

Management Report
for
City of Farmington, Minnesota
December 31, 2016

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PRINCIPALS

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To the City Council and Management
City of Farmington, Minnesota

We have prepared this management report in conjunction with our audit of the City of Farmington, Minnesota's (the City) financial statements for the year ended December 31, 2016. We have organized this report into the following sections:

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

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

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

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

Minneapolis, Minnesota
May 8, 2017

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AUDIT SUMMARY

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

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

We have audited the financial statements of the governmental activities, the business-type activities, the discretely presented component unit, each major fund, and the aggregate remaining fund information of the City as of and for the year ended December 31, 2016, and the related notes to the financial statements. Professional standards require that we provide you with information about our responsibilities under auditing standards generally accepted in the United States of America and *Government Auditing Standards*, as well as certain information related to the planned scope and timing of our audit. We have communicated such information to you verbally and in our audit engagement letter. Professional standards also require that we communicate the following information related to our audit.

PLANNED SCOPE AND TIMING OF THE AUDIT

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

AUDIT OPINION AND FINDINGS

Based on our audit of the City's financial statements for the year ended December 31, 2016:

- We have issued an unmodified opinion on the City's basic financial statements.
- We reported one matter involving the City's internal control over financial reporting that we consider to be a material weakness. Due to the limited size of the City's office staff, the City has limited segregation of duties in certain areas.
- The results of our testing disclosed no instances of noncompliance that are required to be reported under *Governmental Auditing Standards*.
- We reported no findings based on our testing of the City's compliance with Minnesota laws and regulations.

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, 2016, we performed procedures to follow-up on the findings and recommendations that resulted from our prior year audit. We reported the following findings that were corrected by the City in the current year:

- One claim selected for testing was not reviewed and approved by the City Council prior to payment as required by Minnesota Statutes. The disbursement had been inadvertently omitted from the check listing submitted to the City Council for approval. Based on our testing, there is not a similar finding in the current year.

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, 2016. We noted no transactions entered into by the City during the year for which there is a lack of authoritative guidance or consensus. All significant transactions have been recognized in the financial statements in the proper period.

CORRECTED AND UNCORRECTED MISSTATEMENTS

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

ACCOUNTING ESTIMATES AND MANAGEMENT JUDGMENTS

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

- **Net Other Post-Employment Benefit (OPEB) and Pension Liabilities** – The City has recorded liabilities and activity for other post-employment benefits (OPEB) and pension benefits. These obligations are calculated using actuarial methodologies described in Governmental Accounting Standards Board Statement (GASB) Nos. 45 and 68. These actuarial calculations include significant assumptions, including projected changes, healthcare insurance costs, investment returns, retirement ages, proportionate share, and employee turnover.
- **Depreciation** – Management's estimates of depreciation expense are based on the estimated useful lives of the assets.
- **Compensated Absences** – Management's estimate is based on current rates of pay, compensated absence balances, and the likelihood that sick leave will ultimately be paid at termination.

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

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

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.

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 May 8, 2017.

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 management's discussion and analysis and the pension and OPEB-related required supplementary information (RSI) that supplements the basic financial statements. Our procedures consisted of inquiries of management regarding the methods of preparing the information and comparing the information for consistency with management's responses to our inquiries, the basic financial statements, and other knowledge we obtained during our audit of the basic financial statements. We did not audit the RSI and do not express an opinion or provide any assurance on the RSI.

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

We were not engaged to report on the introductory and statistical sections which accompany the financial statements but are not RSI. We did not audit or perform other procedures on this other information and we do not express an opinion or provide any assurance on it.

GOVERNMENTAL FUNDS OVERVIEW

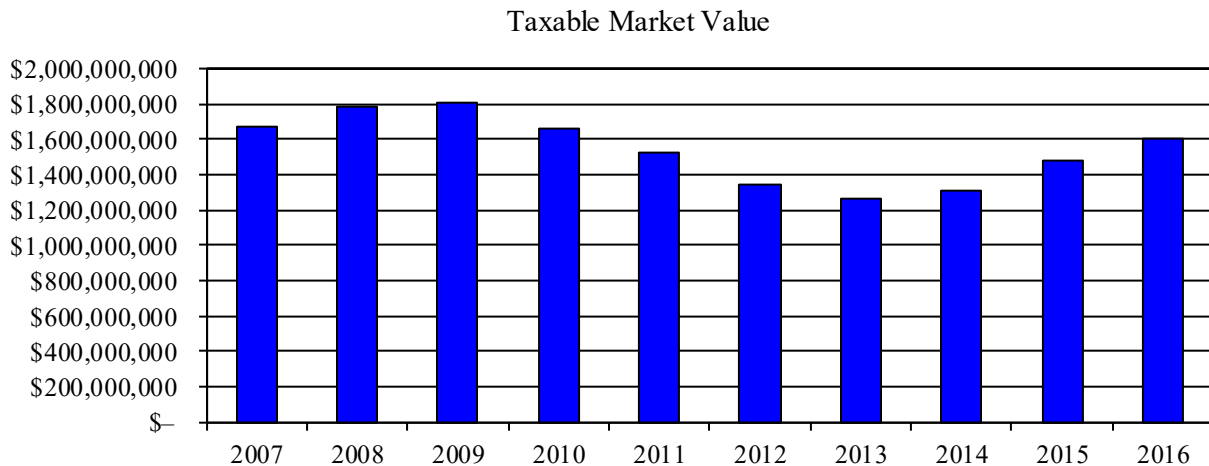
This section of the report provides you with an overview of the financial trends and activities of the City's governmental funds, which includes the General, special revenue, debt service, and capital project funds. These funds are used to account for the basic services the City provides to all of its 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 2015 fiscal year, local ad valorem property tax levies provided 39.8 percent of the total governmental fund revenues for cities over 2,500 in population, and 35.6 percent for cities under 2,500 in population. Property tax levies certified by Minnesota cities for 2016 increased about 4.8 percent over 2015, compared to an increase of 4.0 percent the prior year.

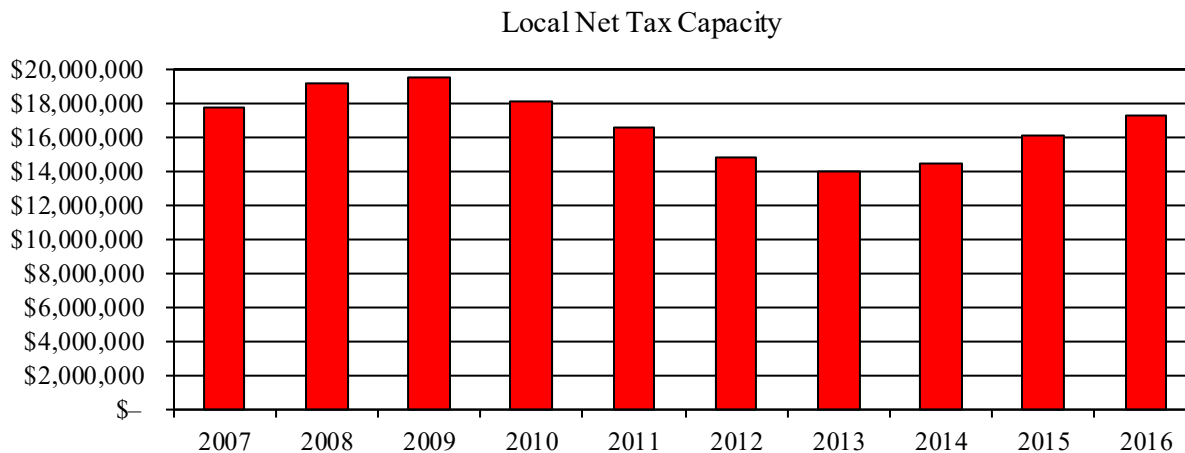
The total market value of property in Minnesota cities increased about 5.7 percent for the 2016 levy year. While the percentage of market value growth was less than the 8.5 percent increase for levy year 2015, it was considerably larger than the 1.1 percent growth experienced in levy year 2014. Market values increased across all property categories for 2016, with gains in the market values of non-homestead residential properties (9.1 percent) and other properties (7.3 percent) outpacing the market value gain of residential homestead properties (5.0 percent), commercial/industrial properties (4.9 percent), and farms (0.1 percent). The market values used for levying property taxes are based on the previous fiscal year (e.g., market values for taxes levied in 2016 were based on assessed values as of January 1, 2015), so the trend of change in these market values lags somewhat behind the housing market and economy in general.

