

Management Report
for
City of Ramsey, Minnesota
December 31, 2012

To the City Council and Management
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, 2012. 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
- Enterprise Funds Overview
- Government-Wide Financial Statements
- Accounting and Auditing Updates

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

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

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

Minneapolis, Minnesota
June 10, 2013

AUDIT SUMMARY

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

OUR RESPONSIBILITY UNDER AUDITING STANDARDS GENERALLY ACCEPTED IN THE UNITED STATES OF AMERICA, *GOVERNMENT AUDITING STANDARDS*, AND THE U.S. OFFICE OF MANAGEMENT AND BUDGET (OMB) CIRCULAR A-133

We have audited the financial statements of the governmental activities, the business-type activities, each major fund, and the aggregate remaining fund information of the City as of and for the year ended December 31, 2012. Professional standards require that we provide you with information about our responsibilities under auditing standards generally accepted in the United States of America, *Government Auditing Standards*, and OMB Circular A-133, as well as certain information related to the planned scope and timing of our audit. We have communicated such information to you verbally and in our audit engagement letter. Professional standards also require that we communicate the following information related to our audit.

PLANNED SCOPE AND TIMING OF THE AUDIT

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

AUDIT OPINION AND FINDINGS

Based on our audit of the City's financial statements for the year ended December 31, 2012:

- 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 is fairly stated, in all material respects, in relation to the basic financial statements.
- We reported no deficiencies in the internal controls over compliance and its operation that we consider to be material weaknesses in our testing of major federal programs.
- 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.
- There was one Minnesota Legal Compliance Finding in the current year. Minnesota Statutes require investments in mutual funds to have a rating in one of the two highest rating categories by at least one nationally recognized statistical ratings organization, and investments in general obligations of state or local government with taxing powers to have a rating of "A" or better. This requirement was not met for two investments at December 31, 2012.

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, 2012, we performed procedures to follow-up on the findings and recommendations that resulted from our prior year audit. During our audit for the year ended December 31, 2011, the City had a reportable instance of noncompliance with Minnesota laws and regulations. The City's deposits at December 31, 2011 exceeded 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 was not a finding for the current year.

AUDIT COMMENTS

Land Held for Resale – The City currently holds a material 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 fiscal year ended December 31, 2012, the City implemented Governmental Accounting Standards Board (GASB) Statement No. 63, *Financial Reporting of Deferred Outflows of Resources, Deferred Inflows of Resources, and Net Position*. GASB Statement No. 63 changed how governmental entities present a statement of net position, adding two new basic financial statement elements, and replacing “net assets” with “net position” as the terminology used to describe the difference between the other four elements. The two basic financial statement elements added are “deferred inflows of resources” and “deferred outflows of resources.” These new elements are differentiated from assets (deferred outflows of resources) and liabilities (deferred inflows of resources), but have similar effects on net position.

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

ACCOUNTING ESTIMATES AND MANAGEMENT JUDGMENTS

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

- **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.

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.

DISAGREEMENTS WITH MANAGEMENT

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

MANAGEMENT REPRESENTATIONS

We have requested certain representations from management that are included in the management representation letter dated June 10, 2013.

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 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, 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 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 basic 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 was very long and difficult. It featured a large budget deficit and a very contentious battle between the Democratic Governor and the Republican-led House and Senate; and resulted in numerous vetoes, a special session, and the longest shutdown of non-essential state government services in Minnesota history.

The outlook going into the 2012 Legislative Session was brightened somewhat by positive economic news. The November 2011 financial forecast projected a surplus of \$876 million in the state general fund for the biennium ending June 30, 2013, later revised to a surplus of almost \$1.2 billion in the February 2012 forecast. This meant that the Legislature would not have to pass a “supplemental budget” to deal with projected shortfalls for the second half of the biennium, as was the case in the previous short session.

The positive feeling was short-lived, however, as the 2012 Legislative Session quickly degenerated into more partisan squabbling. Once again, the Governor exercised his veto power a number of times to block Republican legislative initiatives. The Republican Legislature reacted by introducing several potential amendments to the state constitution, which once passed would be subject to a public vote and could not be vetoed by the Governor. Two potential amendments, addressing voter identification and the legal definition of marriage, made it on the ballot for the November 2012 election and were voted down by the public. In the end, the main accomplishment of the session was a hard-fought compromise on partial public funding for a Vikings stadium.

