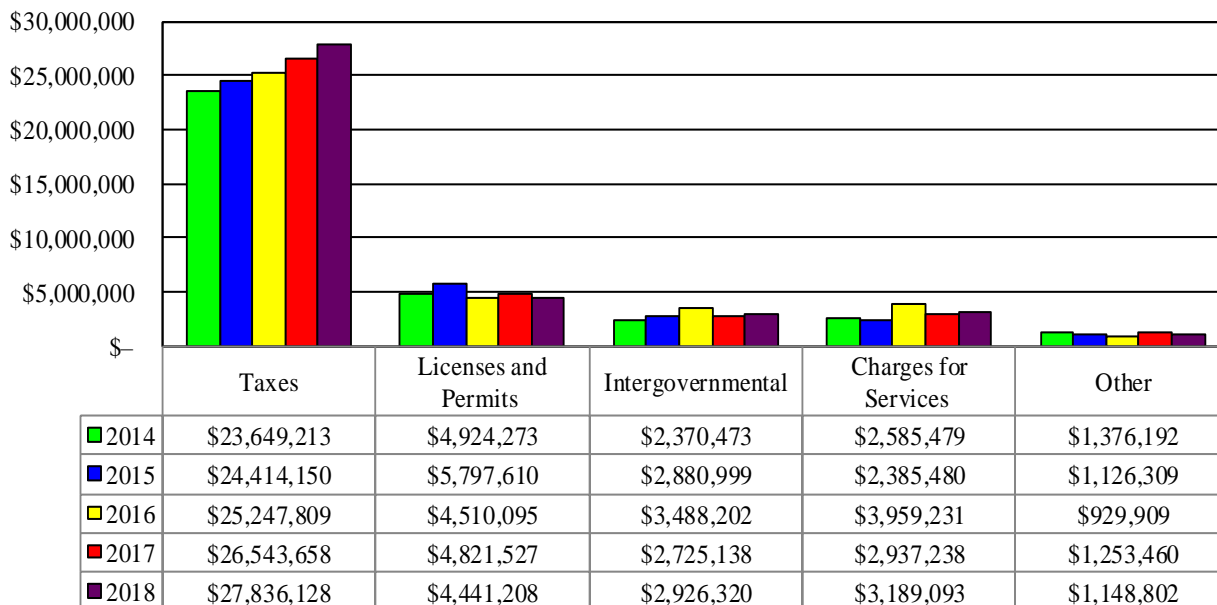


	Other	Charges for Services	Intergovernmental	Licenses and Permits	Taxes
■ Budget	\$1,089,400	\$3,470,970	\$2,624,138	\$4,042,460	\$28,113,058
■ Actual	\$1,148,802	\$3,189,093	\$2,926,320	\$4,441,208	\$27,836,128

Total General Fund revenues for 2018 were \$39,541,551, which was \$201,525 (0.5 percent) more than budget. Licenses and permits, intergovernmental revenues, and others sources were over budget \$398,748, \$302,182, and \$59,402, respectively. Elevated development activity and conservative budgeting contributed to the favorable variances. Taxes and charges for services ended the year less than anticipated by \$276,930 and \$281,877, respectively, partially offsetting the favorable variances previously mentioned.

The following graph presents the City's General Fund revenue by source for the last five years and reflects the City's reliance on property taxes in recent years:

General Fund Revenue by Source  
Year Ended December 31,

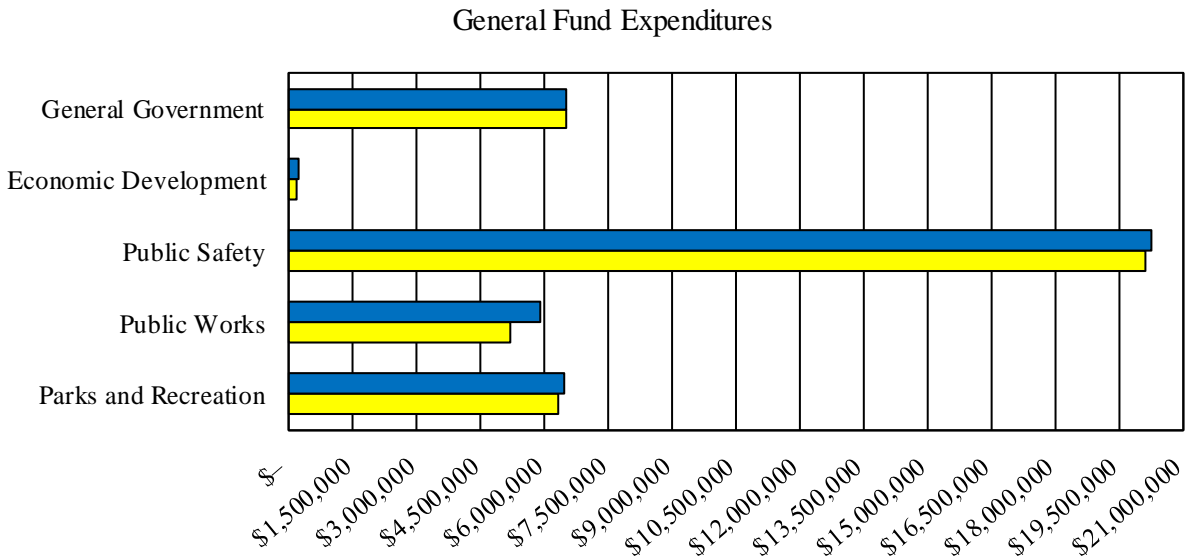


Total General Fund revenue for 2018 was \$1,260,530 (3.3 percent) higher than last year. Taxes increased by \$1,292,470, due to an increase in the tax levy over the prior year. Licenses and permits revenue decreased by \$380,319. Intergovernmental revenue increased \$201,182, due to an increase in grants and aid received from the state. Charges for services increased by \$251,855, due to an increase in project related activity. Remaining revenues decreased by \$104,658, primarily due to a large asset (land) that was sold in 2017 versus minimal asset sales in 2018.



## GENERAL FUND EXPENDITURES

The following graph illustrates the components of General Fund spending for 2018 compared to budget:

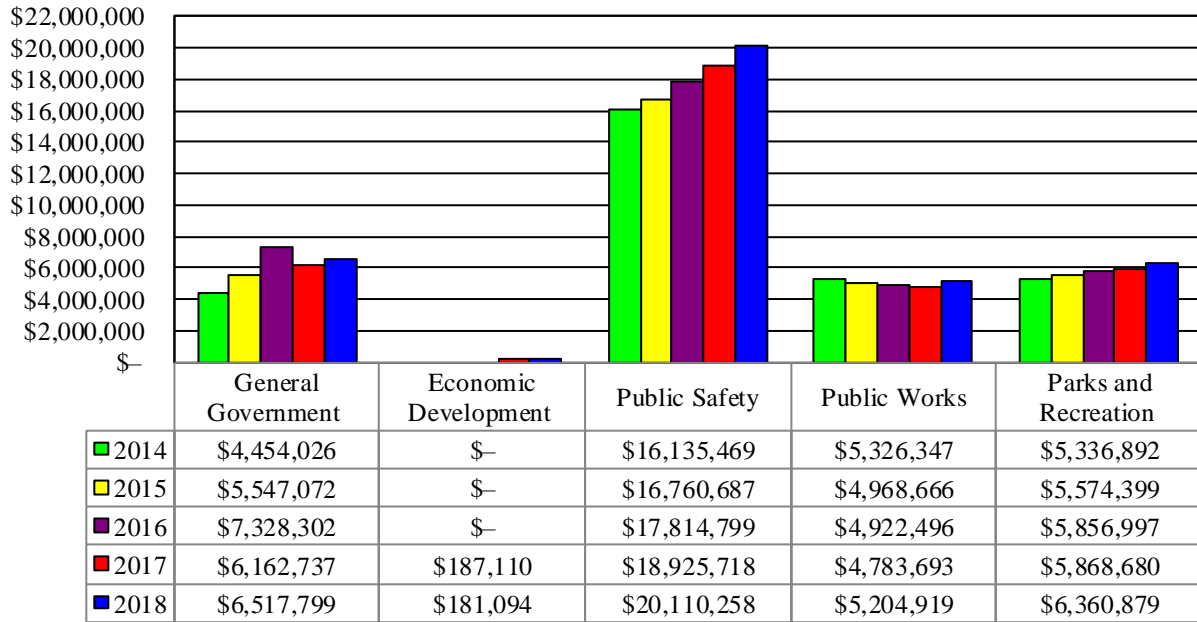


	Parks and Recreation	Public Works	Public Safety	Economic Development	General Government
■ Budget	\$6,463,198	\$5,917,841	\$20,252,532	\$265,541	\$6,544,414
■ Actual	\$6,360,879	\$5,204,919	\$20,110,258	\$181,094	\$6,517,799

Total General Fund expenditures for 2018 were \$38,374,949, which was \$1,068,577 (2.7 percent) under the final budget. The largest variance was in public works, which experienced savings of \$712,922, due to less personal services, materials and supplies, and contractual services for street repairs than anticipated. Overall savings in personal costs, due to attrition and cost restraints shared by all departments, contributed to the favorable expenditure variance.

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

General Fund Expenditures by Function  
Year Ended December 31,



Total General Fund expenditures for 2018 increased \$2,447,011 over the prior year. General government expenditures increased by \$355,062 (5.8 percent) from the prior year, mainly in personal and contractual services. Public safety expenditures increased by \$1,184,540 (6.3 percent), public works increased by \$421,226 (8.8 percent), and parks and recreation expenditures increased by \$492,199 (8.4 percent) over the prior year, mainly in personal services as anticipated in the budget. Economic development spending was similar to the prior year with a slight decrease (\$6,016) in spending in the current year.