The City's taxable market value increased 12.5 percent for taxes payable in 2015 and 8.5 percent for taxes payable in 2016. 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 increased 11.4 percent for taxes payable in 2015 and 7.9 percent for taxes payable in 2016.

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:

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

The City's portion of the tax rate is higher than the average Minnesota city. The City has historically received more of its governmental fund revenue from property taxes than the average Minnesota city, due to the lower than average amount of aid it typically receives from the state. The City portion of the tax rates for 2016 showed a small decrease from the prior year, as a levy increase was offset by improvements in property tax capacities.

GOVERNMENTAL FUND BALANCES

The following table summarizes the changes in the fund balances of the City's governmental funds during the year ended December 31, 2016, presented both by fund balance classification and by fund:

Governmental Funds Change in Fund Balance			
	Fund Balance as of December 31,		Increase (Decrease)
	<u>2016</u>	<u>2015</u>	
Fund balances of governmental funds			
Total by classification			
Nonspendable	\$ 33,872	\$ 6,184	\$ 27,688
Restricted	16,959,150	5,776,314	11,182,836
Committed	5,158,828	8,025,185	(2,866,357)
Assigned	-	4,250	(4,250)
Unassigned	<u>5,031,529</u>	<u>4,734,534</u>	<u>296,995</u>
Total – governmental funds	<u>\$ 27,183,379</u>	<u>\$ 18,546,467</u>	<u>\$ 8,636,912</u>
Total by fund			
General	\$ 5,065,291	\$ 4,744,818	\$ 320,473
Debt Service	16,663,140	5,482,325	11,180,815
State Aid Construction Capital Projects	396,538	1,731,020	(1,334,482)
Storm Water Trunk Capital Projects	2,603,763	3,689,276	(1,085,513)
Permanent Improving Revolving Capital Projects	151,184	135,560	15,624
Maintenance Capital Projects	136,382	968,730	(832,348)
Nonmajor	<u>2,167,081</u>	<u>1,794,738</u>	<u>372,343</u>
Total – governmental funds	<u>\$ 27,183,379</u>	<u>\$ 18,546,467</u>	<u>\$ 8,636,912</u>

In total, the fund balances of the City's governmental funds increased by \$8,636,912 during the year ended December 31, 2016.

The increase in restricted fund balances of \$11,182,836 relates primarily to interfund transfers and refunding bond proceeds recorded in the Debt Service Fund, which will be used to redeem several outstanding bond issues on their optional payment date of February 1, 2017.

Committed fund balance decreased \$2,866,357, mainly due to the combination of transfers from the State Aid Construction Capital Projects Fund to the Debt Service Fund for future bond redemption, and the City electing to redeem another outstanding debt issue in 2016 using resources available in the Storm Water Trunk Capital Projects Fund.

Unassigned fund balance increased \$296,995 due primarily to positive operating results in the General Fund.

GOVERNMENTAL FUNDS REVENUE AND EXPENDITURES

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

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

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

Governmental Funds Revenue per Capita						
With State-Wide Averages by Population Class						
Year	State-Wide		City of Farmington			
	December 31, 2015		2014	2015	2016	
Population	10,000–20,000	20,000–100,000	22,386	22,451	22,451	
Property taxes	\$ 414	\$ 443	\$ 493	\$ 511	\$ 528	
Tax increments	33	37	–	–	–	
Franchise and other taxes	42	39	12	12	12	
Special assessments	52	59	37	29	24	
Licenses and permits	31	43	23	17	29	
Intergovernmental revenues	322	156	45	93	73	
Charges for services	85	94	40	37	48	
Other	62	58	17	17	24	
Total revenue	\$ 1,041	\$ 929	\$ 667	\$ 716	\$ 738	

The City's governmental fund revenues for 2016 were \$16,575,132, an increase of \$511,321 (3.2 percent), or \$22 per capita from the prior year. Revenue from property taxes was \$17 per capita higher than the prior year due to increases in the City's levy and excess tax increments redistributed by the county from the City's decertified TIF District #2 City Center. Licenses and permits were \$12 per capita higher than last year, mainly as a result of increased residential development. Intergovernmental revenue was down \$20 per capita from the previous year, as the City received less state aid for street improvements in 2016.

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

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

- **Current** – These are typically the general operating type expenditures occurring on an annual basis, and are primarily funded by general sources such as taxes and intergovernmental revenues.
- **Capital Outlay and Construction** – These expenditures do not occur on a consistent basis, more typically fluctuating significantly from year-to-year. Many of these expenditures are project-oriented, and are often funded by specific sources that have benefited from the expenditure, such as special assessment improvement projects.
- **Debt Service** – Although the expenditures for debt service may be relatively consistent over the term of the respective debt, the funding source is the important factor. Some debt may be repaid through specific sources such as special assessments or redevelopment funding, while other debt may be repaid with general property taxes.

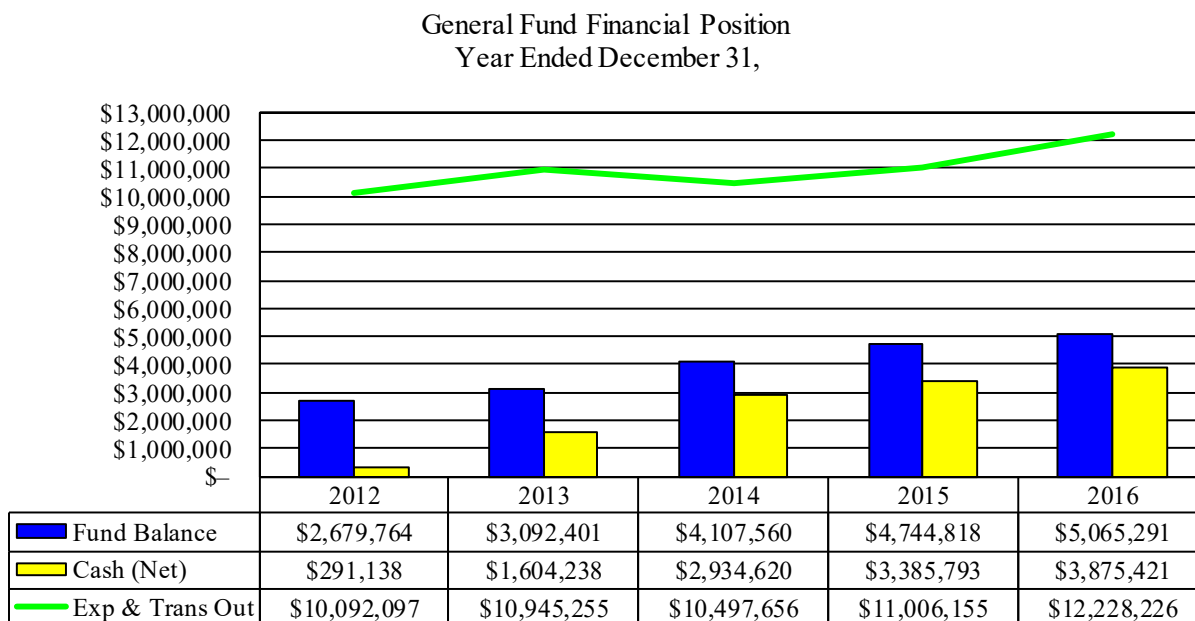
The City’s expenditures per capita of its governmental funds for the past three years, together with state-wide averages, are presented in the following table:

Governmental Funds Expenditures per Capita With State-Wide Averages by Population Class					
Year	State-Wide		City of Farmington		
	December 31, 2015		2014	2015	2016
Population	10,000–20,000	20,000–100,000	22,386	22,451	22,451
Current					
General government	\$ 109	\$ 89	\$ 77	\$ 87	\$ 89
Public safety	244	261	218	229	236
Streets and highways	117	99	91	88	89
Culture and recreation	108	94	65	69	67
All other	70	89	2	4	2
	<u>648</u>	<u>632</u>	<u>453</u>	<u>477</u>	<u>483</u>
Capital outlay and construction	389	286	82	209	123
Debt service					
Principal	178	117	106	129	196
Interest and fiscal charges	40	33	49	46	49
	<u>218</u>	<u>150</u>	<u>155</u>	<u>175</u>	<u>245</u>
Total expenditures	<u>\$ 1,255</u>	<u>\$ 1,068</u>	<u>\$ 690</u>	<u>\$ 861</u>	<u>\$ 851</u>

Total expenditures in the City’s governmental funds for 2016 were \$19,120,332, a decrease of \$194,566 (1.0 percent), or \$10 per capita, from the previous year. Capital outlay and construction expenditures were \$86 per capita lower than last year, primarily due to funds expended for the Henderson Project and the joint county/city 195th Street Reconstruction Project in the previous year. This was partially offset by a \$70 per capita increase debt service, due to the City electing to redeem the 2017 through 2026 maturities of its 2005C General Obligation Capital Improvement bonds on the optional February 1, 2016 call date using available internal resources.