The 2012 Legislature did pass a state bonding bill, a technical tax bill (after two omnibus tax bills were vetoed), and a few other bills that impacted Minnesota cities. The following is a summary of recent legislative activity affecting the finances of Minnesota cities in 2012 and into the future:

Local Government Aid (LGA) – The state-wide LGA appropriation for fiscal 2012 was \$425.2 million. For fiscal 2012, cities received the lesser of their 2010 actual or 2011 certified LGA allocations. For fiscal 2013 and beyond, the state-wide LGA appropriation had been set to increase to \$426.4 million; however, the 2012 Legislature made some changes. LGA payments for 2013 are frozen at 2012 levels for cities with a population of 5,000 or more. For cities with populations below 5,000, 2013 LGA will be the greater of their 2012 aid or the amount they would have received for 2013 under existing law. The Legislature also froze the base for calculating the maximum increases and decreases for a city’s 2013 and 2014 LGA to their 2012 aid. Beginning in 2015, the previous year’s LGA payment will be used to calculate the minimum and maximum increases.

Market Value Homestead Credit (MVHC) – The 2011 Legislature eliminated the MVHC reimbursement program beginning in fiscal 2012. Rather than receiving a property tax credit, qualifying homeowner taxpayers had a portion of the market value of their house excluded from their taxable market value. This new system provides 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 varies depending on the makeup of the taxing jurisdictions that levy on their particular property.

Depositories Authorized to Redeposit City Funds – Banks designated as depositories of city funds are authorized to redeposit the funds in another bank, savings and loan, or credit union located within the United States, provide the redeposited funds are fully covered by federal depository insurance (FDIC or NCUA). This law change was enacted to make additional federal depository insurance available to cover municipal deposits in anticipation of the December 31, 2012 sunset of the temporary unlimited coverage for non-interest bearing municipal accounts provisions of the Dodd-Frank Act.

Municipal State Aid (MSA) Eligibility – Three changes were made that protect the MSA of cities dropping below a population of 5,000, which is the eligibility threshold for receiving MSA for street maintenance. Under previous law, if a city that formerly had a population of 5,000 or more fell below a 5,000 population at the 2010 decennial census, it would have been ineligible for MSA beginning in fiscal 2012. The first change enacted allows previously eligible cities falling below 5,000 population at a decennial census to continue to be considered to have a population of 5,000 for purposes of calculating MSA, thereby remaining eligible, until the end of the fourth year of the decade. The second change enacted states that for purposes of calculating MSA, which is based 50 percent on population, a city is deemed to have a population equal to the greater of 5,000 or as otherwise determined by statute. The final change requires that, for 2013 MSA only, the aid be allocated in a manner that backfills the MSA cities lost in 2012 due to population drops.

Contractor Bond Threshold – The threshold at which a municipality is required to obtain contractor performance and payment bonds for public construction contracts was increased from \$75,000 to match the current competitive bid law threshold of \$100,000.

Municipal Detachment of Parcels – A number of corrections and clarifications were made related to petitions for the detachment of parcels from a municipality. The changes affect petition requirements, the hearing process, and the sharing of associated hearing and mediation costs with the landowners.

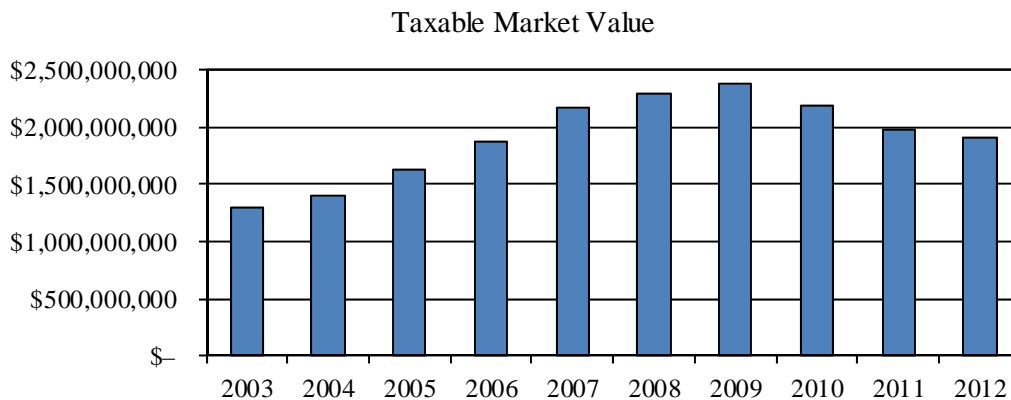
Tort Liability Limits for Cities Contracting With Certain Nonprofits – The liability limit on claims against cities involving nonprofit organizations that are engaged in or administer outdoor recreational activities that are funded or authorized by a municipality were lowered from \$1.5 million to \$1.0 million.