## ENTERPRISE FUNDS OVERVIEW

The City maintains enterprise funds to account for services the City provides that are financed primarily through fees charged to those utilizing the service. This section of the report provides you with an overview of the financial trends and activities of the City's enterprise funds, which includes the Water Sewer Utility, Ice Center, Water Resources, Solid Waste Management, and Field House Funds.

The utility funds comprise a considerable portion of the City's activities. These funds help to defray overhead and administrative costs and provide additional support to general government operations by way of annual transfers. We understand that the City is proactive in reviewing these activities on an ongoing basis and we want to reiterate the importance of continually monitoring these operations. Over the years, we have emphasized to our city clients the importance of these utility operations being self-sustaining, preventing additional burdens on general government funds. This would include the accumulation of net position for future capital improvements and to provide a cushion in the event of a negative trend in operations.

### ENTERPRISE FUNDS FINANCIAL POSITION

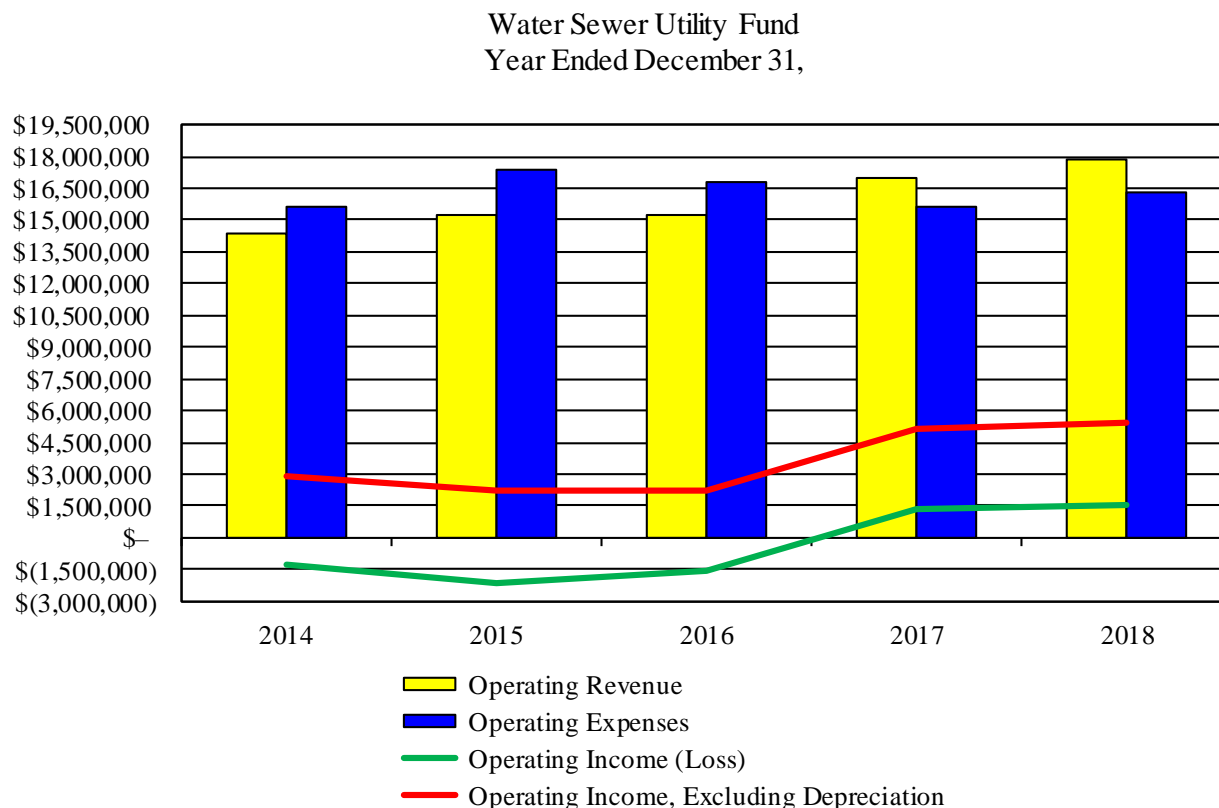
The following table summarizes the changes in the financial position of the City's enterprise funds during the years ended December 31, 2018 and 2017, presented both by classification and by fund:

<b>Enterprise Funds Change in Financial Position</b>			
	Net Position as of December 31,		Increase (Decrease)
	2018	2017	
Net position of enterprise funds			
Total by classification			
Net investment in capital assets	\$ 137,396,254	\$ 130,912,363	\$ 6,483,891
Restricted	20,483,426	22,004,066	(1,520,640)
Unrestricted	<u>12,623,433</u>	<u>10,769,180</u>	<u>1,854,253</u>
Total enterprise funds	<u>\$ 170,503,113</u>	<u>\$ 163,685,609</u>	<u>\$ 6,817,504</u>
Total by fund			
Water Sewer Utility	\$ 133,311,224	\$ 128,266,940	\$ 5,044,284
Ice Center	9,824,209	10,015,564	(191,355)
Water Resources	24,084,139	22,104,788	1,979,351
Nonmajor funds			
Solid Waste Management	1,481,900	1,612,533	(130,633)
Field House	<u>1,801,641</u>	<u>1,685,784</u>	<u>115,857</u>
Total enterprise funds	<u>\$ 170,503,113</u>	<u>\$ 163,685,609</u>	<u>\$ 6,817,504</u>

In total, enterprise fund net position increased by \$6,817,504, for the year ended December 31, 2018. The City's net investment in capital assets increased by \$6,483,891, including capital contributions from governmental funds and developers. The restricted portion of net position decreased (\$1,520,640) for utility trunk and water resources, which reflects restricted equity to invest in capital infrastructure of the City. Unrestricted net position increased \$1,854,253 from the prior year-end balance as presented in the table above. Capital contributions, mentioned earlier, contributed significantly to the increases in net position of the Water Sewer Utility and Water Resources Funds.

## WATER SEWER UTILITY FUND

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



The Water Sewer Utility Fund ended 2018 with a total net position of \$133,311,224, an increase of \$5,044,284 from the prior year. Of this, \$105,711,052 represents the net investment in capital assets, and \$17,312,271 is restricted, leaving \$10,287,901 of unrestricted net position.

The Water Sewer Utility Fund operating revenue was \$17,903,872 for 2018, an increase of \$907,552 (5.3 percent). An increase in rates and an increase in consumption in 2018 contributed to this increase. Consumption will fluctuate from year-to-year based on many factors, including weather patterns and the number of utility customers.

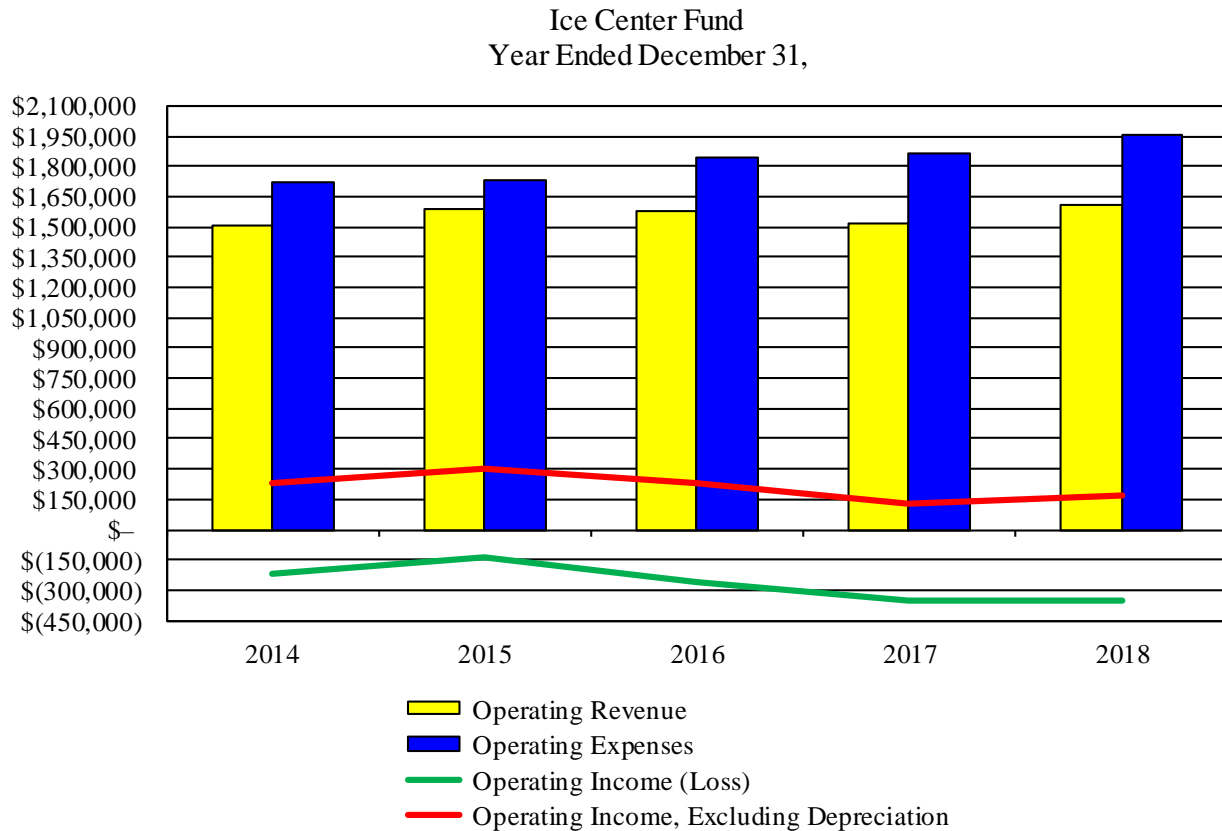
Operating expenses (including depreciation of \$3,839,353) were \$16,322,227, an increase of \$681,624 (4.4 percent); the increase was mainly due to increases in contractual and personal services.

