

Management Report
for
City of Ramsey, Minnesota
December 31, 2011



PRINCIPALS

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To the City Council
City of Ramsey, Minnesota

We have prepared this management report in conjunction with our audit of the City of Ramsey, Minnesota'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.

May 31, 2012

AUDIT SUMMARY

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

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

We have audited the financial statements of the governmental activities, the business-type activities, each major fund, and the aggregate remaining fund information of the City as of and for the year ended December 31, 2011. 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, 2011:

- We have issued an unqualified opinion on the City's basic financial statements.
- We reported 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 December 31, 2011.

AUDIT COMMENTS

Land Held for Resale – The City currently holds a significant amount of land for resale in the Housing and Redevelopment Special Revenue Fund, which management reports at the lower of cost or net realizable value. City staff has also prepared a schedule comparing the current carrying value of these properties to estimated market values provided by Anoka County to support these values. We recognize the City is working on an ongoing basis to utilize these assets in the best interest of the City. We recommend that the City continue to review these property values and related internal loans on an ongoing basis to ensure a proper reporting of city assets and financial activity between funds is accurately presented.

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.

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 as follows:

- **Value of Land Held for Resale** – These assets are stated at the lower of cost or net realizable value based on management's estimates.
- **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.

Management expects any differences between estimates and actual amounts of these estimates to be insignificant. We evaluated the key factors and assumptions used to develop these accounting estimates in determining that they are reasonable in relation to the basic financial statements taken as a whole.

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

DIFFICULTIES ENCOUNTERED IN PERFORMING THE AUDIT

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

DISAGREEMENTS WITH MANAGEMENT

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

MANAGEMENT REPRESENTATIONS

We have requested certain representations from management that are included in the management representation letter dated May 31, 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, combining and individual fund statements and schedules, 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 combining and individual fund statements and schedules 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 combining and individual fund statements and schedules 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.

FUNDING CITIES IN MINNESOTA

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.

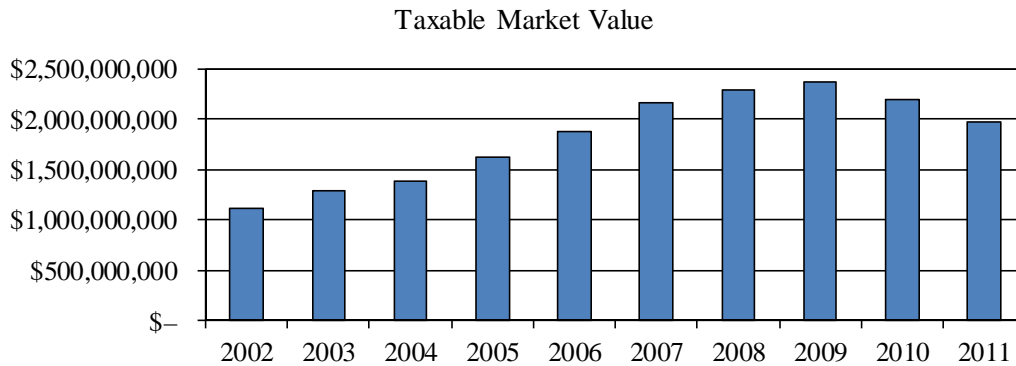
Civil Immunity for Donated Public Safety Equipment – Immunity from civil tort claims is extended to municipalities that donate public safety equipment to another municipality, unless the claim is a direct result of fraud or intentional misrepresentation. The statute defines “public safety equipment” 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.