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 due to reductions in state aids and fees from new development due to the struggling economy. As a result, many cities have repeatedly been faced with the difficult choice of either reducing services or increasing taxes on their already overburdened constituents.

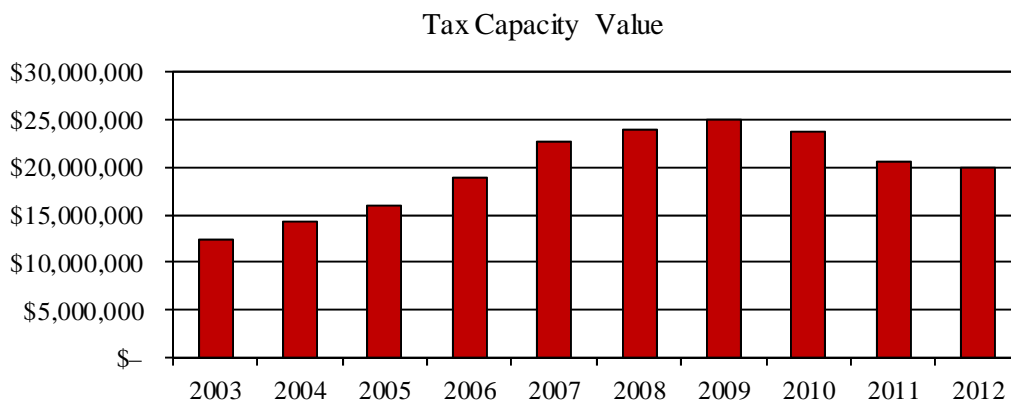
Property values within Minnesota cities experienced average decreases of 5.7 percent and 8.8 percent for taxes payable in 2011 and 2012, respectively, as market values have continued to slide despite recent signs of improvement in other areas of the economy. In comparison, the City's taxable market value decreased 9.6 percent and 3.7 percent for 2011 and 2012, respectively. The market value for taxes payable in 2012 is based on estimated values as of January 1, 2011.

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 13.4 percent and 3.5 percent for taxes payable in 2011 and 2012, respectively.

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



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

Rates expressed as a percentage of net tax capacity						
	All Cities State-Wide		Seven-County Metro Area		City of Ramsey	
	<u>2011</u>	<u>2012</u>	<u>2011</u>	<u>2012</u>	<u>2011</u>	<u>2012</u>
Average tax rate						
City	42.5	46.3	40.0	43.4	39.8	44.2
County	43.7	46.8	42.1	45.0	40.4	41.6
School	25.2	27.3	26.8	28.5	26.5	26.0
Special taxing	<u>6.4</u>	<u>6.8</u>	<u>8.1</u>	<u>8.7</u>	<u>6.2</u>	<u>5.8</u>
Total	<u><u>117.8</u></u>	<u><u>127.2</u></u>	<u><u>117.0</u></u>	<u><u>125.6</u></u>	<u><u>112.9</u></u>	<u><u>117.6</u></u>

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.

As presented in the table above the average tax rates for the City and other taxing authorities are similar to the state-wide and metro area averages. In total the City of Ramsey is below both averages for both the current year and prior year presented.

GOVERNMENTAL FUNDS OVERVIEW

This section of the report provides an overview of the financial trends and activities of the City's governmental funds, which includes the General Fund, 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.