GENERAL FUND

The City's General Fund accounts for the financial activity of the basic services provided to the community. The primary services included within this fund are the administration of the municipal operation, police and fire protection, building inspection, streets and highway maintenance, and parks and recreation. The graph below illustrates the change in the General Fund financial position over the last five years. We have also included a line representing annual expenditures and transfers out to reflect the change in the size of the General Fund operation over the same period.



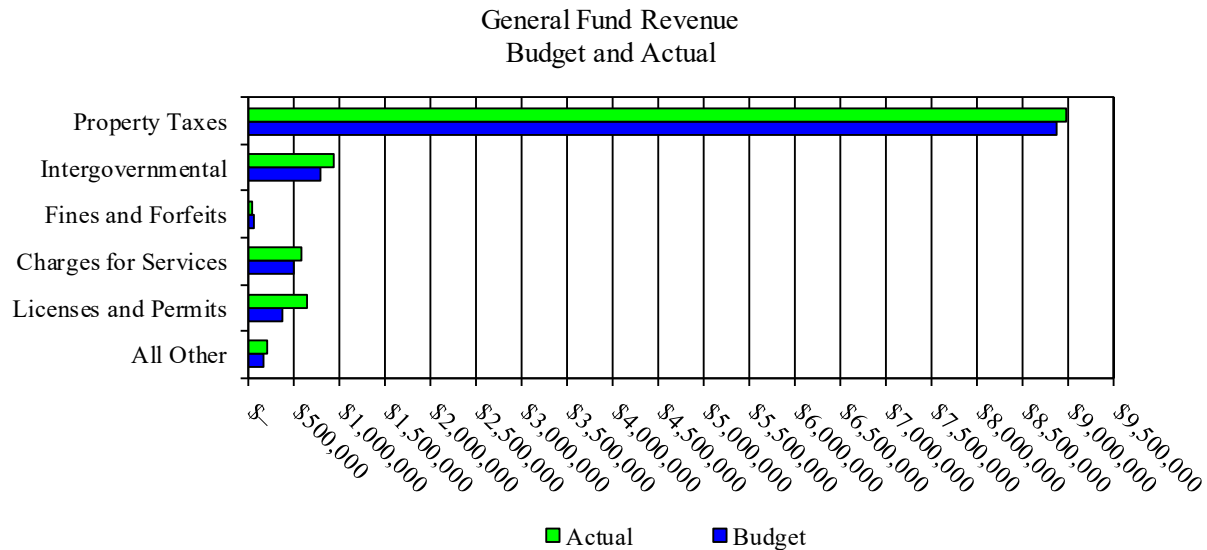
The City's General Fund cash and investments, net of interfund borrowing at December 31, 2016 was \$489,628 higher than at the previous year-end. Total fund balance at December 31, 2016 of \$5,065,291 represented an increase of \$320,473 from the prior year, as compared to a breakeven budget.

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

A trend that is typical to Minnesota local governments, especially the General Fund of cities, is the unusual cash flow experienced throughout the year. The City's General Fund cash disbursements are made fairly evenly during the year other than the impact of seasonal services such as snowplowing, street maintenance, and park activities. Cash receipts of the General Fund are quite a different story. Property taxes comprise about 78.7 percent of the fund's total annual revenue. Approximately half of these revenues are received by the City in July and the rest in December. Consequently, the City needs to have adequate cash reserves to finance its everyday operations between these payments.

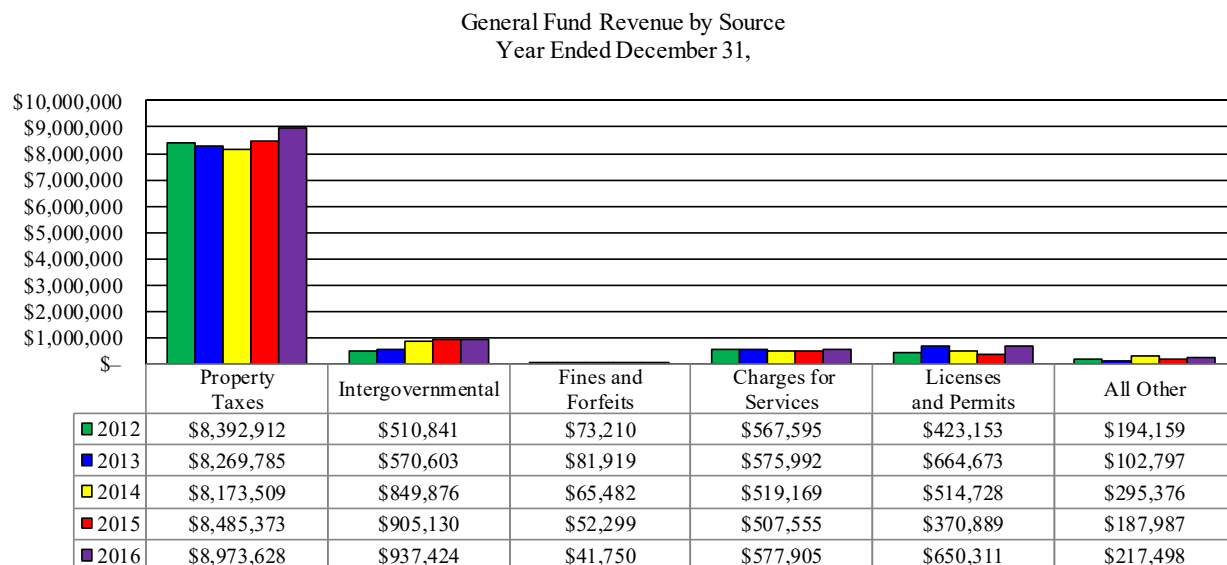
The City's unrestricted (assigned and unassigned) General Fund balance of \$5,031,529 at the end of the 2016 fiscal year represented approximately 41.2 percent of budgeted expenditures and transfers out for 2017. This is within the City's policy that calls for maintaining an unrestricted fund balance of between 40.0–50.0 percent of the subsequent year's budgeted expenditures and transfers out.