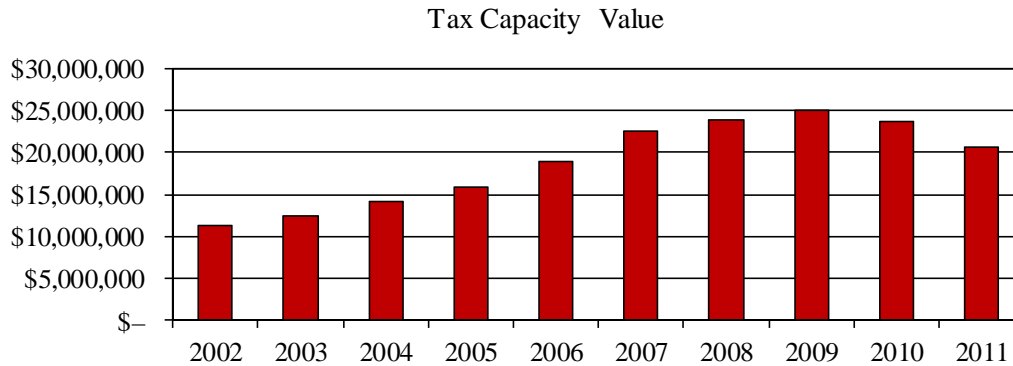
Property values within Minnesota cities experienced average decreases of 3.0 percent and 5.7 percent for taxes payable in 2010 and 2011, respectively, reflecting the weak housing market and economic conditions experienced in recent years. In comparison, the City's market value decreased 7.6 percent in 2010 and 9.6 percent in 2011. It is important to remember that the 2011 market value is based on estimated values as of January 1, 2010, and the housing market is still experiencing difficult times.

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 5.0 percent for 2010 and 13.4 percent for 2011.

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 previously discussed.

| Rates expressed as a percentage of net tax capacity | | | | | | |
|---|--------------------------|--------------|----------------------------|--------------|---------------------|---------------------|
| | All Cities State-Wide | | Seven-County Metro Area | | City of Ramsey | |
| | 2010 | 2011 | 2010 | 2011 | 2010 | 2011 |
| Average tax rate | | | | | | |
| City | 39.2 | 42.5 | 36.0 | 40.0 | 38.0 | 39.8 |
| County | 41.0 | 43.7 | 36.8 | 42.1 | 35.6 | 40.4 |
| School | 23.0 | 25.2 | 24.0 | 26.8 | 22.5 | 26.5 |
| Special taxing | 5.9 | 6.4 | 6.5 | 8.1 | 6.2 | 6.2 |
| Total | <u>109.1</u> | <u>117.8</u> | <u>103.3</u> | <u>117.0</u> | <u>102.3</u> | <u>112.9</u> |

The City's portion of the tax rate increased slightly for 2011, despite the City reducing its levy, due largely to the declining market values of property within the City's taxing jurisdiction, which has reduced tax capacity.

The school tax rate for the City represents an average of Independent School District No. 11, Anoka-Hennepin and Independent School District No. 728, Elk River Area Schools.

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, and capital project funds. We have also included the most recent comparative state-wide averages available from 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 | | | | | | | | |
| Year | State-Wide | | | | City of Ramsey | | | |
| | December 31, 2010 | | | | 2009 | 2010 | 2011 | |
| Population | 2,000–2,500 | 2,500–10,000 | 10,000–20,000 | 20,000–100,000 | 24,300 | 23,668 | 23,702 | |
| Property taxes | \$ 367 | \$ 386 | \$ 359 | \$ 407 | \$ 400 | \$ 361 | \$ 341 | |
| Tax increments | 38 | 45 | 52 | 56 | 145 | 153 | 153 | |
| Franchise and other taxes | 7 | 26 | 34 | 30 | – | – | – | |
| Special assessments | 73 | 74 | 60 | 66 | 18 | 21 | 23 | |
| Licenses and permits | 17 | 19 | 22 | 29 | 15 | 17 | 16 | |
| Intergovernmental revenues | 399 | 291 | 271 | 149 | 71 | 86 | 133 | |
| Charges for services | 106 | 89 | 83 | 76 | 39 | 56 | 64 | |
| Other | 101 | 73 | 70 | 57 | 109 | 93 | 74 | |
| Total revenue | <u>\$ 1,108</u> | <u>\$ 1,003</u> | <u>\$ 951</u> | <u>\$ 870</u> | <u>\$ 797</u> | <u>\$ 787</u> | <u>\$ 804</u> | |

Total revenue per capita remained similar to the prior year, increasing by \$17. The decrease in property taxes per capital of \$20 was primarily due to a decrease in the approved levy. This decrease was offset by increases in intergovernmental revenues of \$47 per capita, as well as increases in charges for services of \$8 per capita, which were due to additional engineering billable time on public projects. Other local services revenue per capita decreased \$19 per capita, which includes fines and forfeits, investment earnings, and other miscellaneous revenue sources.