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, 2012, presented both by fund balance classification and by fund:

Governmental Fund Changes in Fund Balance			
	Fund Balance as of December 31,		Increase (Decrease)
	<u>2012</u>	<u>2011</u>	
Fund balances of governmental funds			
Total by classification			
Nonspendable	\$ 4,042	\$ 10,233	\$ (6,191)
Restricted	17,606,291	25,032,219	(7,425,928)
Committed	946,312	819,839	126,473
Assigned	10,104,800	10,677,369	(572,569)
Unassigned	<u>6,122,130</u>	<u>5,400,602</u>	<u>721,528</u>
Total – governmental funds	<u>\$ 34,783,575</u>	<u>\$ 41,940,262</u>	<u>\$ (7,156,687)</u>
Total by fund			
Major funds			
General	\$ 6,725,283	\$ 6,388,632	\$ 336,651
Special revenue funds			
Tax Increment	1,146,330	8,816,253	(7,669,923)
Housing and Redevelopment Authority	8,259,754	8,335,507	(75,753)
Debt Service Fund			
2012A/2005A G.O. Improvement Bond Refund	959,891	2,155,461	(1,195,570)
Capital Project Fund			
Public Improvement Revolving	2,237,526	1,829,367	408,159
Landfill	2,135,357	3,099,101	(963,744)
Equipment Revolving	1,780,818	3,276,236	(1,495,418)
Public Improvement Revolving The COR	(103,504)	(256,024)	152,520
Armstrong/Bunker Street Improvement	–	260,269	(260,269)
Sunwood Drive Realignment	1,074,576	(33,220)	1,107,796
Nonmajor funds	<u>10,567,544</u>	<u>8,068,680</u>	<u>2,498,864</u>
Total – governmental funds	<u>\$ 34,783,575</u>	<u>\$ 41,940,262</u>	<u>\$ (7,156,687)</u>

As reflected in the table above total governmental fund balance decreased by \$7,156,687. The decrease reflects the approved use of restricted resources of the Tax Increment Special Revenue Fund primarily within Tax Increment District 14, The COR (Center of Ramsey) Development Project.

GOVERNMENTAL FUNDS REVENUE

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 the 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 the City's operation. 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 per Capita							
With State-Wide Averages by Population Class							
Year	State-Wide			City of Ramsey			
	December 31, 2011			2010	2011	2012	
Population	2,500–10,000	10,000–20,000	20,000–100,000	23,668	23,702	23,835	
Property taxes	\$ 390	\$ 363	\$ 406	\$ 361	\$ 341	\$ 371	
Tax increments	40	48	51	153	153	113	
Franchise and other taxes	27	36	30	–	–	–	
Special assessments	70	56	56	21	23	18	
Licenses and permits	23	21	31	17	16	22	
Intergovernmental revenues	283	263	152	86	133	157	
Charges for services	95	79	78	56	64	71	
Other	65	75	65	93	74	103	
Total revenue	<u>\$ 993</u>	<u>\$ 941</u>	<u>\$ 869</u>	<u>\$ 787</u>	<u>\$ 804</u>	<u>\$ 855</u>	

Total revenues for the City's governmental funds for 2012, were \$20,387,885, an increase of \$1.4 million (7.1 percent) from the prior year. On a per capita basis, the City's governmental funds revenue for 2012 was \$855, an increase of \$51 from the prior year. The increase in property taxes per capita of \$30 was primarily due to an increase in the approved levy. Intergovernmental revenue increased \$24 per capita due to receiving reimbursement from Anoka County Highway Department for the county's portion of the Sunwood Drive construction project. Other local services revenue per capita increased \$29 per capita, which includes fines and forfeits, investment earnings, and other miscellaneous revenue sources. The increase was offset by decreases in tax increment revenues of \$40 per capita, due to the decertification of a tax increment financing district at the end of the prior year.