The following chart reflects the City's General Fund revenue sources for 2016 compared to budget:



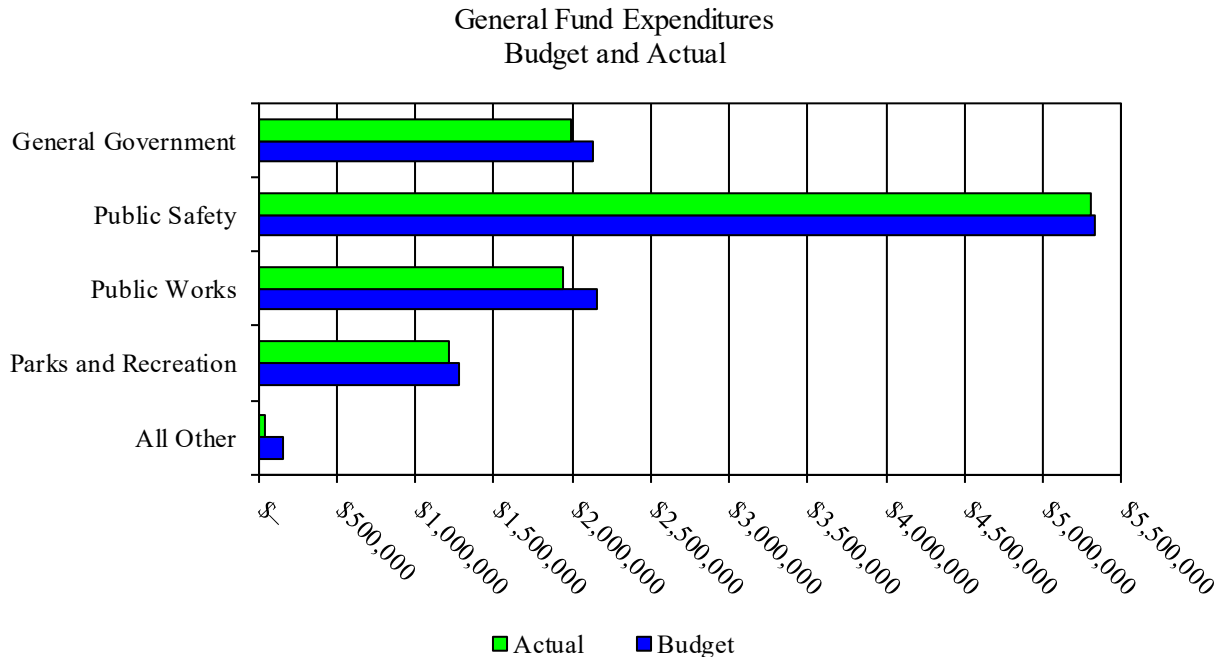
General Fund revenue for 2016 was \$11,398,516, which was \$628,662 (5.8 percent) more than budget. Property tax revenues were \$106,458 over budget, mainly due to the excess tax increment distribution received that was not anticipated in the budget. Intergovernmental revenue exceeded budget by \$134,290, as MSA street maintenance, fire pension and training aid, and police aid were all higher than projected. Charges for services exceeded budget by \$86,205, mainly due to fire charges exceeding expectations. Revenue from licenses and permits were \$282,608 more than budget, as building permits were higher than anticipated. Finally, revenue in the “all other” category was over budget by \$42,351.

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



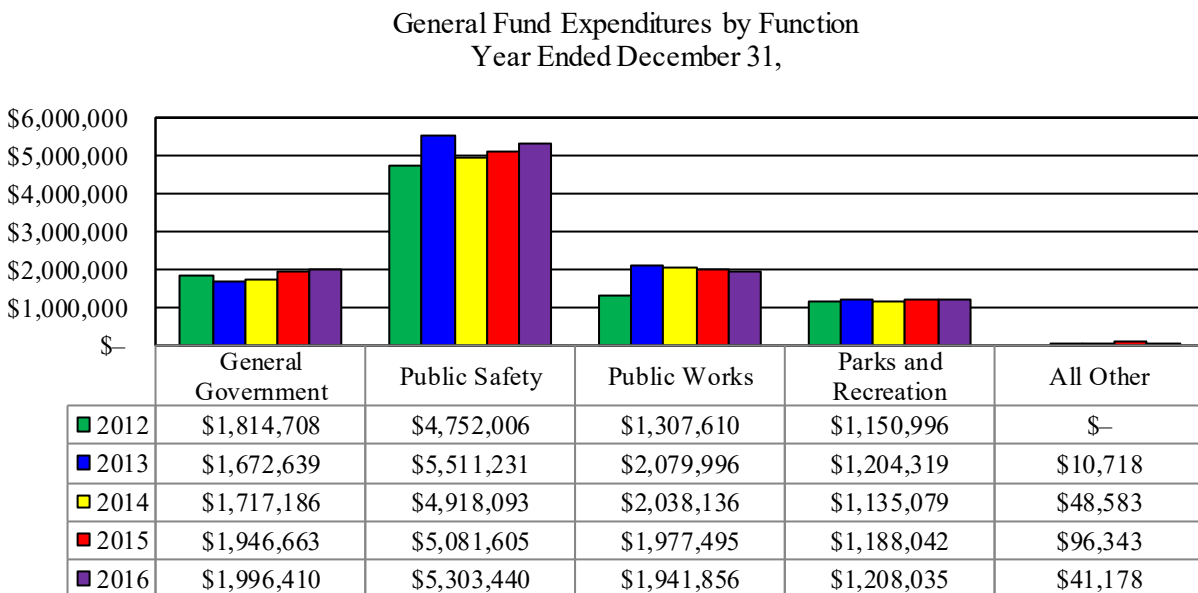
Total General Fund revenue for 2016 was \$889,283 (8.5 percent) higher than last year. Property taxes were \$488,255 higher than last year due to the increased tax levy and the excess tax increment distribution received. License and permit revenues increased \$279,422 from last year due to an increase in building permits. Charges for service increased \$70,350, mainly as a result of increased fire charges.

The following graphs illustrate the components of General Fund spending for 2016 compared to budget:



General Fund expenditures for 2016 were \$10,490,919, which was \$560,699 (5.1 percent) under budget. Expenditures were under budget due to milder weather, lower fuel prices, and conservative spending, with the largest savings in general government (\$134,486) and public works (\$217,055). Expenditures in the “all other” category were under budget by (\$118,822), mainly due to a difference between how the City’s \$120,000 interfund loan principal repayment was budgeted (as an expenditure) and how it is reflected in the financial statements (impacts the Balance Sheet only).

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



Total General Fund expenditures for 2016 were \$200,771 (2.0 percent) higher than the previous year. The largest increase was in public safety expenditures, which were \$221,835 higher than last year.

ENTERPRISE FUNDS OVERVIEW

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

ENTERPRISE FUNDS FINANCIAL POSITION

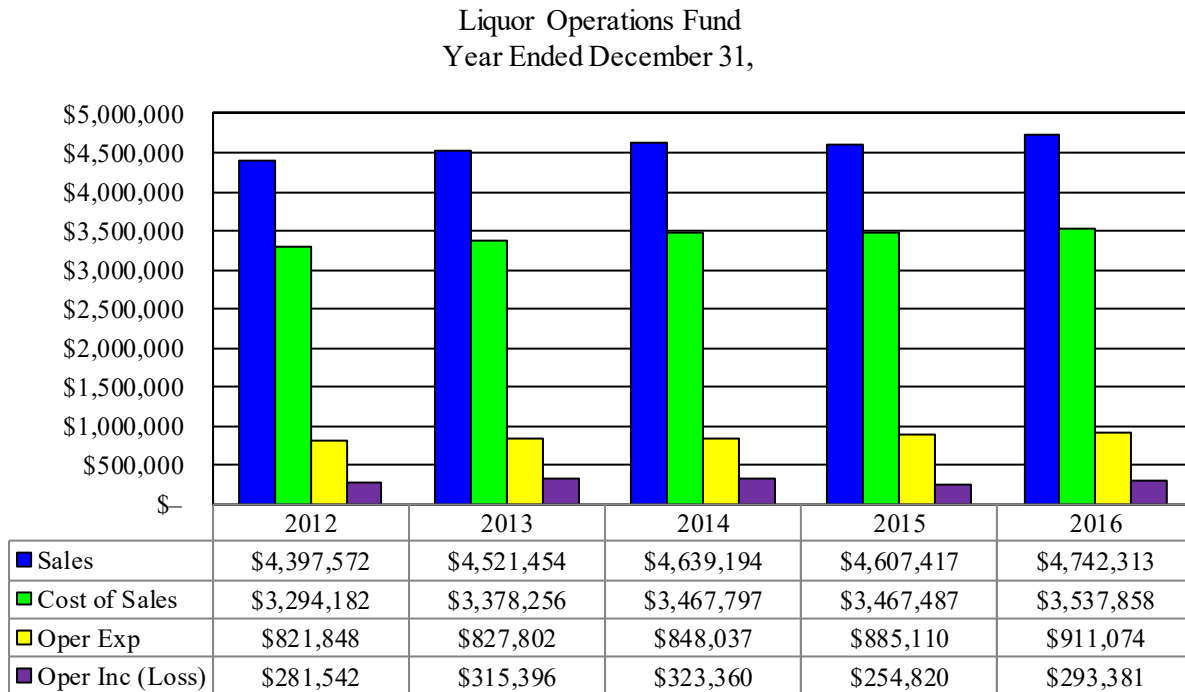
The following table summarizes the changes in the financial position of the City's enterprise funds during the year ended December 31, 2016, presented both by classification and by fund:

Enterprise Funds Change in Financial Position			
	Net Position as of December 31,		Increase (Decrease)
	<u>2016</u>	<u>2015</u>	
Net position of enterprise funds			
Total by classification			
Net investment in capital assets	\$ 53,225,787	\$ 54,807,938	\$ (1,582,151)
Restricted – future drinking water treatment plant	2,231,966	2,160,566	71,400
Unrestricted	<u>12,575,526</u>	<u>11,439,369</u>	<u>1,136,157</u>
Total – enterprise funds	<u>\$ 68,033,279</u>	<u>\$ 68,407,873</u>	<u>\$ (374,594)</u>
Total by fund			
Liquor Operations	\$ 1,057,545	\$ 956,725	\$ 100,820
Sewer Operations	21,148,014	21,446,130	(298,116)
Solid Waste	1,545,800	1,347,092	198,708
Storm Water	14,684,236	14,907,068	(222,832)
Water	29,531,419	29,622,133	(90,714)
Street Light	<u>66,265</u>	<u>128,725</u>	<u>(62,460)</u>
Total – enterprise funds	<u>\$ 68,033,279</u>	<u>\$ 68,407,873</u>	<u>\$ (374,594)</u>

In total, the net position of the City's enterprise funds decreased by \$374,594 during the year ended December 31, 2016. The City's net investment in capital assets decreased \$1,582,151 during the year due to depreciation. Unrestricted net position increased by \$1,136,157, as most of the City's enterprise operations had positive operating results prior to transfers out. The enterprise funds transferred a total of \$1,428,106 to the governmental and internal service funds during the year to support the General Fund, help pay for capital improvements, and for debt service.

LIQUOR OPERATIONS FUND

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



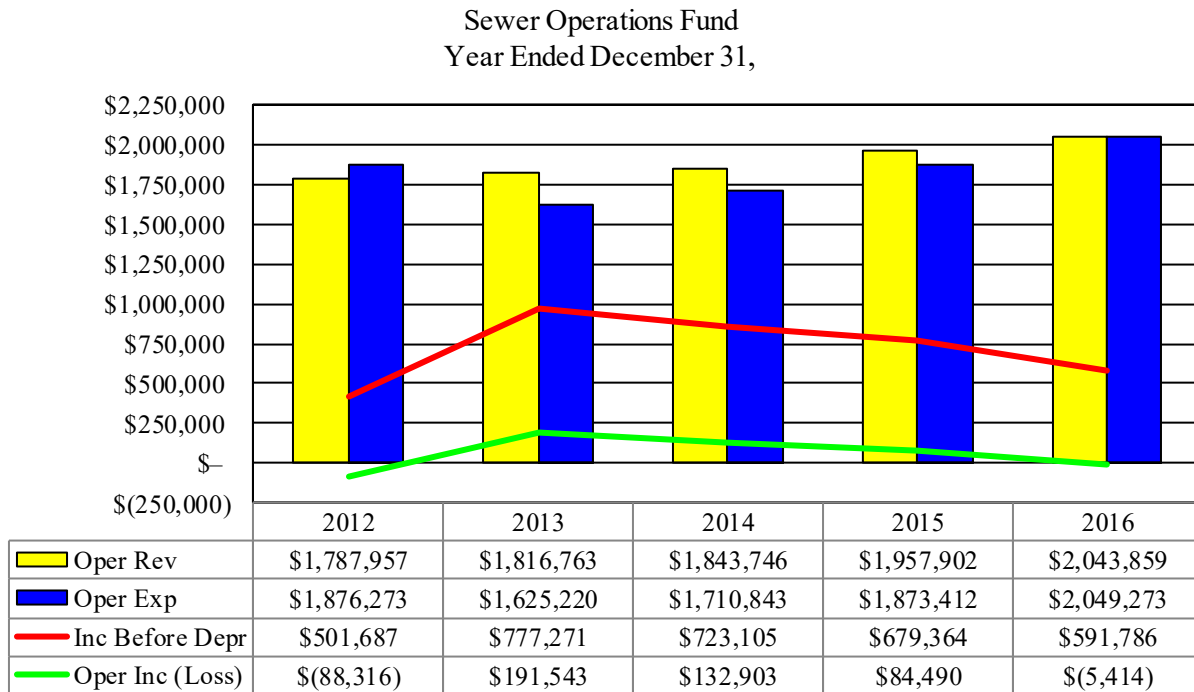
The City's Liquor Operations Fund ended 2016 with an unrestricted net position of \$1,057,545, an increase of \$100,820 from the prior year.

The Liquor Operations Fund had gross sales of \$4,742,313 in 2016, an increase of \$134,896 (2.9 percent) from the previous year. Gross profit was \$1,204,455, about 25.4 percent of sales, up from 24.7 percent in 2015.

Operating expenses for 2016 increased of \$25,964 (2.9 percent) from the previous year, mainly in salaries and benefits related to the City's proportionate share of the state's underfunded pension plan obligations.

SEWER OPERATIONS FUND

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



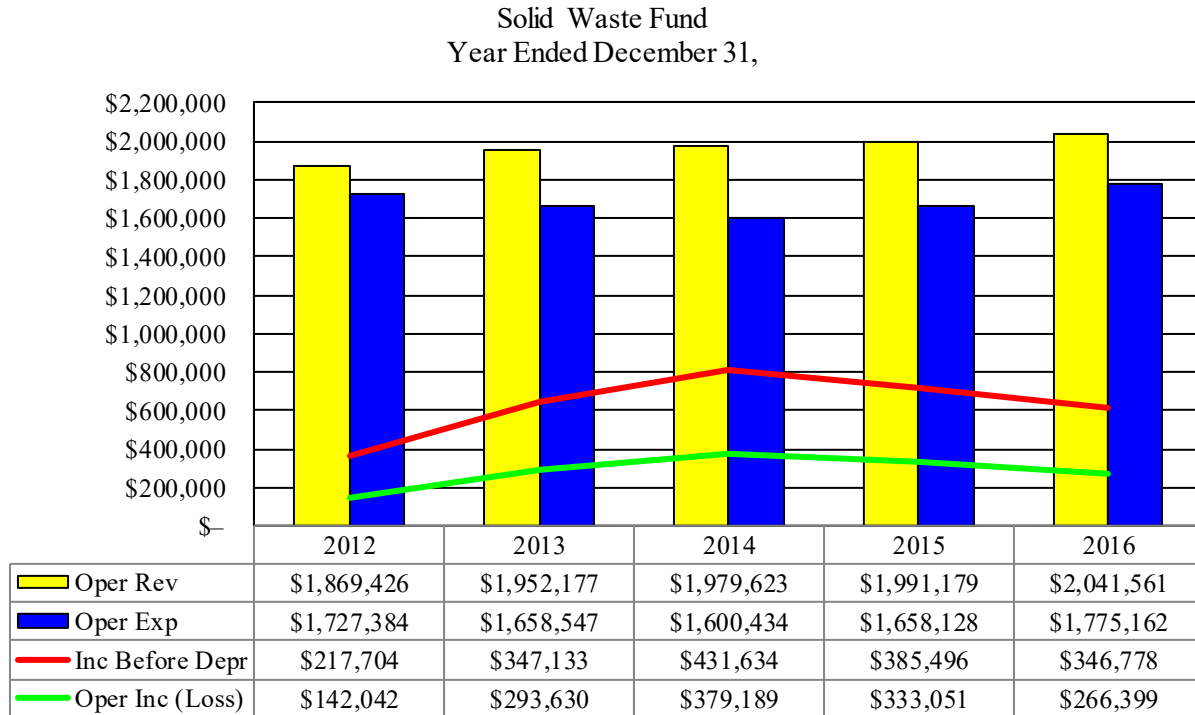
The Sewer Operations Fund ended 2016 with a total net position of \$21,148,014, a decrease of \$298,116 from the prior year due to charges for services not being sufficient to cover depreciation expense. Of this, \$17,951,642 represents the investment in sewer collection system capital assets, leaving an unrestricted net position of \$3,196,372.