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, 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 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 | | | | | | | | |
|---|-------------------|---------------|---------------|----------------|----------------|---------------|---------------|--|
| Year | State-Wide | | | | City of Ramsey | | | |
| | December 31, 2010 | | | | 2009 | 2010 | 2011 | |
| Population | 2,000–2,500 | 2,500–10,000 | 10,000–20,000 | 20,000–100,000 | 24,300 | 23,668 | 23,702 | |
| Current | | | | | | | | |
| General government | \$ 161 | \$ 125 | \$ 102 | \$ 85 | \$ 162 | \$ 181 | \$ 205 | |
| Public safety | 247 | 227 | 223 | 235 | 162 | 160 | 164 | |
| Street maintenance and lighting | 129 | 108 | 107 | 86 | 94 | 116 | 209 | |
| Parks and recreation | 91 | 75 | 93 | 87 | 35 | 35 | 36 | |
| All other | 90 | 81 | 81 | 91 | – | – | – | |
| | <u>\$ 718</u> | <u>\$ 616</u> | <u>\$ 606</u> | <u>\$ 584</u> | <u>\$ 453</u> | <u>\$ 492</u> | <u>\$ 614</u> | |
| Capital outlay and construction | <u>\$ 333</u> | <u>\$ 299</u> | <u>\$ 321</u> | <u>\$ 232</u> | <u>\$ 182</u> | <u>\$ 268</u> | <u>\$ 278</u> | |
| Debt service | | | | | | | | |
| Principal | \$ 234 | \$ 180 | \$ 181 | \$ 111 | \$ 141 | \$ 94 | \$ 76 | |
| Interest and fiscal | 82 | 63 | 53 | 43 | 55 | 56 | 52 | |
| | <u>\$ 316</u> | <u>\$ 243</u> | <u>\$ 234</u> | <u>\$ 154</u> | <u>\$ 196</u> | <u>\$ 150</u> | <u>\$ 128</u> | |

Total expenditures in the City's governmental funds for 2011 were \$24,156,413, an increase of \$2,613,402 (12.1 percent) from the prior year. On a per capita basis, the City expended a total of \$1,020 in 2011. Current expenditures increased \$122 per capita from last year. General government and street maintenance and lighting expenditures increased from last year due to street and other improvements completed jointly with other governments. Capital outlay expenditures for 2011 were \$10 more per capita than the prior year due to higher city street construction expenditures. Debt service expenditures for 2011 were \$22 per capita lower than the prior year as scheduled, with final payment on two bond issues in the prior year.