GOVERNMENTAL FUNDS EXPENDITURES

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

- **Current** – These are typically the general operating type expenditures occurring on an annual basis, and are primarily funded by general sources such as taxes and intergovernmental revenues.
- **Capital Outlay and Construction** – These expenditures do not occur on a consistent basis, more typically fluctuating significantly from year-to-year. Many of these expenditures are project-oriented, which are often funded by specific sources that have benefited from the expenditure, such as special assessment improvement projects.
- **Debt Service** – Although the expenditures for 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:

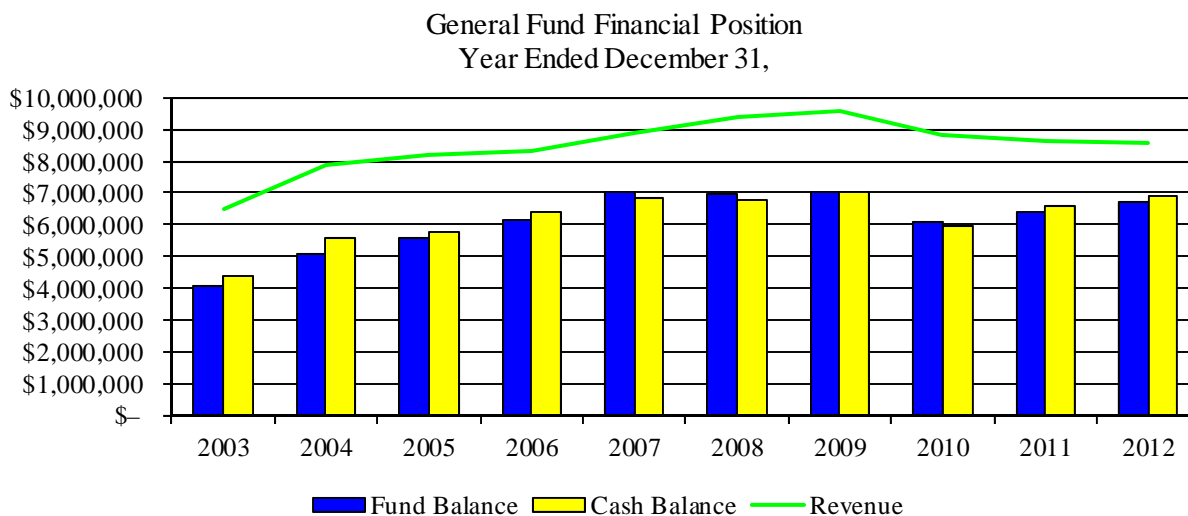
Governmental Funds Expenditures per Capita With State-Wide Averages by Population Class								
Year	State-Wide			City of Ramsey				
	December 31, 2011			2010	2011	2012		
Population	2,500–10,000	10,000–20,000	20,000–100,000	23,668	23,702	23,835		
Current								
General government	\$ 126	\$ 99	\$ 82	\$ 181	\$ 205	\$ 767		
Public safety	231	225	238	160	164	162		
Street maintenance and lighting	114	108	89	116	209	184		
Parks and recreation	79	96	87	35	36	35		
All other	74	81	82	–	–	–		
	<u>\$ 624</u>	<u>\$ 609</u>	<u>\$ 578</u>	<u>\$ 492</u>	<u>\$ 614</u>	<u>\$ 1,148</u>		
Capital outlay and construction	<u>\$ 258</u>	<u>\$ 272</u>	<u>\$ 233</u>	<u>\$ 268</u>	<u>\$ 278</u>	<u>\$ 141</u>		
Debt service								
Principal	\$ 186	\$ 148	\$ 109	\$ 94	\$ 76	\$ 62		
Interest and fiscal	60	48	41	56	52	112		
	<u>\$ 246</u>	<u>\$ 196</u>	<u>\$ 150</u>	<u>\$ 150</u>	<u>\$ 128</u>	<u>\$ 174</u>		

The City has historically and consistently used limited expenditure functions for financial statement reporting purposes. As the City has grown and increased spending for community development and other areas, we encourage the City to review the format and level of functional detail presented in future comprehensive annual financial reports. We believe this will enhance comparisons to state-wide averages and improve financial statement transparency, identifying changes from year-to-year.