Operating revenue in the Sewer Operations Fund increased \$85,957 (4.4 percent) from the prior year due to an increase in rates and more customers on the system.

Operating expenses for 2016 were \$175,861 (9.4 percent) higher than the previous year. The largest factor contributing to the change was an increase of approximately \$170,000 in disposal fees paid to Metropolitan Council Environmental Services.

SOLID WASTE FUND

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



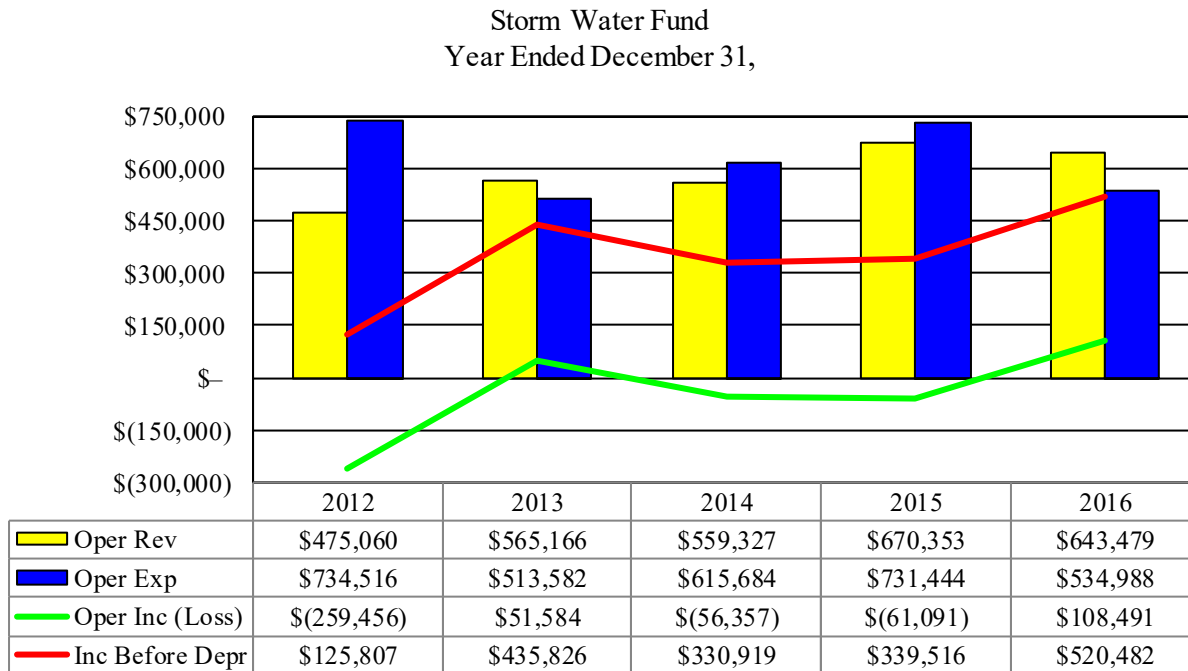
The Solid Waste Fund ended 2016 with a total net position of \$1,545,800, an increase of \$198,708 from the prior year. Of this, \$327,801 represents the investment in solid waste operation capital assets, leaving an unrestricted net position of \$1,217,999.

Operating revenue in the Solid Waste Fund increased \$50,382 (2.5 percent) from the prior year due to increases in both tonnage collected and the number of customers.

Operating expenses for 2016 were \$117,034 (7.1 percent) higher than the previous year, mainly due to an increase in tipping fees charged to the City for solid waste disposal.

STORM WATER FUND

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



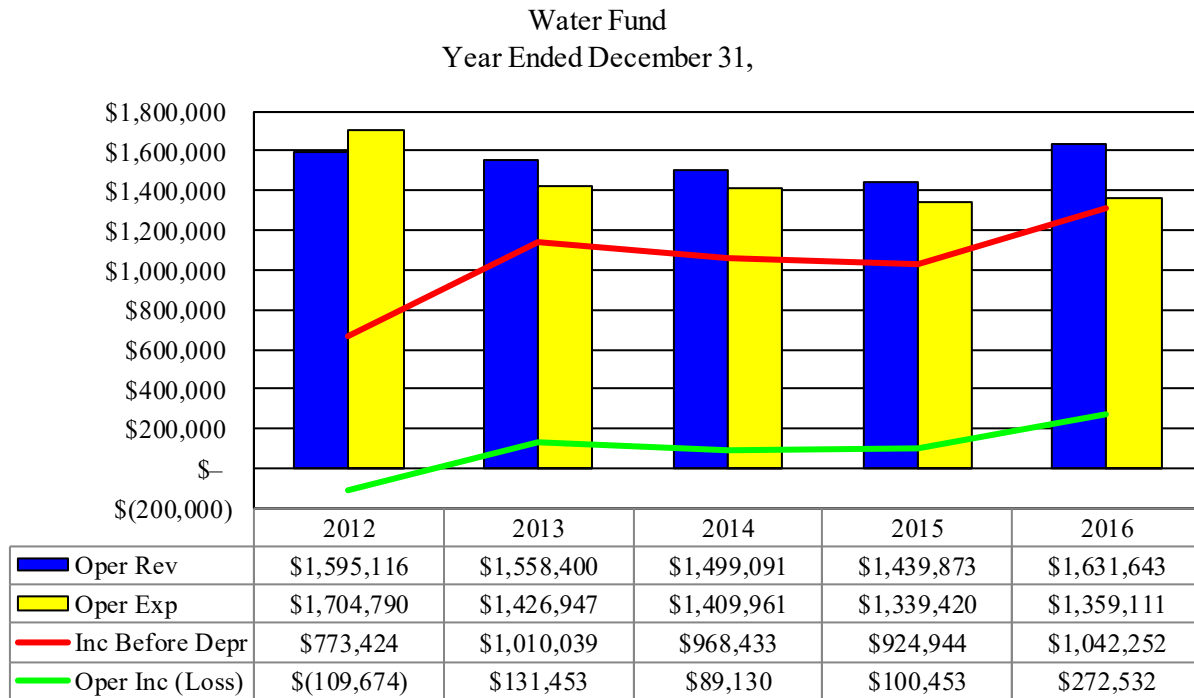
The Storm Water Fund ended 2016 with a total net position of \$14,684,236, a decrease of \$222,832 from the prior year due to charges for services not being sufficient to cover depreciation expense. Of this, \$13,535,377 represents the investment in storm water operation capital assets, leaving an unrestricted net position of \$1,148,859.

Operating revenue in the Storm Water Fund decreased \$26,874 (4.0 percent) from the prior year, mainly due to engineering fees collected in the prior year for miscellaneous projects with no similar revenue in the current year.

Operating expenses for 2016 were \$196,456 (26.9 percent) lower than the previous year. Most of the decrease was in purchased service costs related to the joint county/city 195th Street Reconstruction Project in the previous year.

WATER FUND

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



The Water Fund ended 2016 with a total net position of \$29,531,419, a decrease of \$90,714 from the prior year due to charges for services not being sufficient to cover depreciation expense. Of this, \$21,410,967 represents the investment in water distribution system capital assets, \$2,231,966 is restricted for a future drinking water treatment plant, and unrestricted net position is \$5,888,486.