FINANCIAL TRENDS AND CONDITIONS OF SELECTED FUNDS

FINANCIAL CONDITION OF THE GOVERNMENTAL FUNDS AND ACTIVITIES AS A WHOLE

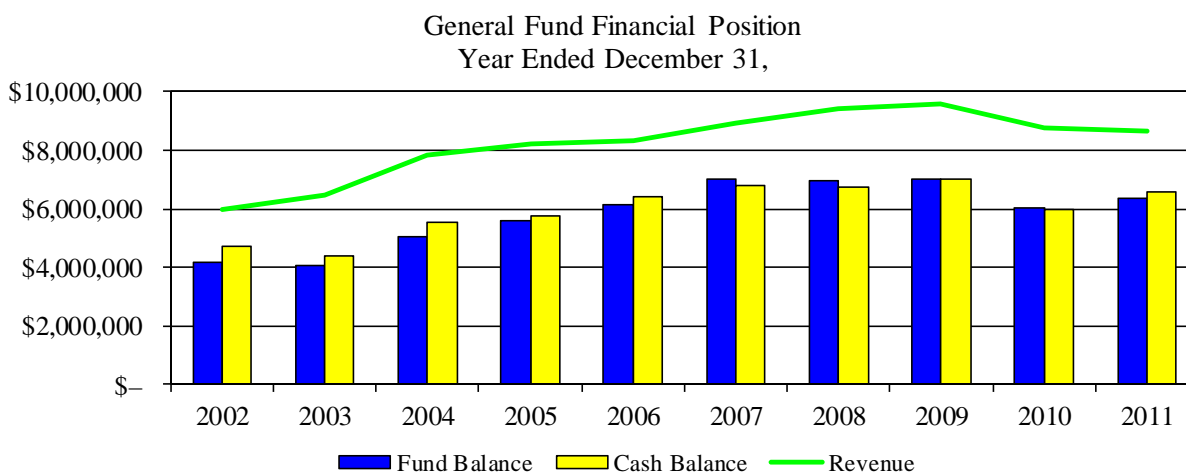
The governmental funds reported total fund balances of \$41,940,262 at December 31, 2011. This level of fund balance for all governmental funds represents an increase of \$3,525,271 from the prior year fund balance for all governmental funds of \$38,414,991. The Armstrong/Bunker Street Improvement Debt Service Fund increased by approximately \$260,000 due to the issuance of \$4,365,000 General Obligation Bonds, Series 2011A, while the 2011–2005 General Obligation Improvement Bonds Fund increased over \$3 million due to the issuance of \$3,090,000 General Obligation Improvement Crossover Refunding Bonds, Series 2011B.

The Statement of Net Assets shows an increase in the net assets of the governmental activities of \$1,810,089, with ending net assets of \$76,332,107. Since this statement is based on accrual accounting rather than modified accounting, the money spent on capital project costs are capitalized as assets, while in the fund statements they are expended.

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 culture and recreation.

The following graph displays the City’s General Fund trends of financial position and changes in the volume of financial activity. Fund balance and cash balance are typically used as indicators of financial health or equity, while annual revenue is often used to measure the size of the operation.