Total expenditures in the City's governmental funds for 2012 were \$34,916,380, an increase of \$10,759,967, (44.5 percent) from the prior year. On a per capita basis, the City expended a total of \$1,463 in 2012. Current expenditures increased \$534 per capita from last year. This increase was primarily for approved expenditures incurred within Tax Increment District 14, for The COR (Center of Ramsey) Development project as mentioned earlier for the decrease in governmental fund balance. Capital outlay expenditures for 2012 were \$137 less per capita than the prior year due to fewer city street construction expenditures. Debt service expenditures for 2012 were \$46 per capita higher than the prior year as scheduled, with two bonds issued in the current year and schedule debt payments, including current refunding payments made to escrow.

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.



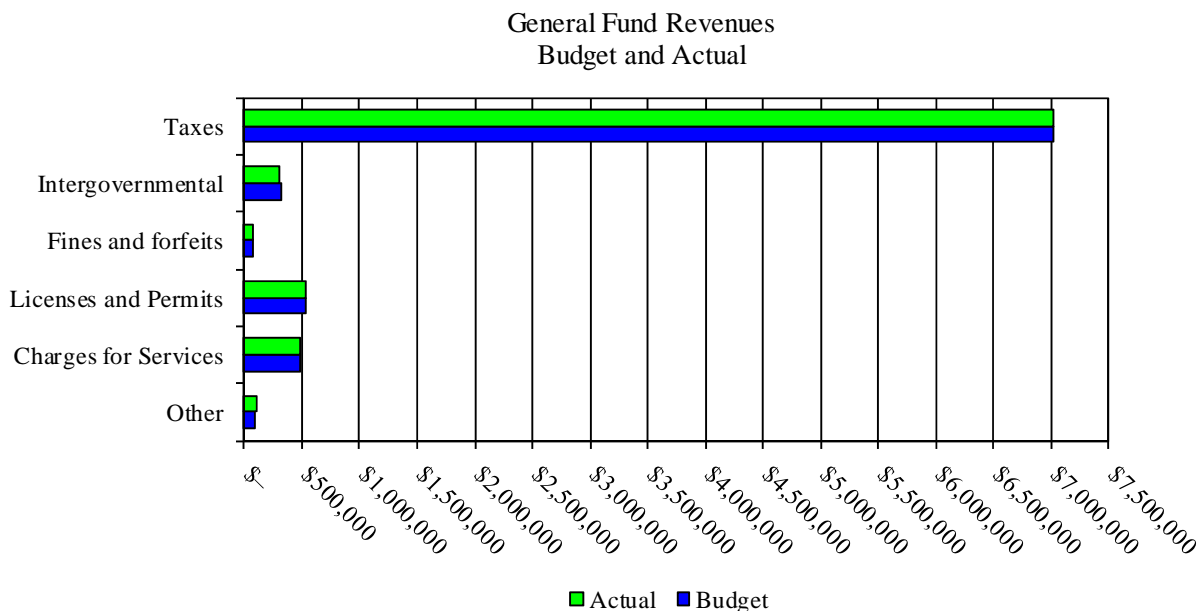
The City's General Fund cash and investments balance (net of interfund borrowing) at December 31, 2012 was \$6,910,921, an increase of \$310,335 from the previous year. Total fund balance at year-end was \$6,725,283, an increase of \$336,651 from the prior year.

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 above 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.