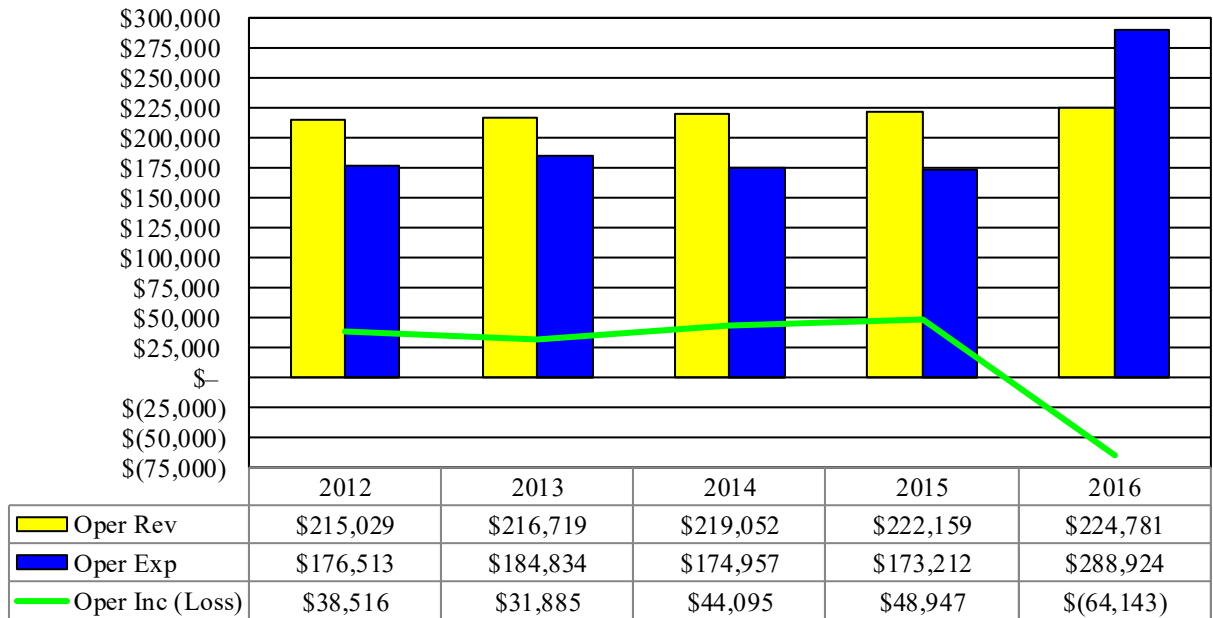
Operating revenue in the Water Fund for 2016 increased \$191,770 (13.3 percent) from the prior year due to an increase in consumption, as well as increases in water main trunk charges and water quality management fees related to the development of the City's new senior living facility, the Legacy of Farmington, in the current year.

Water Fund operating expenses for 2016 were \$19,691 (1.5 percent) higher than the previous year, mainly in purchased service costs related to water main maintenance.

STREET LIGHT FUND

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

Street Light Fund
Year Ended December 31,



Street Light Fund operating revenue for 2016 increased \$2,622 (1.2 percent) from the prior year.

Operating expenses were \$115,712 (66.8 percent) more than the previous year, due to the cost of the City beginning to convert to LED lights, as well as the TH-3 Traffic Signal Change Project.

Unrestricted net position decreased \$62,460 in 2016, ending the year at \$66,265.

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, 2016 and 2015, for governmental activities and business-type activities:

	As of December 31,		Increase (Decrease)
	2016	2015	
Net position			
Governmental activities			
Net investment in capital assets	\$ 23,684,773	\$ 21,417,203	\$ 2,267,570
Restricted	10,441,391	9,063,587	1,377,804
Unrestricted	5,142,435	8,920,144	(3,777,709)
Total governmental activities	<u>39,268,599</u>	<u>39,400,934</u>	<u>(132,335)</u>
Business-type activities			
Net investment in capital assets	53,225,787	54,807,938	(1,582,151)
Restricted	2,231,966	2,160,566	71,400
Unrestricted	12,575,526	11,439,369	1,136,157
Total business-type activities	<u>68,033,279</u>	<u>68,407,873</u>	<u>(374,594)</u>
Total net position	<u>\$ 107,301,878</u>	<u>\$ 107,808,807</u>	<u>\$ (506,929)</u>

The City's total net position at December 31, 2016 was \$506,929 lower than the previous year-end. The City's net position decreased \$132,335 from current year governmental activities and \$374,594 from current year business-type activities.

The governmental activities net investment in capital assets increased \$2.3 million and the unrestricted portion of governmental net position decreased \$3.8 million in 2016, mainly due to the repayment of the outstanding debt used to acquire the City's related capital assets.

The business-type activities net investment in capital assets decreased \$1.6 million in 2016, mainly due to depreciation. The unrestricted portion of the business-type activities net position increased \$1.1 million due to the operating results of the City's enterprise operations as previously discussed.

STATEMENT OF ACTIVITIES

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

The following table presents the change in the net position of the City for the years ended December 31, 2016 and 2015:

	2016			2015
	Expenses	Program Revenues	Net Change	Net Change
Net (expense) revenue				
Governmental activities				
General government	\$ 2,268,779	\$ 724,412	\$ (1,544,367)	\$ (1,828,666)
Public safety	6,979,608	923,790	(6,055,818)	(4,594,415)
Public works	5,497,796	1,185,900	(4,311,896)	(6,612,682)
Parks and recreation	1,904,792	704,914	(1,199,878)	(1,210,888)
Economic development	40,000	—	(40,000)	(90,000)
Interest on long-term debt	1,032,748	—	(1,032,748)	(992,422)
Business-type activities				
Liquor	4,448,932	4,742,313	293,381	254,820
Sewer	2,051,152	2,043,859	(7,293)	82,677
Solid waste	1,753,162	2,064,561	311,399	355,051
Storm water	534,988	643,479	108,491	884,847
Water	1,359,215	1,631,643	272,428	100,285
Street light	288,924	224,781	(64,143)	48,947
Total net (expense) revenue	<u>\$ 28,160,096</u>	<u>\$ 14,889,652</u>	(13,270,444)	(13,602,446)
General revenues				
Property taxes			11,806,302	11,460,209
Franchise taxes			275,691	265,485
Unrestricted grants			287,252	278,974
Investment earnings			394,270	342,494
Total general revenues			<u>12,763,515</u>	<u>12,347,162</u>
Change in net position			<u>\$ (506,929)</u>	<u>\$ (1,255,284)</u>

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

The difference in the year-to-year net change in the public safety function was mainly due to an increase in the City's proportionate share of the state-wide Public Employees Retirement Association pension plans. The difference in the year-to-year net change in the public works function resulted primarily from a higher level of uncapitalized street maintenance expense in 2015 attributable to the county's reconstruction of 195th Street.

LEGISLATIVE UPDATES

The 2016 legislative session, falling in the second half of the state's fiscal biennium, was scheduled to be a short session lasting only 11 weeks. Since biennial budgets are adopted in odd-year legislative sessions, less time is usually needed for the even-year sessions. However, because the 2015 Legislature adjourned without passing funding bills in several significant areas, it was anticipated that the 2016 legislative session would be considerably more active than the typical short session. In spite of this, only a few funding bills were brought forth to the Governor by the end of the 2016 regular legislative session, including a supplemental budget bill and an omnibus tax bill. The Governor chose not to sign the tax bill due to a drafting error that would have resulted in an unintended reduction of state revenues. When the framework for a special session could not be agreed upon, the fiscal year ended without the adoption of a new tax bill, capital bonding bill, or transportation funding package.

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

Border-to-Border Broadband Grants – The 2016 supplemental budget act appropriated \$35 million in fiscal 2017 for a Border-to-Border Broadband Grant Program. The grants, available through the Office of Broadband Development in the Department of Employment and Economic Development (DEED), provide funding to help communities meet state goals for the development of state-wide high-speed broadband access, focusing on areas currently considered to be underserved or with a high concentration of low-income households.

Equity-Related Programs and Grants – The 2016 supplemental budget act also appropriated \$35 million in fiscal 2017 for the financing of equity-related programs through DEED, the majority of which was allocated for programs and grants for communities of color, people with disabilities, seniors, and youth.

Sales Tax Exemption – Effective January 1, 2017, the sales tax exemption on the purchase of goods or services enacted for cities in 2014 is expanded to include all special districts; city, county, or township instrumentalities; economic development authorities; housing and redevelopment authorities; and all joint power boards or organizations.

Taxes Covered Under Debt Management Services – Amendments were made to the statutes governing debt management and debt settlement services to clarify the status of delinquent taxes owed to Minnesota local governments and political subdivisions as debt with regard to those services, and include those entities as creditors for the purpose of debt management services.