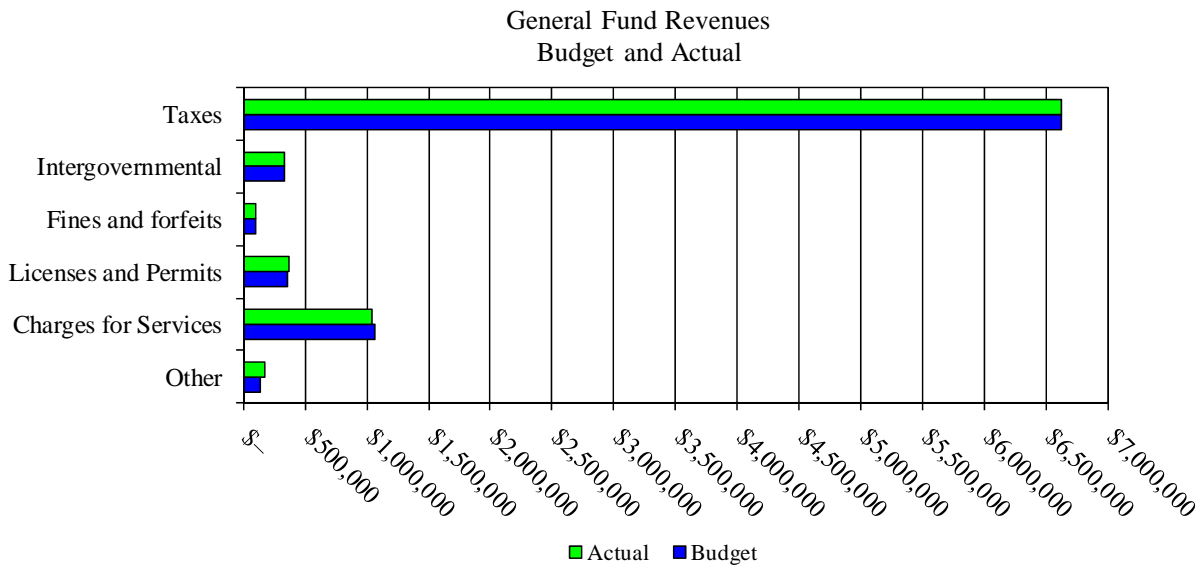


The City’s General Fund cash and investments balance (net of interfund borrowing) at December 31, 2011 was \$6,600,586, an increase of \$629,340 from the previous year. Total fund balance at year-end was \$6,388,632, an increase of \$210,762 from the prior year. The stability of the General Fund’s financial position is greatly attributed to the City’s “Fund Balance and Excess Revenue Policy” as well as the general budgeting policies. These policies have allowed the City to provide funding for equipment replacement and recurring capital maintenance programs without disrupting the General Fund’s financial position. 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. Increase in the size of the operation is 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.

The graph on the previous page shows the rapid yet steady growth in fund equity, absent of significant year-to-year fluctuations through 2009. This indicates a stable operation with effective financial controls. The decrease in 2010 cash and fund balance is largely due to the City's change in its fund balance policy, which was amended to require 50 percent of the following years' adopted budgeted expenditures. Prior to 2010, this requirement was at 60 percent. The City transferred the amount above, the 50 percent required, in accordance with the fund balance policy, thereby decreasing the ending balance when compared to the previous year.

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 revenues, budget and actual, for 2011:

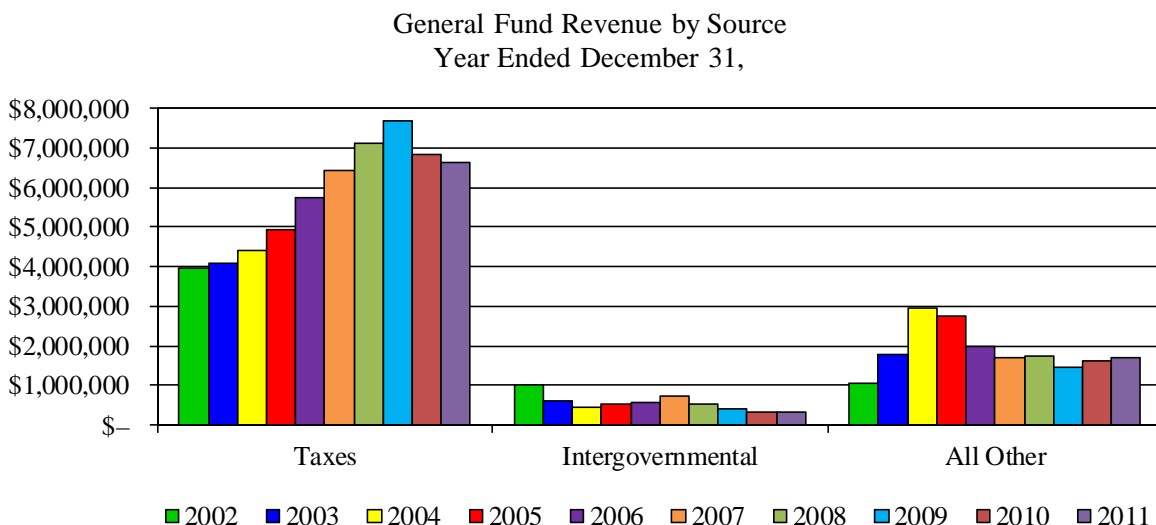


Total General Fund revenues for 2011 were \$8,655,880, a decrease of \$133,399 from the previous year and \$25,003 more than budget.

Property tax revenue decreased by \$218,764, due to a decrease in the approved levy adopted as discussed earlier in this report.

Investment earnings surpassed budget expectations by \$42,881, due to conservative budgeting in this area due to the volatility in the nature of this source.

