Management Report

for

City of Plymouth, Minnesota

December 31, 2011

MMKR
CERTIFIED PUBLIC
ACCOUNTANTS

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To the City Council
City of Plymouth, Minnesota

We have prepared this management report in conjunction with our audit of the City of Plymouth's (the City) financial statements for the year ended December 31, 2011. The purpose of this report is to provide comments resulting from our audit process and to communicate information relevant to city finances in Minnesota. We have organized this report into the following sections:

- Audit Summary
- Funding Cities in Minnesota
- Governmental Funds Overview
- Financial Trends and Conditions of Selected Funds
- 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.

This report is intended solely for the information and use of those charged with governance of the City, management, and those who have responsibility for oversight of the financial reporting process. It is not intended to be, and should not be, used by anyone other than these specified parties.

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

June 20, 2012

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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, *GOVERNMENT AUDITING STANDARDS*, AND THE U.S. OFFICE OF MANAGEMENT AND BUDGET (OMB) CIRCULAR A-133

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, 2011. 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 OMB Circular A-133, 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, 2011:

- We have issued an unqualified opinion on the City's basic financial statements.
- We noted no matters involving the City's internal control over financial reporting that we consider to be material weaknesses.
- The results of our testing disclosed no instances of noncompliance required to be reported under *Government Auditing Standards*.
- We noted that the Schedule of Expenditures of Federal Awards (SEFA) 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 requirements that could have a direct and material effect on each major federal program.
- We noted no matters involving internal control over compliance and its operation that we consider to be material weaknesses in our testing of major federal programs.
- There was one Minnesota Legal Compliance Finding in the current year. Minnesota Statute § 118A.03 requires that if a city's deposits exceed federal insurance coverage, excess deposits must be covered by corporate surety bonds or collateral that has a market value of at least 110 percent of such excess. This requirement was not met for one of the City's accounts at June 30, 2011.

FOLLOW-UP ON PRIOR YEAR FINDINGS AND RECOMMENDATIONS

As a part of our audit of the City's financial statements for the year ended December 31, 2011, we performed procedures to follow-up on the findings and recommendations that resulted from our prior year audit. We reported the following findings in federal programs that were corrected by the City in the current year:

- During the 2010 Federal Programs audit we noted that the City did not have sufficient controls in place to ensure compliance with the reporting requirements for the ARRA Energy Efficiency and Conservation Block Grant. As part of our federal programs audit for the year ended December 31, 2011, we noted no instances of noncompliance with this requirement and have eliminated this finding.
- During the 2010 Federal Programs audit we noted that the City did not have sufficient internal controls in place to ensure compliance with the equipment and real property management compliance requirements for the ARRA Energy Efficiency and Conservation Block Grant. As part of our federal programs audit for the year ended December 31, 2011, we noted no instances of noncompliance with this requirement and have eliminated this finding.

SIGNIFICANT ACCOUNTING POLICIES

Management is responsible for the selection and use of appropriate accounting policies. The significant accounting policies used by the City are described in Note 1 of the notes to basic financial statements. For the year ended December 31, 2011, the City has implemented Governmental Accounting Standards Board (GASB) Statement No. 54, "Fund Balance Reporting and Governmental Fund Type Definitions." This statement established new fund balance classifications that comprise a hierarchy based primarily on the extent to which a government is bound to observe constraints imposed upon the use of the resources reported in governmental funds. It also clarifies existing governmental fund type definitions to improve the comparability of governmental fund financial statements.

The application of remaining policies was not changed during the year. We noted no transactions entered into by the City during the year for which there is a lack of authoritative guidance or consensus. All significant transactions have been recognized in the financial statements in the proper period.

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 as follows:

- **Depreciation** – Management's estimates of depreciation expense are based on the estimated useful lives of the assets.
- **Net Other Post-Employment Benefit (OPEB) Liabilities** – Actuarial estimates of the net OPEB obligation is based on eligible participants, estimated future health insurance premiums, and estimated retirement dates.
- **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.

Management expects any differences between estimates and actual amounts of these estimates to be insignificant. We evaluated the key factors and assumptions used by management in the areas discussed above in determining that they are reasonable in relation to the 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 trivial, and communicate them to the appropriate level of management. Where applicable, management has corrected all such misstatements. In addition, none of the misstatements detected as a result of audit procedures and corrected by management, when applicable, were material, either individually or in the aggregate, to each opinion unit's financial statements taken as a whole.

DIFFICULTIES ENCOUNTERED IN PERFORMING THE AUDIT

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

DISAGREEMENTS WITH MANAGEMENT

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

MANAGEMENT REPRESENTATIONS

We have requested certain representations from management that are included in the management representation letter dated June 20, 2012.

MANAGEMENT CONSULTATIONS WITH OTHER INDEPENDENT ACCOUNTANTS

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

OTHER AUDIT FINDINGS OR ISSUES

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

OTHER INFORMATION IN DOCUMENTS CONTAINING AUDITED FINANCIAL STATEMENTS

Our audit was conducted for the purpose of forming opinions on the financial statements that collectively comprise the City's basic financial statements. Other information, including the introductory section, supplementary information, and the statistical section accompanying the basic financial statements; and the SEFA are presented for purposes of additional analysis and are not required parts of the basic financial statements.

With respect to the supplementary information accompanying the financial statements and the SEFA, we made certain inquiries of management and evaluated the form, content, and methods of preparing the information to determine that the information complies with accounting principles generally accepted in the United States of America, the method of preparing it has not changed from the prior period, and the information is appropriate and complete in relation to our audit of the basic financial statements. We compared and reconciled the supplementary information and the SEFA to the underlying accounting records used to prepare the basic financial statements or to the basic financial statements themselves.

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

LEGISLATION

The 2011 legislative session began with the state facing a projected budget deficit of $6.2 billion (later revised down to $5.0 billion in the February 2011 Economic Forecast) for the 2012–2013 biennium. In addition, the 2010 election dramatically changed the state's political landscape. A Democratic Governor was in power for the first time since 1991, while Republicans had majority control of both the House and the Senate for the first time since 1971. Predictably, as the session progressed, the Governor and Legislature had difficulty agreeing on a state budget for the next biennium. Shortly after the 2011 regular session ended, the Governor vetoed eight major state appropriation bills and the omnibus tax bill passed by the Legislature, which left the majority of state agencies without a budget for the next fiscal year. This resulted in a shutdown of "nonessential" state agencies that began July 1, 2011 and effectively ended with the passing of appropriation bills in a special session on July 19th and 20th.