It is important to note that a portion of the operating expenses in this fund is depreciation on assets paid for and contributed to the City by developers. In general, the City's utility rates have not been designed to fully recover depreciation costs on such assets. Utility rates are normally designed to cover current operating expenses and to provide for future repairs and replacement of these assets.

These operating losses, however, have generally been more than offset by amounts in other revenues and contributions over the same time period. Other revenues and contributions include a number of revenue sources that are normally one-time or inconsistent from year-to-year. It includes such things as interest income, grants, contributions from developers and residents, special assessments, and income from sales of assets.

**ICE CENTER FUND**

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



The Ice Center Fund ended 2018 with a net position of \$9,824,209, a decrease of \$191,355 from the prior year. Of this, \$10,052,460 represents the net investment in capital assets, leaving an unrestricted deficit net position of \$228,251.

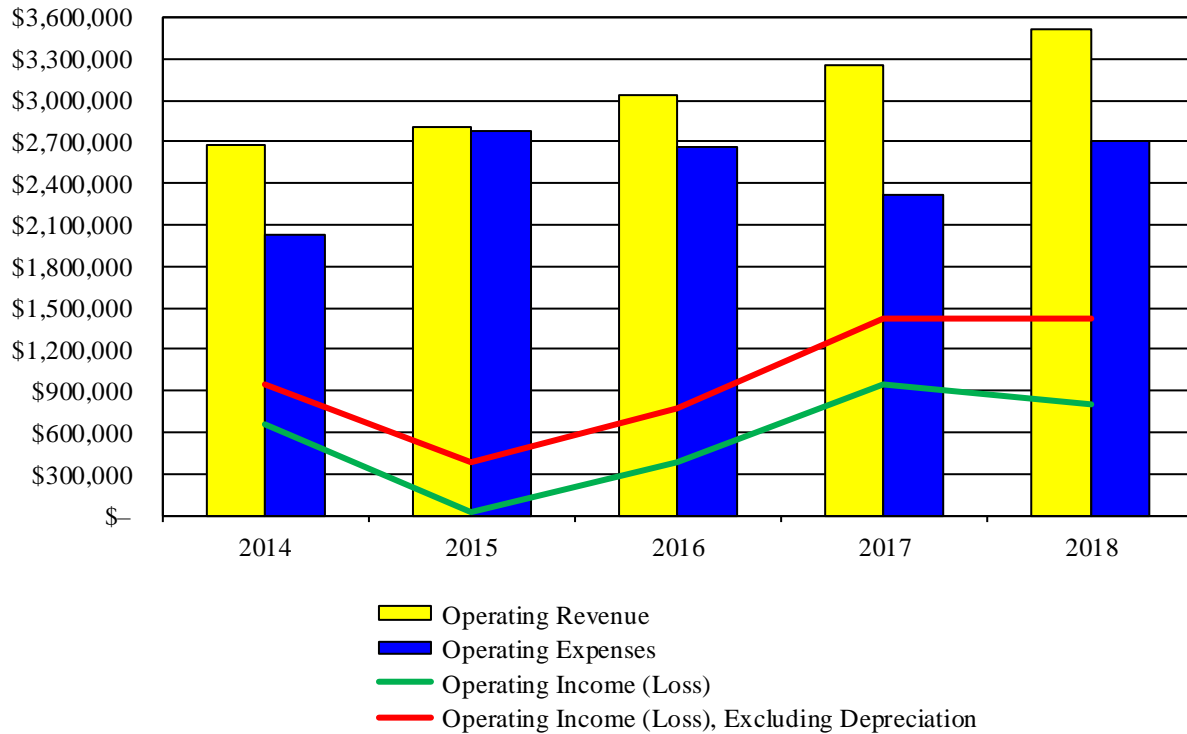
Operating revenue in the Ice Center Fund was \$1,612,292, an increase of \$94,995 from the prior year. Operating expenses for 2018 were \$1,962,440, an increase of \$96,057 from the prior year. The increase in expenses was primarily due to more contractual services and depreciation, which were \$30,211 and \$47,325, respectively over the prior year.

It is important to note that a significant portion of the operating expenses in this fund is depreciation on capital assets already funded. The fees charged in this fund are developed to cover operating expenses, repairs, and betterment of the ice center facilities.