Elections – An omnibus elections law was passed making several changes to elections administration requirements. In addition to establishing a presidential primary to take the place of the current caucus system beginning in 2020, the law modified election procedures in a number of areas, including: absentee balloting, voting station dimensions, election canvassing, candidate filing, the extension of polling hours to accommodate voters in line at closing, and emergency election plans.

Police-Worn Body Cameras – A number of new laws were enacted related to portable recording systems (police-worn body cameras) and the data derived from their use, addressing: data retention and destruction, permitted uses of the systems, audits of the data, and vendor practices. Among the changes are a requirement for gathering public input before purchasing or implementing the use of portable recording systems, and requirements for the adoption and dissemination of written policies over the use of portable recording systems.

Veteran Preference Act – New language was added to state statutes clarifying that Minnesota cities and towns may require a veteran to complete an initial probationary period when hired.

Charitable Gambling – Cities that require charitable gambling organizations to contribute 10 percent of their net profits to the city for charitable purposes are now required to acknowledge the source of the funds, either in communications about the receipt or distribution of the funds.

Donation of Surplus Equipment – Local governments are now permitted to donate surplus public works equipment, cell phones, or emergency medical and firefighting equipment to nonprofit organizations. The donation of surplus equipment was added to the list of exceptions to municipal tort liability. Prior to making any such donations, a city must adopt a policy on how it will determine what equipment is considered surplus and eligible for donation and how it will determine which nonprofit organizations will receive such donations. The policy must address the city’s obligation to disclose that the donated equipment may be defective and cannot be relied upon for safety.

Temporary Family Health Care Housing Permits – A new special land use permit system was established for a specific type of mobile health care-related mobile housing, intended to provide transitional housing for seniors. Cities will be required to implement the new permit system unless they officially act to opt out of the program. The program sets forth requirements for structure and placement, the permit process and duration, applicants, inspections, and the process for opting out.

Partition Fence Viewing Exemption – Cities now have the authority to pass a resolution to exempt adjoining owners or occupants from the partition fence law when their land is considered to be less than 20 acres combined, thereby relieving the city of the responsibility of participating in a potentially costly “fence-viewing” process to mediate disputes between adjoining landowners required to share the costs of constructing fences.

ACCOUNTING AND AUDITING UPDATES

GASB STATEMENT NO. 73, ACCOUNTING AND FINANCIAL REPORTING FOR PENSIONS AND RELATED ASSETS THAT ARE NOT WITHIN THE SCOPE OF GASB STATEMENT 68, AND AMENDMENTS TO CERTAIN PROVISIONS OF GASB STATEMENTS 67 AND 68

This statement extends the approach to accounting and financial reporting established in GASB Statement No. 68 to all pensions, including those not administered through a trust. Governmental employers participating in such plans will be required to report the total of any unfunded pension liability related to the plan in their accrual basis financial statements, rather than the net pension liability. The requirements of this statement that address accounting and financial reporting by employers and governmental nonemployer contributing entities for pensions not within the scope of GASB Statement No. 68, are effective for financial statements for fiscal years beginning after June 15, 2016.

This statement also clarified the application of certain provisions of GASB Statement Nos. 67 and 68 regarding 10-year schedules of required supplementary information (RSI) and other recognition issues pertaining to employers and nonemployer contributing entities effective for financial statements for fiscal years beginning after June 15, 2015.

GASB STATEMENT NO. 74, FINANCIAL REPORTING FOR POSTEMPLOYMENT BENEFIT PLANS OTHER THAN PENSION PLANS

This statement establishes new accounting and financial reporting requirements for other post-employment benefits (OPEB) plans, replacing GASB Statement Nos. 43 and 57. It also includes requirements for defined contribution OPEB plans that replace the requirements for those OPEB plans in GASB Statement Nos. 25, 43, and 50.

This statement will improve financial reporting primarily through enhanced note disclosures and schedules of RSI that will be presented by OPEB plans administered through trusts meeting the specified criteria. The new information will enhance the decision-usefulness of the financial reports of those OPEB plans, their value for assessing accountability, and their transparency by providing information about measures of net OPEB liabilities and explanations of how and why those liabilities changed from year-to-year. The net OPEB liability information, including ratios, will offer an up-to-date indication of the extent to which the total OPEB liability is covered by the fiduciary net position of the OPEB plan. The comparability of the reported information for similar types of OPEB plans will be improved by the changes related to the attribution method used to determine the total OPEB liability. The contribution schedule will provide measures to evaluate decisions related to the assessment of contribution rates in comparison with actuarially determined rates, if such rates are determined. In addition, new information about rates of return on OPEB plan investments will inform financial report users about the effects of market conditions on the OPEB plan's assets over time and provide information for users to assess the relative success of the OPEB plan's investment strategy and the relative contribution that investment earnings provide to the OPEB plan's ability to pay benefits to plan members when they come due.

This statement is effective for financial statements for fiscal years beginning after June 15, 2016. Earlier application is encouraged.

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

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

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

This statement is effective for fiscal years beginning after June 15, 2017. Earlier application is encouraged.

GASB STATEMENT NO. 80, BLENDING REQUIREMENTS FOR CERTAIN COMPONENT UNITS—AN AMENDMENT OF GASB STATEMENT NO. 14

The objective of this statement is to clarify the financial statement presentation requirements for certain component units. This statement amends the blending requirements for the financial statement presentation of component units of all state and local governments. The additional criterion requires blending of a component unit incorporated as a not-for-profit corporation in which the primary government is the sole corporate member. The additional criterion does not apply to component units included in the financial reporting entity pursuant to the provisions of GASB Statement No. 39, *Determining Whether Certain Organizations Are Component Units—an amendment of GASB Statement No. 14*.

The requirements of this statement are effective for reporting periods beginning after June 15, 2016. Earlier application is encouraged.

GASB STATEMENT NO. 81, IRREVOCABLE SPLIT-INTEREST AGREEMENTS

This statement provides recognition and measurement guidance for the accounting and financial reporting of irrevocable split-interest agreements by governments that are the beneficiary of such an agreement. Split-interest agreements are a type of giving agreement used by donors to provide resources to two or more beneficiaries, including governments.

This statement requires that a government that receives resources pursuant to an irrevocable split-interest agreement (1) recognize assets, liabilities, and deferred inflows of resources at the inception of the agreement, (2) recognize assets representing its beneficial interests in irrevocable split-interest agreements that are administered by a third party if the government controls the present service capacity of the beneficial interests, and (3) recognize revenue when the resources become applicable to the reporting period.

The requirements of this statement are effective for financial statements for periods beginning after December 15, 2016, and should be applied retroactively. Earlier application is encouraged.

GASB STATEMENT NO. 82, *PENSION ISSUES—AN AMENDMENT OF GASB STATEMENTS NO. 67, NO. 68, AND NO. 73*

The intent of this statement is to address certain issues raised with respect to GASB Statement Nos. 67, 68, and 73.

This statement amends GASB Statement Nos. 67 and 68, changing the definition of “covered payroll” utilized in schedules of RSI from the payroll of employees that are provided with pensions through the pension plan, to the payroll on which contributions to a pension plan are based. It clarifies that a deviation, as the term is used in Actuarial Standards of Practice, is not considered to be in conformity with the requirements of GASB Statement Nos. 67, 68, or 73 for the selection of assumptions used in determining the total pension liability and related measures. It also clarifies that payments made by an employer to satisfy contribution requirements that are identified by the pension plan terms as plan member contribution requirements should be classified as plan member contributions for purposes of Statement No. 67 and as employee contributions for purposes of Statement No. 68, and requires that an employer’s expense and expenditures for those amounts be recognized in the period for which the contribution is assessed and classified in the same manner as the employer classifies similar compensation other than pensions.

The requirements of this statement are effective for reporting periods beginning after June 15, 2016, except for the requirements of this statement for the selection of assumptions in a circumstance in which an employer’s pension liability is measured as of a date other than the employer’s most recent fiscal year-end. In that circumstance, the requirements for the selection of assumptions are effective for that employer in the first reporting period in which the measurement date of the pension liability is on or after June 15, 2017. Earlier application is encouraged.

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

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

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

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

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

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

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

GASB STATEMENT NO. 84, *FIDUCIARY ACTIVITIES*

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