The large projected budget deficit facing the 2011 Legislature was typical of the financial challenges the state has experienced in recent years. Unfavorable economic conditions have caused a steady deterioration of the state's financial condition, which has resulted in a series of cuts and holdbacks in state aids to local governments and other entities. As was the case in the last biennium, the Legislature utilized several one-time revenue sources, transfers, and accounting shifts to minimize the need for tax increases or state aid cuts to balance the state budget.

The following is a summary of significant legislative activity passed in calendar year 2011 affecting the finances of Minnesota cities:

Local Government Aid (LGA) and Market Value Homestead Credit (MVHC) – One of the appropriation bills passed in the 2011 special session was the omnibus tax bill, which includes the appropriations for LGA and MVHC.

The Legislature retroactively reduced the fiscal 2011 appropriation for LGA by approximately $102 million, leaving a total appropriation of $425.3 million for 2011 LGA. Minnesota cities will receive 2011 LGA equal to the lesser of their final 2010 LGA (after the cuts by the Legislature and Governor) or their 2011 certified LGA amount. The first half LGA payment for 2011 was also delayed one week to July 27, so the reduced LGA amounts could be recomputed after the government shutdown. The total LGA appropriation for fiscal 2012 will be $425.2 million, with cities again receiving the lesser of their 2010 actual or 2011 certified amounts. In essence, this bill extended the LGA cuts originally made in fiscal 2010 for the two subsequent years. For fiscal 2013 and beyond, the LGA appropriation is set at $426.4 million, to be allocated using the LGA formula.

The omnibus tax bill also extended the 2010 MVHC reductions of approximately $48 million to fiscal 2011, with cities to receive the same allocation. Beginning in fiscal 2012, the MVHC reimbursement program is eliminated. Rather than receiving a property tax credit, qualifying homeowner taxpayers will have a portion of the market value of their house excluded from their taxable market value. This new system will provide homeowners property tax relief by shifting a portion of their potential tax burden to other property classifications, rather than directly reducing their taxes through a state paid tax credit reimbursement. While this new homestead exclusion is calculated in a similar manner to the repealed MVHC, the actual tax relief to individual homeowner taxpayers may vary significantly depending on the makeup of the taxing jurisdictions that levy on their particular property.

The agriculture market value credit, however, will continue as a state-paid tax credit.

Levy Limitations – A 2008 law limited general operating property tax levy increases for cities with populations over 2,500 to an inflationary increase based on the state determined implicit price deflator (IPD) to a maximum of 3.9 percent annually for the next three calendar years. Modifications were made in subsequent legislative sessions to allow cities subject to levy limitation to declare "special levies" to replace the LGA and MVHC losses. The 2010 Legislature also established a floor of zero percent for the inflationary increase, so levies would not be reduced in the event of IPD deflation. The 2011 Legislature passed an omnibus tax bill during the regular session that would have extended levy limits for two years (taxes payable in 2012 and 2013). However, this was among the bills vetoed by the Governor, and the final omnibus tax bill passed in the special session did not address levy limits.

Sales and Use Taxes – A number of changes and clarifications were made to Minnesota sales and use tax provisions, including:

- Made water used directly for public safety purposes (fighting fires) exempt from sales tax.
- Expanded the sales tax exemption for the lease of motor vehicles used as ambulances to the lease of vehicles used for emergency response.
- Added townships to the list of entities exempt from sales tax.
- Provided an exemption from sales tax for technology and electricity for qualifying large data centers as a business incentive.
- Clarified the sales tax regulations for online hotel sales.

"Buy American" Provision Repealed – The "Buy American" provision, enacted in 2010, which prohibited public employers from purchasing or requiring employees to purchase any uniforms, safety equipment, or protective accessories not manufactured in the United States, was repealed. Cities may continue to purchase American-made uniforms and equipment, but they are not required to do so.

Prohibition of Referendum Spending – Political subdivisions, including cities, are prohibited from expending funds to promote a referendum to support imposing a local option sales tax. The political subdivision may only expend funds to conduct the referendum.

Tax Exempt Period for Economic Development Property – The maximum allowable holding period for property held by a political subdivision for economic development to be exempt from property taxes was increased from eight years to nine years.

Concurrent Detachment of Parcels – State law for the concurrent detachment of property from one city to another has been changed. In the past, both cities involved had to support the change for it to be considered. Now, if the property owner and one of the involved cities petition for the detachment, the proposed boundary adjustment qualifies for consideration.

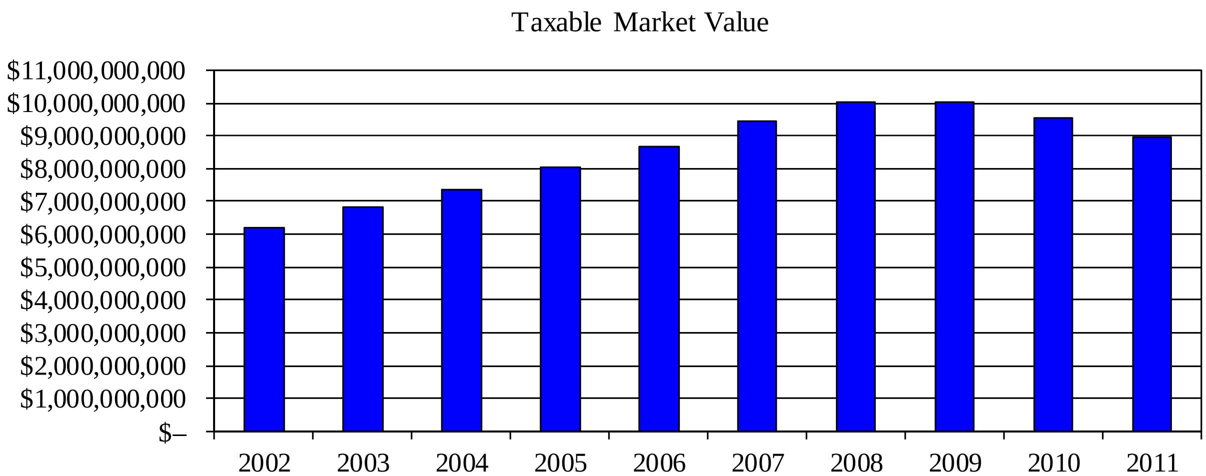
Civil Immunity for Donated Public Safety Equipment – Immunity from civil tort claims is extended to municipalities that donate public safety equipment to another municipality, unless the claim is a direct result of fraud or intentional misrepresentation. The statute defines "public safety equipment" as vehicles and equipment used in firefighter, ambulance and emergency medical treatment services, rescue, and hazardous material response.