## WATER RESOURCES FUND

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

Water Resources Fund  
Year Ended December 31,

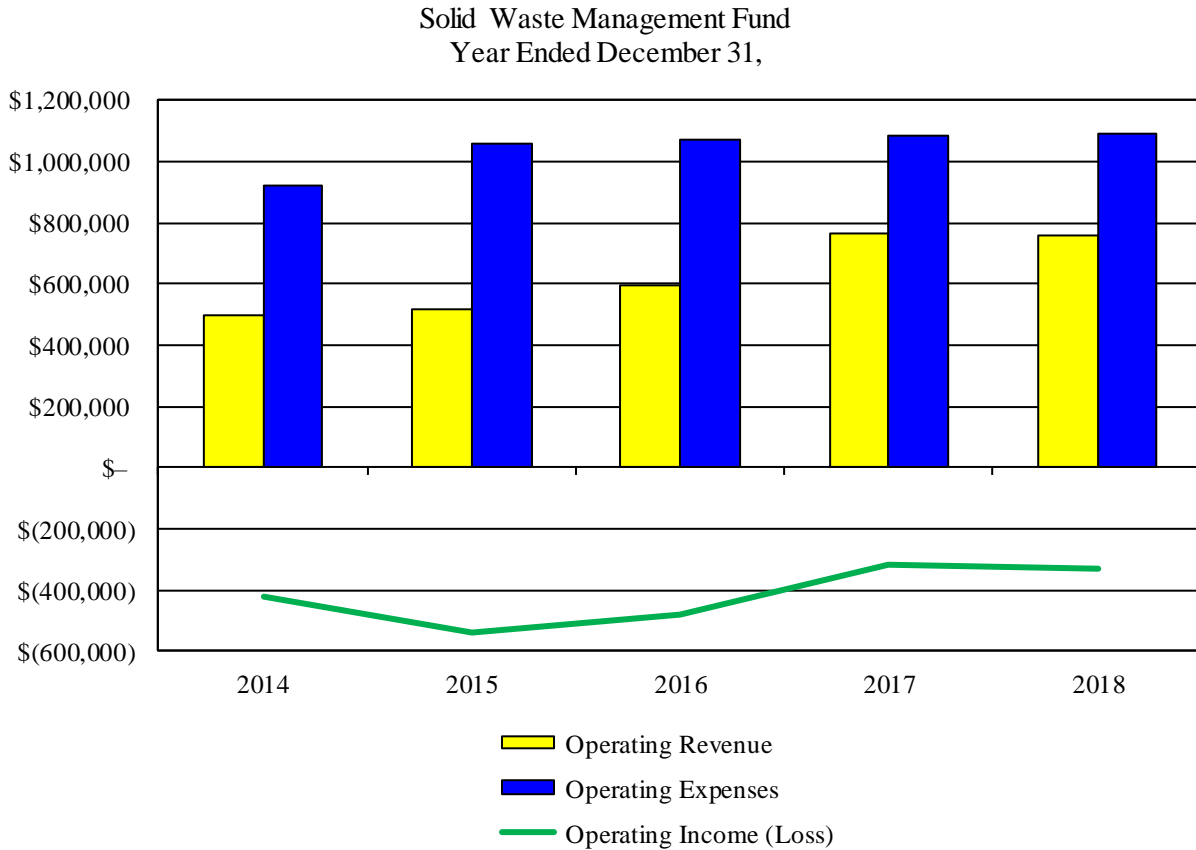


The Water Resources Fund ended 2018 with a net position of \$24,084,139, an increase of \$1,979,351 from the prior year. Of this, \$20,912,984 represents the net investment in capital assets, while the remaining \$3,171,155 is considered restricted.

Operating revenue in the Water Resources Fund was \$3,512,164, an increase of \$264,113 (8.1 percent) from the prior year. Operating expenses for 2018 were \$2,703,907, an increase of \$394,380 from the prior year. The increase in expenses was primarily due to increased materials and supplies, contractual services, and depreciation.