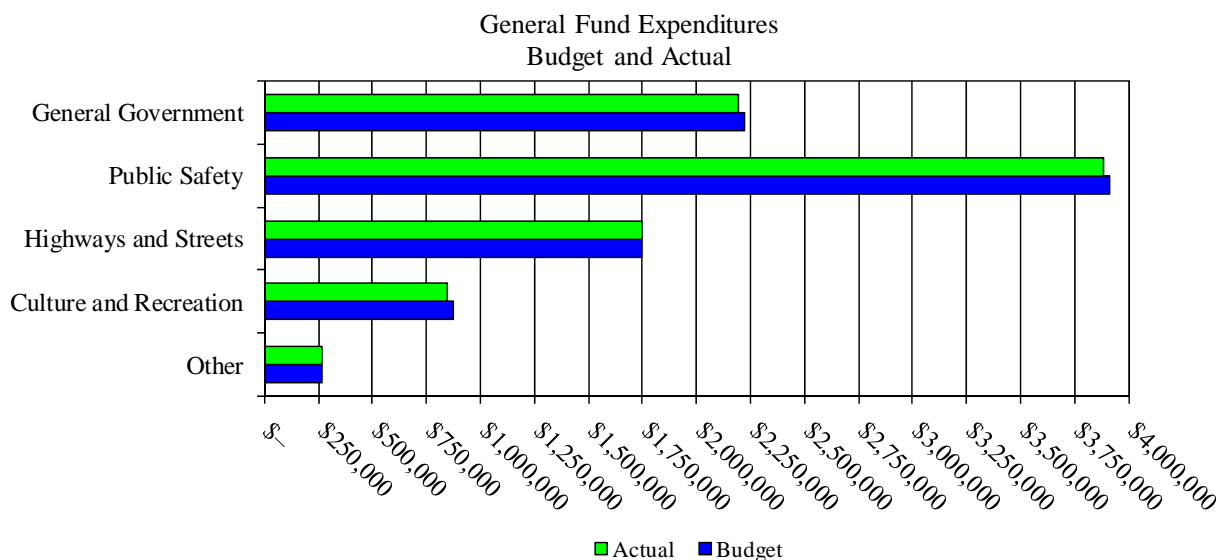
The following graph presents the City's General Fund revenues by source for the last 10 years:



The trend of increased reliance on tax revenue and decreasing intergovernmental (primarily state revenue) is typical to Minnesota cities. As presented in the graph above, property taxes account for 77 percent of General Fund revenues even after the recent reductions discussed on the previous page.

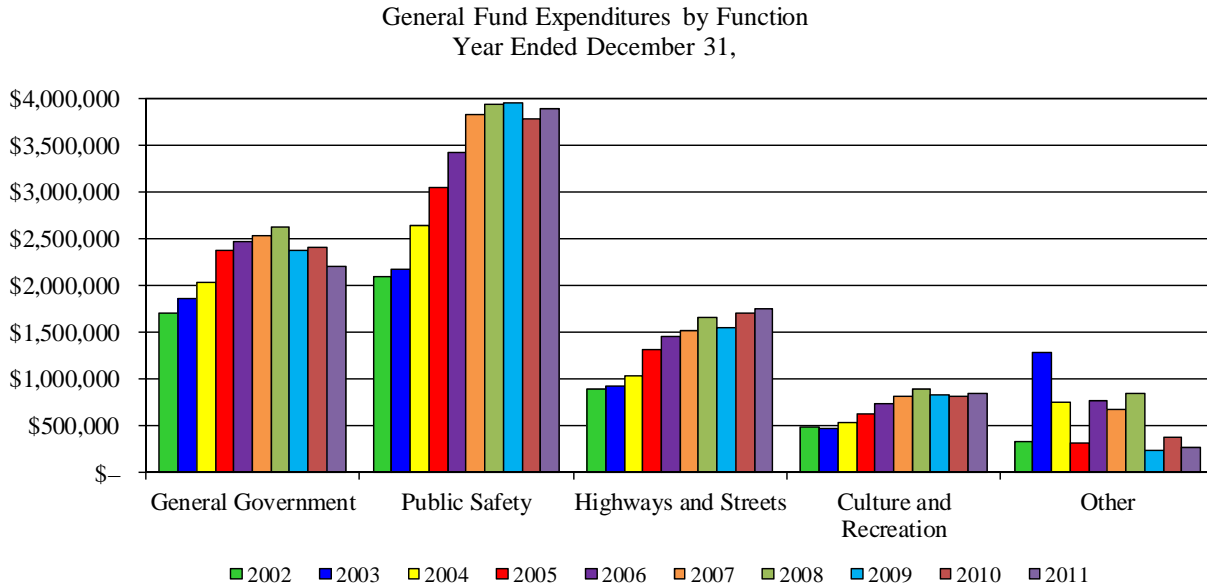
The City has received a significant amount of other revenue in the form of licenses, permits, and charges for services relating to new development in past years, but as displayed in the graph above, these sources have declined and leveled off with the slowing economy.