PROPERTY TAXES

Minnesota cities rely heavily on local property tax levies to support their governmental fund activities. In recent years this dependence has been heightened, as revenue from state aids and fees related to new development have dwindled due to the struggling economy. This has placed added pressure on local taxpayers already beset by higher unemployment, lower property values, and tighter credit markets. As a result, municipalities in general are experiencing increases in tax delinquencies, abatements, and foreclosures. This instability has led to significant fiscal challenges for many local governments, and increased the investing public's concerns about the security of the municipal debt market.

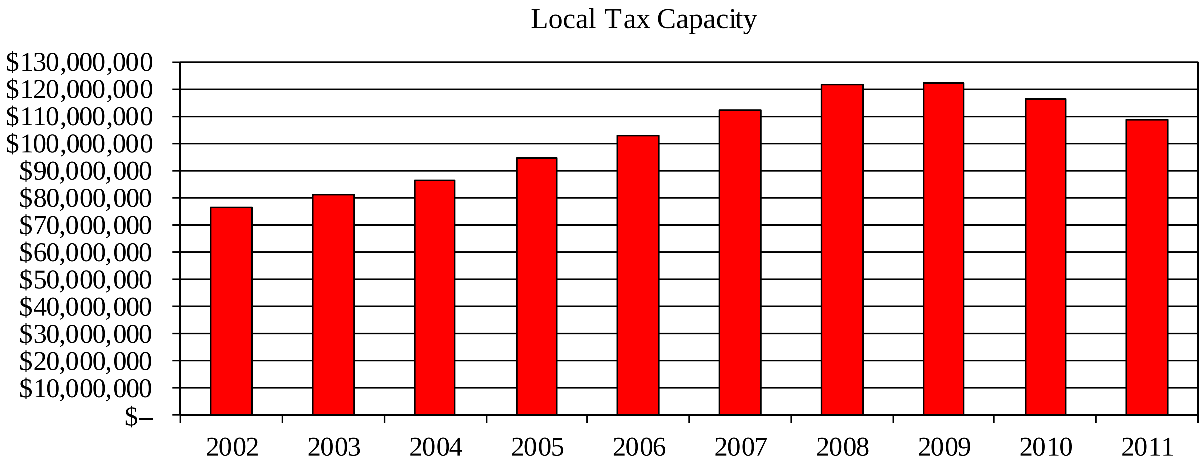
Property values within Minnesota cities experienced average decreases of 3.0 percent and 5.7 percent for taxes payable in 2010 and 2011, respectively, reflecting the weak housing market and economic conditions experienced in recent years. In comparison, the City's taxable market value decreased 4.6 percent for taxes payable in 2010 and 6.0 percent for taxes payable in 2011. The market value for taxes payable in 2011 is based on estimated values as of January 1, 2010.

The following graph shows the City's changes in taxable market value over the past 10 years:



Tax capacity is considered the actual base available for taxation. It is calculated by applying the state's property classification system to each property's market value. Each property classification, such as commercial or residential, has a different calculation and uses different rates. Consequently, a city's total tax capacity will change at a different rate than its total market value, as tax capacity is affected by the proportion of the City's tax base that is in each property classification from year-to-year, as well as legislative changes to tax rates. The City's tax capacity decreased 4.8 percent and 6.4 percent for taxes payable in 2010 and 2011, respectively.

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



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

Rates expressed as a percentage of net tax capacity

	All Cities State-Wide		Seven-County Metro Area		**City of Plymouth**	
	2010	2011	2010	2011	**2010**	**2011**
Average tax rate						
City	39.2	42.5	36.0	40.0	**25.5**	**26.9**
County	41.0	43.7	36.8	42.1	**42.6**	**45.8**
School	23.0	25.2	24.0	26.8	**24.3**	**26.3**
Special taxing	5.9	6.4	6.5	8.1	**9.3**	**10.5**
Total	109.1	117.8	103.3	117.0	**101.7**	**109.5**

As the table displays, the City's average tax rate is significantly lower than state-wide averages. The City's lower than average tax rate has resulted in a total tax rate that is below both averages presented in the table above.

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. Governmental funds include the General Fund, special revenue, debt service, capital project, and permanent funds. We have also included the most recent comparative state-wide averages available from the Office of the State Auditor. The reader needs to consider the effect of inflation and other known changes or differences when comparing this data. Also, certain data on these tables may be classified differently than how they appear on the City's financial statements in order to be more comparable to the state-wide information, particularly in separating capital expenditures from current expenditures.

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

GOVERNMENTAL FUNDS REVENUE

The amounts received from the typical major sources of revenue will naturally vary between cities based on their particular situation. This would include the City's stage of development, location, size and density of its population, property values, services it provides, and other attributes. The following table presents the City's revenue per capita of its governmental funds for the past three years, together with state-wide averages:

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

	State-Wide			**City of Plymouth**		
Year	December 31, 2010			**2009**	**2010**	**2011**
Population	2,500–10,000	10,000–20,000	20,000–100,000	**72,268**	**70,576**	**71,263**
Property taxes	$ 386	$ 359	$ 407	**$ 384**	**$ 391**	**$ 386**
Tax increments	45	52	56	**18**	**15**	**15**
Franchise and other taxes	26	34	30	**–**	**–**	**–**
Special assessments	74	60	66	**2**	**1**	**1**
Licenses and permits	19	22	29	**31**	**35**	**45**
Intergovernmental revenues	291	271	149	**106**	**119**	**96**
Charges for services	89	83	76	**47**	**58**	**65**
Other	73	70	57	**23**	**36**	**54**
Total revenue	$ 1,003	$ 951	$ 870	**$ 611**	**$ 655**	**$ 662**

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.