**SOLID WASTE MANAGEMENT FUND**

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



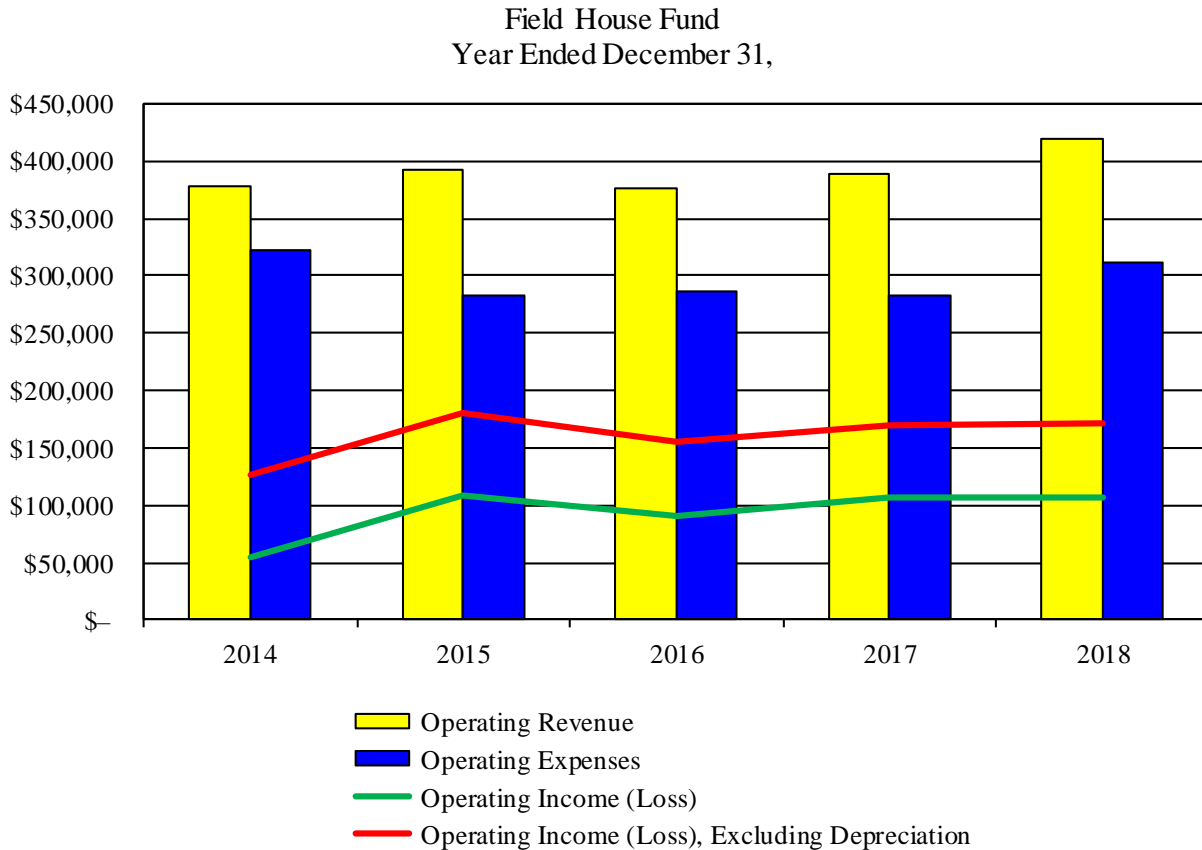
The Solid Waste Management Fund ended 2018 with a net position of \$1,481,900, a decrease of \$130,633 from the prior year. Of this, \$126,577 represents the net investment in capital assets, leaving \$1,355,323 of unrestricted net position.

Operating revenues in the Solid Waste Management Fund were \$761,450, a decrease of \$4,507 from the prior year. Operating expenses for 2018 were \$1,091,039, an increase of \$6,420 from the prior year in contractual services.

The City also recognized \$198,956 in nonoperating revenues that offset a portion of the loss presented in the table above.

## FIELD HOUSE FUND

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



The Field House Fund ended 2018 with a net position of \$1,801,641, an increase of \$115,857 from the prior year. Of this, \$593,181 represents the net investment in capital assets, leaving \$1,208,460 of unrestricted net position.

As presented in the graph above, the Field House Fund experienced positive operating income for all years displayed. Total operating revenue in the Field House Fund was \$418,958, an increase of \$29,954 from the previous year. The fees charged in this fund are developed to cover operating expenses, repairs, and betterment of field house facilities. Field House Fund operating expenses for 2018 were \$312,127, an increase of \$29,268 from the previous year.



## GOVERNMENT-WIDE FINANCIAL STATEMENTS

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

### STATEMENT OF NET POSITION

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

The following table presents the components of the City's net position as of December 31, 2018 and 2017, for governmental activities, business-type activities, and the Housing and Redevelopment Authority (HRA) component unit:

	As of December 31,		Increase (Decrease)
	2018	2017	
Net position			
Governmental activities			
Net investment in capital assets	\$ 234,394,816	\$ 224,668,917	\$ 9,725,899
Restricted	25,663,869	23,181,942	2,481,927
Unrestricted	67,359,816	64,680,437	2,679,379
Total governmental activities	<u>327,418,501</u>	<u>312,531,296</u>	<u>14,887,205</u>
Business-type activities			
Net investment in capital assets	137,396,254	130,912,363	6,483,891
Restricted	20,625,121	22,209,049	(1,583,928)
Unrestricted	10,261,298	8,172,940	2,088,358
Total business-type activities	<u>168,282,673</u>	<u>161,294,352</u>	<u>6,988,321</u>
Housing and Redevelopment Authority			
Net investment in capital assets	(434,730)	(708,530)	273,800
Restricted	4,124,483	4,706,984	(582,501)
Unrestricted	2,048,110	1,362,372	685,738
Total Housing and Redevelopment Authority	<u>5,737,863</u>	<u>5,360,826</u>	<u>377,037</u>
Total net position	<u>\$ 501,439,037</u>	<u>\$ 479,186,474</u>	<u>\$ 22,252,563</u>

The City (including the HRA) ended 2018 with a combined total net position of \$501,439,037, an increase of \$22,252,563 from the prior year. Several factors contributed to this increase, as discussed earlier in the report. Significant capital contributions recognized from grantors and developers contributed to the increase over the prior year.