The following graph reflects the City's General Fund expenditures, budget and actual, for 2011:



General Fund expenditures totaled \$8,941,231 in 2011, a decrease of \$162,288 (or 1.8 percent) from the prior year, and were \$77,903 (or 0.9 percent) under the final budget.

The following graph shows General Fund expenditures for the last 10 years:



The graph shows that the largest share of General Fund expenditures is for public safety, while general government expenditures make up the second largest expenditure category. As the graph displays, expenditures increased in all categories presented above, with the exception of general government, which decreased \$217,630, and other, which decreased \$120,589.

Utility Enterprise Funds

The City's enterprise funds report positive components of net assets in all utility operations. Total cash balances equaled \$16,134,860, while net assets totaled \$75,512,152 at December 31, 2011. Net assets increased \$166,344 over the prior year.

The following table presents five years of comparative operating results for each of the City's utility enterprise funds:

| | 2007 | 2008 | 2009 | 2010 | 2011 |
|--|-------------------|-------------------|--------------------|--------------------|-------------------|
| Utility enterprise funds | | | | | |
| Water | | | | | |
| Operating revenue | \$ 1,440,658 | \$ 1,539,665 | \$ 1,693,581 | \$ 1,633,461 | \$ 1,821,386 |
| Operating expenses | 912,094 | 1,247,248 | 1,291,952 | 1,295,721 | 1,358,050 |
| Operating income | <u>\$ 528,564</u> | <u>\$ 292,417</u> | <u>\$ 401,629</u> | <u>\$ 337,740</u> | <u>\$ 463,336</u> |
| Operating income as a % of operating revenue | <u>36.7 %</u> | <u>19.0 %</u> | <u>23.7 %</u> | <u>20.7 %</u> | <u>25.4 %</u> |
| Sewer | | | | | |
| Operating revenue | \$ 1,100,948 | \$ 1,208,843 | \$ 1,214,953 | \$ 1,261,609 | \$ 1,236,771 |
| Operating expenses | 838,452 | 883,214 | 1,076,451 | 1,101,554 | 1,149,318 |
| Operating income | <u>\$ 262,496</u> | <u>\$ 325,629</u> | <u>\$ 138,502</u> | <u>\$ 160,055</u> | <u>\$ 87,453</u> |
| Operating income as a % of operating revenue | <u>23.8 %</u> | <u>26.9 %</u> | <u>11.4 %</u> | <u>12.7 %</u> | <u>7.1 %</u> |
| Street Light | | | | | |
| Operating revenue | \$ 173,541 | \$ 183,560 | \$ 172,897 | \$ 179,272 | \$ 178,850 |
| Operating expenses | 110,837 | 123,839 | 148,140 | 158,369 | 163,758 |
| Operating income | <u>\$ 62,704</u> | <u>\$ 59,721</u> | <u>\$ 24,757</u> | <u>\$ 20,903</u> | <u>\$ 15,092</u> |
| Operating income as a % of operating revenue | <u>36.1 %</u> | <u>32.5 %</u> | <u>14.3 %</u> | <u>11.7 %</u> | <u>8.4 %</u> |
| Recycling | | | | | |
| Operating revenue | \$ 291,152 | \$ 332,682 | \$ 284,515 | \$ 294,617 | \$ 297,226 |
| Operating expenses | 283,746 | 300,755 | 298,631 | 307,662 | 302,947 |
| Operating income (loss) | <u>\$ 7,406</u> | <u>\$ 31,927</u> | <u>\$ (14,116)</u> | <u>\$ (13,045)</u> | <u>\$ (5,721)</u> |
| Operating income as a % of operating revenue | <u>2.5 %</u> | <u>9.6 %</u> | <u>(5.0) %</u> | <u>(4.4) %</u> | <u>(1.9) %</u> |
| Storm Water | | | | | |
| Operating revenue | \$ 503,553 | \$ 566,506 | \$ 578,666 | \$ 617,598 | \$ 617,579 |
| Operating expenses | 440,697 | 300,444 | 358,522 | 350,521 | 410,666 |
| Operating income | <u>\$ 62,856</u> | <u>\$ 266,062</u> | <u>\$ 220,144</u> | <u>\$ 267,077</u> | <u>\$ 206,913</u> |
| Operating income as a % of operating revenue | <u>12.5 %</u> | <u>47.0 %</u> | <u>38.0 %</u> | <u>43.2 %</u> | <u>33.5 %</u> |