In total, the City's governmental fund revenues for 2011 were $47,178,523, an increase of $1,019,851 (2.2 percent) from the prior year. On a per capita basis, governmental fund revenue for 2011 increased by $7, or 1.1 percent, from the prior year. The City's per capita governmental funds revenue experienced shifts within various sources, while remaining similar in total compared to the prior year.

GOVERNMENTAL FUNDS EXPENDITURES

Similar to our discussion of revenues, the expenditures of governmental funds will 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, which are often funded by specific sources that have benefited from the expenditure, such as special assessment improvement projects.

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

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

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

	State-Wide			City of Plymouth		
Year	December 31, 2010			**2009**	**2010**	**2011**
Population	2,500–10,000	10,000–20,000	20,000–100,000	**72,268**	**70,576**	**71,263**
Current						
General government	$ 125	$ 102	$ 85	**$ 57**	**$ 62**	**$ 59**
Public safety	227	223	235	**187**	**196**	**189**
Street maintenance and lighting	108	107	86	**57**	**72**	**72**
Parks and recreation	75	93	87	**87**	**94**	**95**
All other	81	81	91	**62**	**61**	**74**
	$ 616	$ 606	$ 584	**$ 450**	**$ 485**	**$ 489**
Capital outlay and construction	$ 299	$ 321	$ 232	**$ 106**	**$ 169**	**$ 144**
Debt service						
Principal	$ 180	$ 181	$ 111	**$ 23**	**$ 27**	**$ 20**
Interest and fiscal	63	53	43	**11**	**10**	**9**
	$ 243	$ 234	$ 154	**$ 34**	**$ 37**	**$ 29**

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 capital and debt service are also much lower than state-wide averages.

In total, the City's governmental fund expenditures for 2011 were $47,180,268, a decrease of $1,544,580 (3.2 percent) from the prior year. The City's current expenditures increased $4 per capita, or 0.8 percent, while debt service expenditures decreased $8 per capita, or 22 percent, which is consistent with current year debt financing plans. The decrease in capital outlay is variable each year and due to the timing of various improvement projects ongoing in a given year.

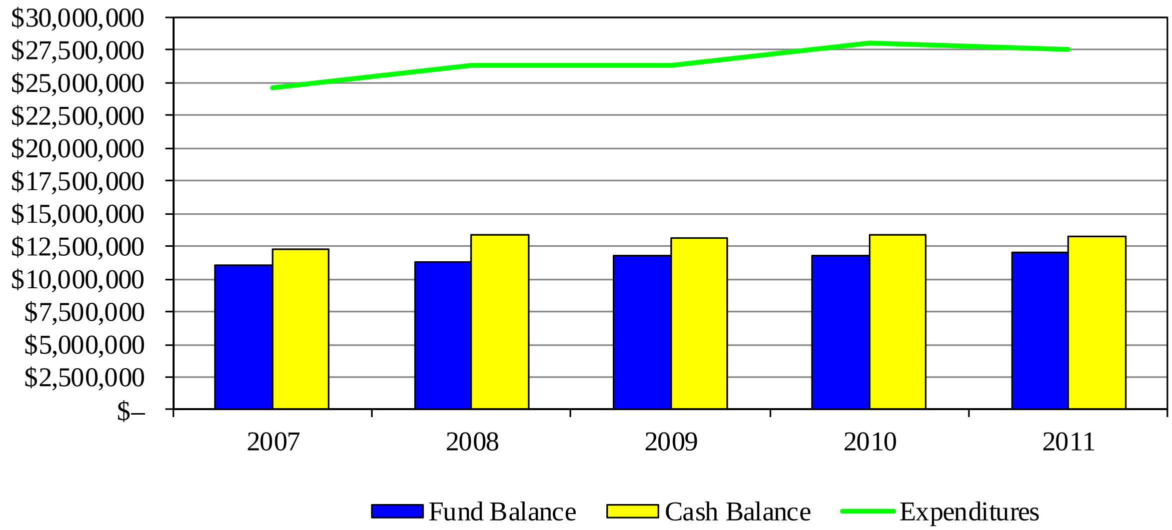
FINANCIAL TRENDS AND CONDITIONS OF SELECTED FUNDS

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 following graph displays the City's General Fund trends of financial position and changes in the volume of financial activity over the last 5 years. Fund balance and cash balance are typically used as indicators of financial health or equity, while annual expenditures are often used to measure the size of the operation.

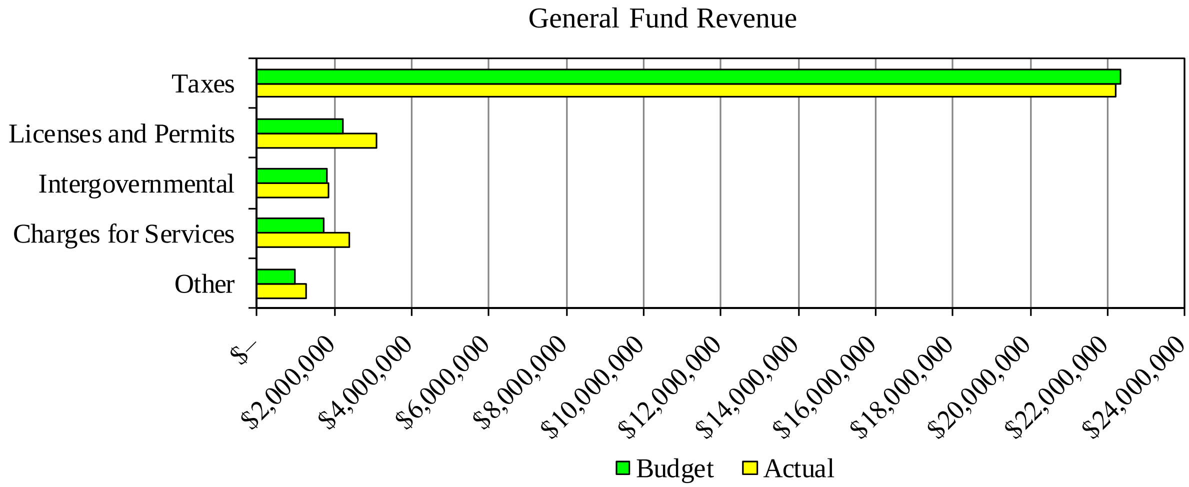
General Fund Financial Position
Year Ended December 31,



The City's General Fund ended the year with a cash balance of $13,276,749 and a fund balance of $12,007,962 at December 31, 2011. The City has again met the fund balance goal in 2011 to maintain a fund balance level within the General Fund approximating 40 percent of General Fund expenditures. As the graph illustrates, the City, in accordance with its fund balance policies, has been able to increase or maintain its cash and fund balance levels as the volume of financial activity has grown, despite significant legislative cuts to state aid. This is an important factor because a government, like any organization, requires a certain amount of equity to operate. The amount of required equity increases as the size of the operation increases. Increases in the size of the operation are natural, caused by such things as inflation, population growth, desired increases in services, and—something which has impacted cities significantly in recent years—mandated increases in services and administrative requirements.