At the end of the fiscal year, the City is able to present positive balances in all three categories of net position for the governmental activities and business-type activities. The same situation held true for the prior fiscal year.

As discussed earlier, the City recorded a change in accounting principle for reporting OPEB that reduced beginning unrestricted net position by \$926,033.

## 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 net position of the City and the HRA for the years ended December 31, 2018 and 2017:

	2018		2017	
	Expenses	Program Revenues	Net Change	Net Change
Net (expense) revenue				
Governmental activities				
General government	\$ 6,916,412	\$ 1,701,677	\$ (5,214,735)	\$ (4,898,846)
Economic development	882,157	82,986	(799,171)	(2,178,166)
Parks and recreation	9,630,368	5,538,217	(4,092,151)	(5,033,693)
Public safety	19,494,540	7,053,887	(12,440,653)	(12,753,468)
Public service	5,430,779	6,327,058	896,279	306,196
Public works	15,344,862	11,111,810	(4,233,052)	(5,764,950)
Interest on long-term debt	233,652	—	(233,652)	(271,710)
Business-type activities				
Water Sewer Utility	16,217,289	21,543,083	5,325,794	5,443,968
Ice Center	1,974,075	1,771,075	(203,000)	(351,236)
Water Resources	2,660,495	5,296,714	2,636,219	2,152,629
Solid Waste Management	1,089,439	935,958	(153,481)	(117,753)
Field House	312,078	419,106	107,028	101,901
Housing and Redevelopment Authority	5,326,185	4,978,627	(347,558)	(242,578)
Total net (expense) revenue	<u>\$ 85,512,331</u>	<u>\$ 66,760,198</u>	(18,752,133)	(23,607,706)
General revenues				
Property taxes and franchise fees			38,241,559	36,597,742
Investment earnings			2,617,198	2,116,299
Gain on sale of capital assets			121,826	111,262
Other			950,146	1,213,632
Total general revenues			<u>41,930,729</u>	<u>40,038,935</u>
Change in net position			<u>\$ 23,178,596</u>	<u>\$ 16,431,229</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 other general sources. 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 shift in the net changes presented above between the current and prior year reflects the change in level of developer contributions as previously mentioned. The change in public works is also due in part to expenses for joint street projects that were not capital assets of the City.

## LEGISLATIVE UPDATES

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

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

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

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

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

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

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

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

- Reforms impacting the PERA Public Employees Police and Fire Fund (PEPFF) plan included:
  - Post-retirement COLAs were permanently set at 1.00 percent.
  - Employer contribution rates increase from the current 16.20 percent of covered salaries to 16.95 percent beginning January 1, 2019, and 17.70 percent beginning January 1, 2020.
  - Employee contribution rates increase from the current 10.80 percent of covered salaries to 11.30 percent beginning January 1, 2019, and 11.80 percent beginning January 1, 2020.
  - To reduce the need for additional contribution increases, the state will contribute an additional \$4.5 million to the plan annually for fiscal years 2019 and 2020, increasing to \$9.0 million annually thereafter through fiscal 2048, or until the plan is fully funded.
  - The rate of interest paid on refunds of employee contributions to former public employees was reduced from an annual rate of 4.00 percent to 3.00 percent.
  
- Reforms impacting the volunteer firefighter relief associations plan included:
  - Added a requirement that the fire chief annually certify each firefighter's service credit to the relief association and the related municipality effective January 1, 2019.

## ACCOUNTING AND AUDITING UPDATES

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

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

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

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

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

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

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

### **GASB STATEMENT NO. 84, *FIDUCIARY ACTIVITIES***

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

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

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

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

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

### **GASB STATEMENT NO. 87, LEASES**

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

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

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

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

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

***GASB STATEMENT NO. 88, CERTAIN DISCLOSURES RELATED TO DEBT, INCLUDING DIRECT BORROWINGS AND DIRECT PLACEMENTS***

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

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

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

***GASB STATEMENT NO. 89, ACCOUNTING FOR INTEREST COST INCURRED BEFORE THE END OF A CONSTRUCTION PERIOD***

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

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

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

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

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

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

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

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

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

**UNIFORM GUIDANCE, MICRO-PURCHASE THRESHOLD**

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