As displayed in the table above, each of the individual enterprise funds was able to report positive operating results for the year ended December 31, 2011, with the exception of the recycling fund. This loss was covered by the County Recycling Grant which typically subsidizes these operations.

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 of the City's governmental activities, and combines them with business-type activities.

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 the components of City's net assets as of December 31, 2011 and 2010, for governmental activities and business-type activities:

| | As of December 31, | | Increase (Decrease) |
|--|-----------------------|-----------------------|------------------------|
| | 2011 | 2010 | |
| Net assets | | | |
| Governmental activities | | | |
| Invested in capital assets, net of related debt | \$ 39,794,321 | \$ 38,466,812 | \$ 1,327,509 |
| Restricted | 22,103,948 | 21,604,295 | 499,653 |
| Unrestricted | 14,433,838 | 14,450,911 | (17,073) |
| Total governmental activities | <u>76,332,107</u> | <u>74,522,018</u> | <u>1,810,089</u> |
| Business-type activities | | | |
| Invested in capital assets, net of related debt | 51,748,092 | 52,500,049 | (751,957) |
| Unrestricted | 23,764,060 | 22,845,759 | 918,301 |
| Total business-type activities | <u>75,512,152</u> | <u>75,345,808</u> | <u>166,344</u> |
| Total net assets | <u>\$ 151,844,259</u> | <u>\$ 149,867,826</u> | <u>\$ 1,976,433</u> |

The increase in governmental and business-type activities represents the results of operations as presented on the next page. The shift between components of net assets in governmental activities reflects the City's use of unrestricted resources in the current year for capital asset infrastructure additions.

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 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 | \$ 5,559,732 | \$ 1,026,608 | \$ (4,533,124) | \$ (3,866,578) |
| Public safety | 4,307,045 | 1,140,897 | (3,166,148) | (2,937,081) |
| Highways and streets | 6,129,272 | 4,254,030 | (1,875,242) | (3,197,530) |
| Culture and recreation | 1,267,292 | 43,344 | (1,223,948) | (997,066) |
| Interest and fiscal charges | 1,302,228 | – | (1,302,228) | (1,316,893) |
| Business-type activities | | | | |
| Water utility | 1,358,050 | 1,904,735 | 546,685 | 582,857 |
| Sewer utility | 1,149,318 | 1,241,771 | 92,453 | 209,261 |
| Street light utility | 163,758 | 178,850 | 15,092 | 20,903 |
| Recycling utility | 302,947 | 347,505 | 44,558 | 36,828 |
| Storm water utility | 410,666 | 617,579 | 206,913 | 282,794 |
| Total net (expense) revenue | <u>\$ 21,950,308</u> | <u>\$ 10,755,319</u> | (11,194,989) | (11,182,505) |
| General revenues | | | | |
| Property taxes | | | 11,671,760 | 12,144,908 |
| General grants and contributions | | | 120,932 | 114,692 |
| Investment earnings | | | 1,364,014 | 1,914,575 |
| Sale of capital assets | | | 14,716 | – |
| Total general revenues | | | <u>13,171,422</u> | <u>14,174,175</u> |
| Change in net assets | | | <u>\$ 1,976,433</u> | <u>\$ 2,991,670</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.

ACCOUNTING AND AUDITING UPDATES

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.