Generally, 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 can be a factor in determining the City's bond rating and resulting interest costs.

The following graph reflects the City's General Fund revenue sources for 2011 compared to budget:

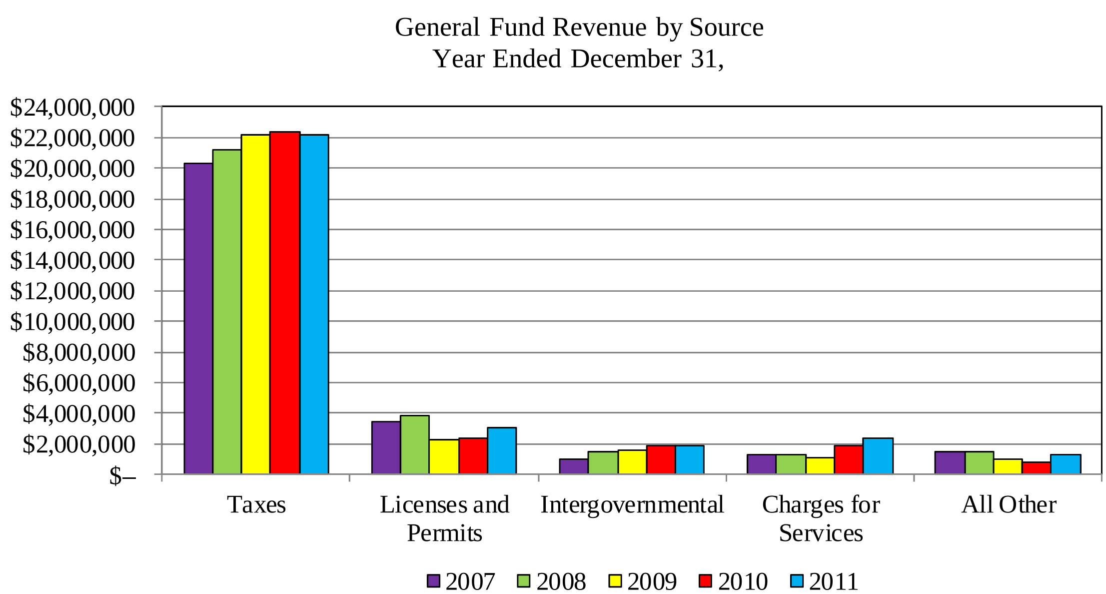


Total General Fund revenues for 2011 were $30,762,769, an increase of $1,523,111 (5.2 percent) from the previous year, and $1,735,582 (6.0 percent) over budget.

Contributing factors to the growth over the prior year and favorable variance to budget included additional licenses and permits revenue and charges for services due to elevated development activity and completed projects in the current year.

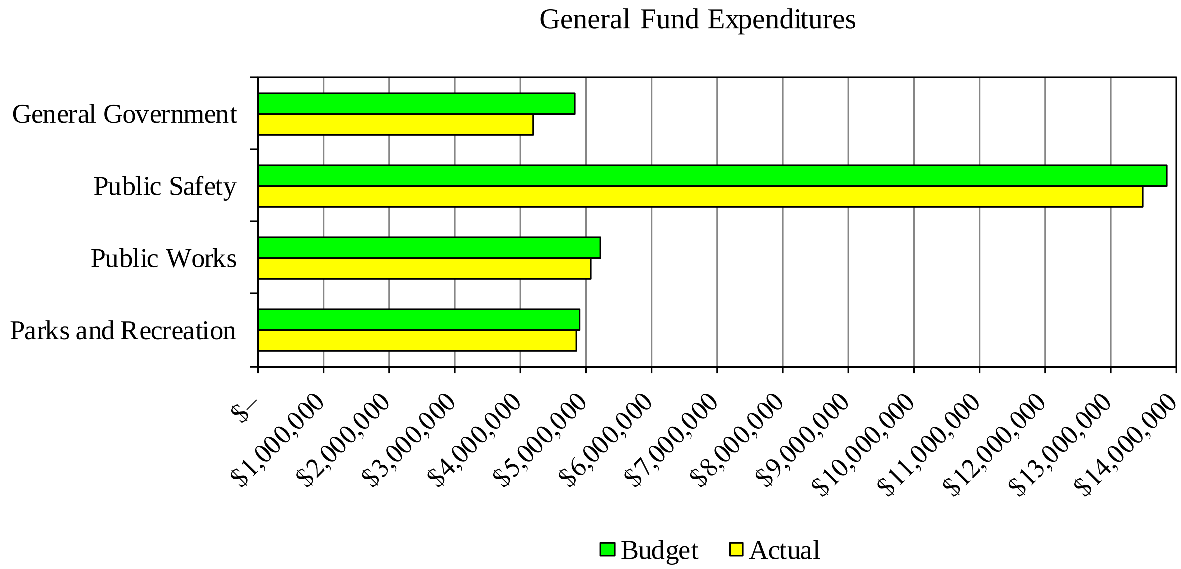
As presented in the graph above, all sources exceeded anticipated levels with the exception of the taxes category. Tax revenue was slightly below amounts anticipated in the budget, by $94,689 (0.4 percent) and down from the prior year by $115,861, as established through the annual levy adoption process.

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



As illustrated by the graph, property taxes are the primary source of funding for the City's General Fund operations. Taxes accounted for 72 percent of the City's General Fund revenues in 2011.

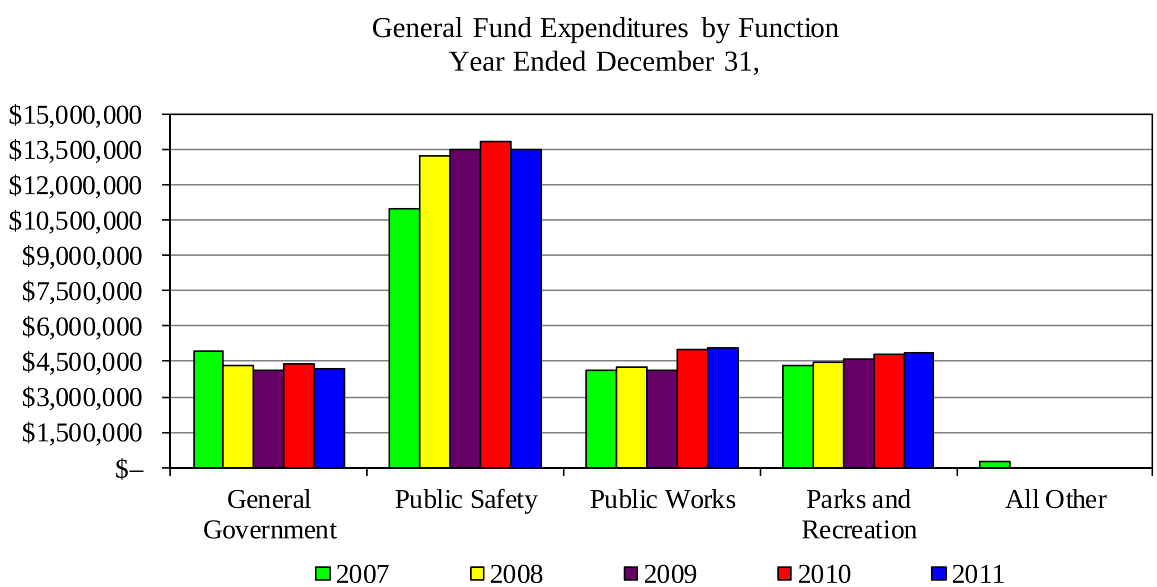
The following graph illustrates the components of General Fund spending for 2011 compared to budget:



Total General Fund expenditures for 2011 were $27,555,949, a decrease of $488,008 (1.7 percent) from the prior year. General Fund expenditures were $1,230,539 (4.3 percent) lower than budget in 2011.

As mentioned in the Management's Discussion and Analysis within the City's financial statements, expenditures were under budget and below prior year levels due to personal cost decreases with attrition and shared restraint spread across several departments. The positive variances in revenues and expenditures allowed the City to make unplanned transfers of $2.5 million to the Infrastructure Replacement Fund.

The following graph illustrates trends in the City's General Fund expenditures by function for the last five years.



UTILITY 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 the City is proactive in reviewing these activities on an ongoing basis and we want to reiterate the importance of continually monitoring these operations. Over the years we have emphasized to our city clients the importance of these utility operations being self-sustaining, preventing additional burdens on general government funds. This would include the accumulation of net assets for future capital improvements and to provide a cushion in the event of a negative trend in operations.

Water Sewer Utility Fund

The following table presents selected data for the City's Water Sewer Utility Fund for the last three years:

	2009		2010		2011	
	Amount	Percent	Amount	Percent	Amount	Percent
Operating revenue	$ 13,089,443	100 %	$ 12,950,063	100 %	$ 12,916,605	100 %
Operating expenses	11,136,477	85	10,523,094	81	10,653,657	82
Depreciation	3,333,342	25	3,403,257	26	3,599,695	28
Operating income (loss)	(1,380,376)	(11)	(976,288)	(8)	(1,336,747)	(10)
Other revenues and contributions	2,279,824	17	1,836,601	14	12,992,030	101
Other expenses	352,412	3	327,125	3	299,173	2
Income before transfers	547,036	4	533,188	4	11,356,110	88
Transfers in	28,953	–	72,354	–	165,080	1
Transfers (out)	(716,741)	(5)	(2,634,995)	(20)	(5,490,504)	(43)
Increase (decrease) in net assets	$ (140,752)	(1) %	$ (2,029,453)	(16) %	$ 6,030,686	47 %

The Water Sewer Utility Fund ended 2011 with net assets of $110,443,265, an increase of $6,030,686 from the prior year. Of this, $81,597,290 represents the investment in capital assets, net of related debt; and $19,572,117 is restricted, leaving $9,273,858 of unrestricted net assets.

This utility experienced significant increases in contributions during the current year for capital assets contributed by other governmental funds and developers.

As seen in the above table, this fund has experienced losses from operations in each of the past three years. 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.

Solid Waste Fund

The following table presents selected data for the City's Solid Waste Fund for the last three years:

	2009		2010		2011	
	Amount	Percent	Amount	Percent	Amount	Percent
Operating revenue	$ 410,956	100 %	$ 710,079	100 %	$ 940,662	100 %
Operating expenses	943,308	230	1,051,623	148	1,057,918	112
Operating income (loss)	(532,352)	(130)	(341,544)	(48)	(117,256)	(12)
Intergovernmental revenue	186,825	45	194,038	27	194,186	21
Other revenue	32,229	8	8,938	1	47,610	5
Income before transfers	(313,298)	(76)	(138,568)	(20)	124,540	13
Transfers (out)	(23,320)	(6)	(23,428)	(3)	(23,538)	(3)
Increase (decrease) in net assets	$(336,618)	(82) %	$ (161,996)	(23) %	$ 101,002	11 %

The Solid Waste Fund ended 2011 with net assets of $2,713,886, an increase of $101,002 from the prior year. The entire net asset balance in this fund is considered unrestricted.

A factor contributing to the change in operating revenue and resulting operations to consider is the impact of changes in the market for recyclable materials, which significantly impacts the shared revenue received from Waste Management.

Water Resources Management Fund

The following table presents selected data for the City's Water Resources Management Fund for the last three years:

	2009		2010		2011	
	Amount	Percent	Amount	Percent	Amount	Percent
Operating revenue	$ 2,546,827	100 %	$ 2,591,565	100 %	$ 2,561,588	100 %
Operating expenses	2,103,338	83	1,841,561	71	1,836,801	72
Operating income	443,489	17	750,004	29	724,787	28
Other revenue	84,776	3	900,907	35	1,030,866	40
Income before transfers	528,265	21	1,650,911	64	1,755,653	69
Contributions	200,570	8	–	–	13,436	1
Transfers in	–	–	41,683	2	1,593	–
Transfers (out)	(127,188)	(5)	(83,020)	(3)	(147,594)	(6)
Increase in net assets	$ 601,647	24 %	$ 1,609,574	62 %	$ 1,623,088	63 %

The Water Resources Management Fund ended 2011 with net assets of $9,524,091, an increase of $1,623,088 from the prior year. Of this, $6,600,143 represents the investment in capital assets, while the remaining $2,923,948 is considered restricted.

Overall, activity of the Water Resources Management Fund was similar to operations experienced in the prior year.

Ice Center Fund

The following table presents selected data for the City's Ice Center Fund for the last three years:

	2009		2010		2011	
	Amount	Percent	Amount	Percent	Amount	Percent
Operating revenue	$1,405,726	100 %	$1,400,703	100 %	$1,406,774	100 %
Operating expenses	1,072,577	76	1,108,263	79	1,180,110	84
Depreciation	470,440	33	470,006	34	470,104	33
Operating income (loss)	(137,291)	(10)	(177,566)	(13)	(243,440)	(17)
Other revenue (expense)	(45,141)	(3)	(60,925)	(4)	(39,349)	(3)
Income (loss) before contributions and transfers	(182,432)	(13)	(238,491)	(17)	(282,789)	(20)
Contributions	–	–	–	–	46,962	3
Transfers in	17,495	1	–	–	–	–
Transfers (out)	(21,439)	(2)	(21,439)	(2)	(21,439)	(2)
Increase (decrease) in net assets	$ (186,376)	(13) %	$ (259,930)	(19) %	$ (257,266)	(18) %

The Ice Center Fund ended 2011 with net assets of $9,992,738, a decrease of $257,266 from the prior year. Of this, $10,191,248 represents the investment in capital assets, net of related debt, leaving an unrestricted net asset deficit of $198,510. This unrestricted deficit is due to the application of interfund loans against the unrestricted component of net assets as required by GASB.

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.

Field House Fund

The following table presents selected data for the City's Field House Fund for the last three years:

	2009		2010		2011	
	Amount	Percent	Amount	Percent	Amount	Percent
Operating revenue	$ 364,353	100 %	$ 368,795	100 %	$ 348,008	100 %
Operating expenses	194,503	53	196,289	53	193,600	56
Depreciation	98,028	27	57,354	16	35,766	10
Operating income (loss)	71,822	20	115,152	31	118,642	34
Other revenue	8,787	2	3,831	1	22,162	6
Income (loss) before transfers	80,609	22	118,983	32	140,804	40
Transfers (out)	(5,724)	(2)	(5,724)	(2)	(5,724)	(2)
Increase (decrease) in net assets	$ 74,885	21 %	$ 113,259	31 %	$ 135,080	39 %

The Field House Fund ended 2011 with net assets of $1,804,705, an increase of $135,080 from the prior year. Of this, $558,052 represents the investment in capital assets, leaving $1,246,653 of unrestricted net assets.

As presented in the table above, the Field House Fund experienced similar operations to the prior year and positive operating income for all years displayed. The fees charged in this fund are developed to cover operating expenses, repairs, and betterment of field house facilities.

GOVERNMENT-WIDE FINANCIAL STATEMENTS

The City's financial statements include fund-based information that focuses on budgetary compliance, and the sufficiency of the City's current assets to finance its current liabilities. The GASB Statement No. 34 reporting model 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 statements provide information on the total cost of delivering services, including capital assets and long-term liabilities.

Statement of Net Assets

The Statement of Net Assets essentially tells you what your city owns and owes at a given point in time, the last day of the fiscal year. Theoretically, net assets represent 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, the Statement of Net Assets divides the net assets into three components: net assets invested in capital assets, net of related debt; restricted net assets; and unrestricted net assets.

The following table presents components of the City's net assets as of December 31, 2011 and 2010 for governmental activities, business-type activities, and the Housing and Redevelopment Authority (HRA) component unit:

	As of December 31,		Increase
	2011	2010	(Decrease)
Net assets			
Governmental activities			
Invested in capital assets, net of related debt	$ 161,819,746	$ 155,551,228	$ 6,268,518
Restricted	16,127,403	5,743,606	10,383,797
Unrestricted	76,772,980	79,792,136	(3,019,156)
Total governmental activities	254,720,129	241,086,970	13,633,159
Business-type activities			
Invested in capital assets, net of related debt	98,946,733	92,171,246	6,775,487
Restricted	22,515,063	20,833,400	1,681,663
Unrestricted	12,781,287	13,540,924	(759,637)
Total business-type activities	134,243,083	126,545,570	7,697,513
Housing and Redevelopment Authority			
Invested in capital assets, net of related debt	(745,736)	(531,626)	(214,110)
Restricted	4,494,253	624,029	3,870,224
Unrestricted	1,314,466	4,564,165	(3,249,699)
Total Housing and Redevelopment Authority	5,062,983	4,656,568	406,415
Total net assets	$ 394,026,195	$ 372,289,108	$ 21,737,087

The City (including the HRA) ended 2011 with combined total net assets of $394,026,195, an increase of $21,737,087 from the prior year. Several factors contributed to this increase as discussed earlier in the report. Significant capital contributions recognized from developers in the current year with elevated development activity also contributed to the increase over the prior year.

Statement of Activities

The Statement of Activities tracks the City's yearly revenues and expenses, as well as any other transactions that increase or reduce total net assets. 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 assets of the City and the HRA for the years ended December 31, 2011 and 2010:

	2011			2010
	Expenses	Program Revenues	Net Change	Net Change
Net (expense) revenue				
Governmental activities				
General government	$ 4,299,985	$ 679,945	$ (3,620,040)	$ (4,158,805)
Economic development	352,956	6,951	(346,005)	(208,496)
Parks and recreation	8,115,235	4,662,697	(3,452,538)	(5,391,098)
Public safety	13,713,491	5,270,348	(8,443,143)	(9,700,667)
Public service	4,431,518	4,253,431	(178,087)	(1,087,915)
Public works	11,936,097	8,761,865	(3,174,232)	(5,135,938)
Interest on long-term debt	636,097	–	(636,097)	(647,858)
Business-type activities				
Water sewer utility	14,497,066	23,309,464	8,812,398	(506,283)
Ice center	1,726,131	1,408,774	(317,357)	(268,442)
Solid waste management	1,054,903	1,134,848	79,945	(144,710)
Water resource	1,817,803	3,538,148	1,720,345	1,654,861
Field house	230,101	348,008	117,907	114,131
Housing and Redevelopment Authority	6,216,246	5,964,878	(251,368)	(463,560)
Total net (expense) revenue	$ 69,027,629	$ 59,339,357	(9,688,272)	(25,944,780)
General revenues				
Property taxes			29,074,567	29,106,018
Unrestricted investment earnings			2,284,723	754,117
Other			66,069	491,995
Total general revenues			31,425,359	30,352,130
Change in net assets			$ 21,737,087	$ 4,407,350

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 City's governmental operations tend to rely more heavily on general revenues, such as property taxes. In contrast, the City's business-type activities tend to rely more heavily on program revenues (service charges and program specific grants) to cover expenses. This is critical given the current external downward pressures on general revenue sources such as taxes and state aids.

GASB STATEMENT NO. 60 – ACCOUNTING AND FINANCIAL REPORTING FOR SERVICE CONCESSION ARRANGEMENTS

This statement provides accounting and financial reporting guidance for governments that participate as either a transferor or an operator in a service concession arrangement (SCA). SCAs are arrangements whereby a government transfers the rights to operate one of its capital assets to a third party operator (either a private party or another government) for consideration, with the operator then being compensated from the fees or charges collected in connection with the operation of the asset. To qualify as an SCA, an arrangement must meet all of the following criteria: 1) the transferor must convey to the operator both the right and the obligation to use one of its capital assets to provide services to the public; 2) the operator must provide significant consideration to the transferor; 3) the operator must be compensated from the fees or charges it collects from third parties; 4) the transferor must have the ability to either determine, modify, or approve what services are to be provided to whom at what price; and 5) the transferor must retain a significant residual interest in the service utility of the asset. This statement provides guidance to governments that are party to an SCA for reporting the assets, obligations, and flow of revenues that result from the arrangement; along with the required financial statement disclosures. The requirements of this statement must be implemented for periods beginning after December 15, 2011, with earlier implementation encouraged.

GASB STATEMENT NO. 61 – THE FINANCIAL REPORTING ENTITY: OMNIBUS

This statement amends the current guidance in GASB Statement No. 14, "The Financial Reporting Entity," for identifying and presenting component units. This statement changes the fiscal dependency criterion for determining component units. Potential component units that meet the fiscal dependency criterion for inclusion in the financial reporting entity under existing guidance will only be included if there is also "financial interdependency" (an ongoing relationship of potential financial benefit or burden) with the primary government. This statement also clarifies the types of relationships that are considered to meet the "misleading to exclude" criterion for inclusion as a component unit; changes the criteria for blending component units; gives direction for the determination and disclosure of major component units; and adds a requirement to report an explicit, measurable equity interest in a discretely presented component unit in a statement of position prepared using the economic resources measurement focus. The requirements of this statement must be implemented for periods beginning after June 15, 2012, with earlier implementation encouraged.

GASB STATEMENT NO. 63 – FINANCIAL REPORTING OF DEFERRED OUTFLOWS OF RESOURCES, DEFERRED INFLOWS OF RESOURCES, AND NET POSITION

This statement provides financial reporting guidance for deferred outflows of resources and deferred inflows of resources; which are defined as the consumption or acquisition of net assets, respectively, applicable to a future reporting period. The statement amends certain reporting requirements in GASB Statement No. 34 and related pronouncements, providing a format for a new Statement of Net Position, which reports deferred outflows of resources and deferred inflows of resources separately from assets and liabilities. It also renames the residual of assets, deferred outflows of resources, liabilities, and deferred inflows of resources as net position, rather than net assets. The requirements of this statement must be implemented for periods beginning after December 15, 2011, with earlier implementation encouraged.

GASB Pension Exposure Drafts

In June 2011, GASB issued two exposure drafts on accounting and reporting for pensions, one for the reporting of pension benefits within the financial statements of participating employers and the other for pension plan financial reporting. These two exposure drafts are intended to update or replace the current guidance for pension reporting in GASB Statement Nos. 25 and 27.

The exposure drafts propose a variety of changes in financial statement presentation, measurement, and required disclosures relating to pension benefits. Included are proposed major changes in how employers that participate in cost-sharing defined benefit pension plans, such as TRA and PERA, account for pension benefit expenses and liabilities. Currently, employers participating in such plans recognize pension expenses and liabilities only to the extent of their contractually required annual contributions to the plan. The exposure draft proposes that those employers recognize their proportionate share of the collective net pension liability and collective pension expense for all participating employers. If adopted, this guidance could have a significant impact on the financial statements of the participating employers, as participants in plans with a substantial unfunded liability would be required to report their proportionate share of the unfunded liability in their government-wide financial statements.

The proposed effective dates for both exposure drafts are for periods beginning after June 15, 2012, if certain conditions are met, otherwise for periods beginning after June 30, 2013.

Federal Funding Accountability and Transparency Act (Transparency Act)

Effective October 1, 2010, the Transparency Act requires federal award recipients to report specific data, including compensation data in certain circumstances, related to subawards. One of the key requirements of the Transparency Act was the creation of a single, searchable website that provides the public with greater access to information on federal spending. The Transparency Act requires recipients to report first-tier subaward and executive compensation data for new federal grants as of October 1, 2010, if the initial award is equal to or over $25,000. Pass through entities (primary recipients) must report subaward data through the Federal Funding Accountability and Transparency Subaward Reporting System (FSRS) by the end of the month following the month in which the subaward obligation is made. For a more detailed discussion of the Transparency Act see Part 3, Section L of the 2011 U.S. Office of Management and Budget (OMB) Circular A-133 *Compliance Supplement* available at www.whitehouse.gov/omb. The OMB has issued several documents that provide guidance on the Transparency Act, including *Open Government Directive – Federal Spending Transparency* and *Subaward and Compensation Data Reporting*, available at www.whitehouse.gov/omb/open.