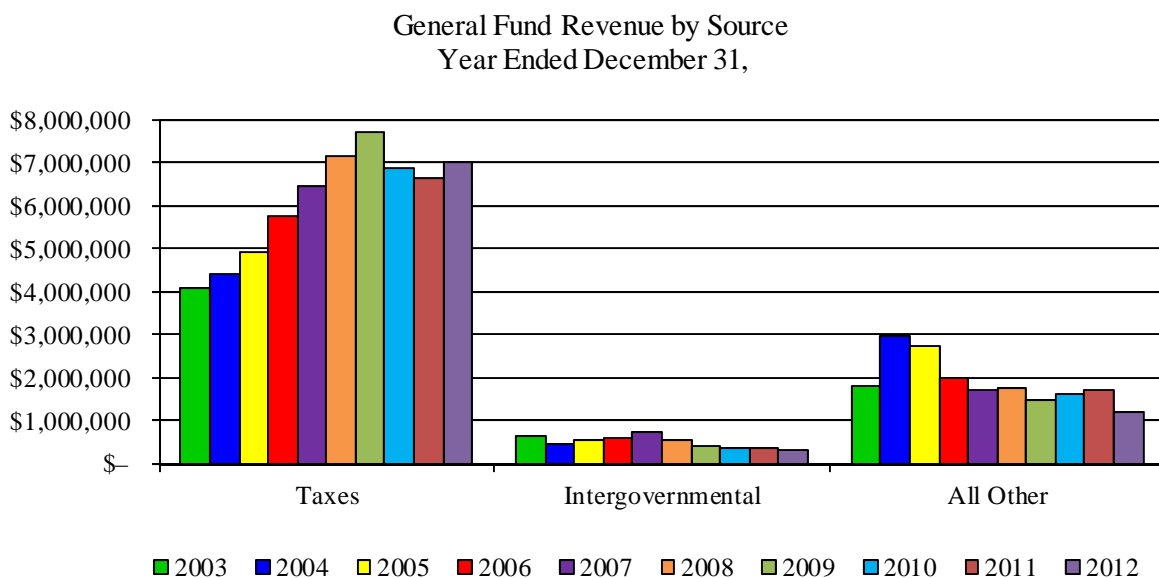
Generally, a healthy financial position allows the City to avoid volatility in tax rates; helps minimize the impact of state funding changes; allows for the adequate and consistent funding of services, repairs, and unexpected costs; and can be a factor in determining the City's bond rating and resulting interest costs.

The following graph reflects the City's General Fund revenues, budget and actual, for 2012:



Total General Fund revenues for 2012 were \$8,544,434, a decrease of \$111,446 (1.3 percent) from the previous year and \$4,526 more than budget. Actual results were very close to final projections as reflected in the graph above.

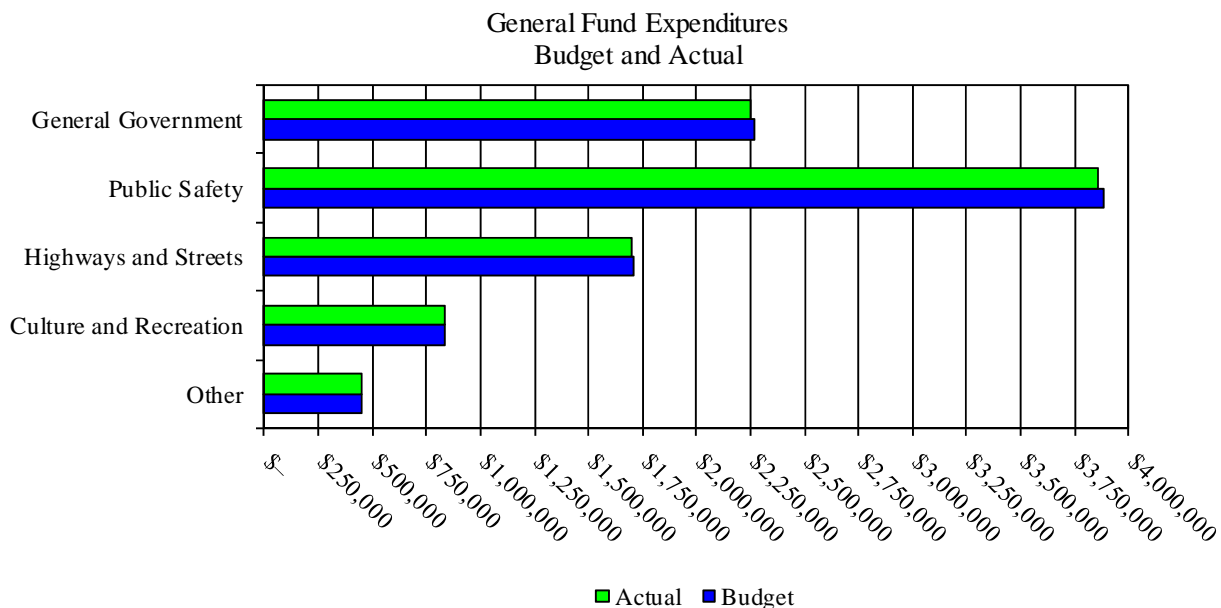
The following graph presents the City's General Fund revenues by source for the last 10 years:



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 82 percent of General Fund revenues. 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.

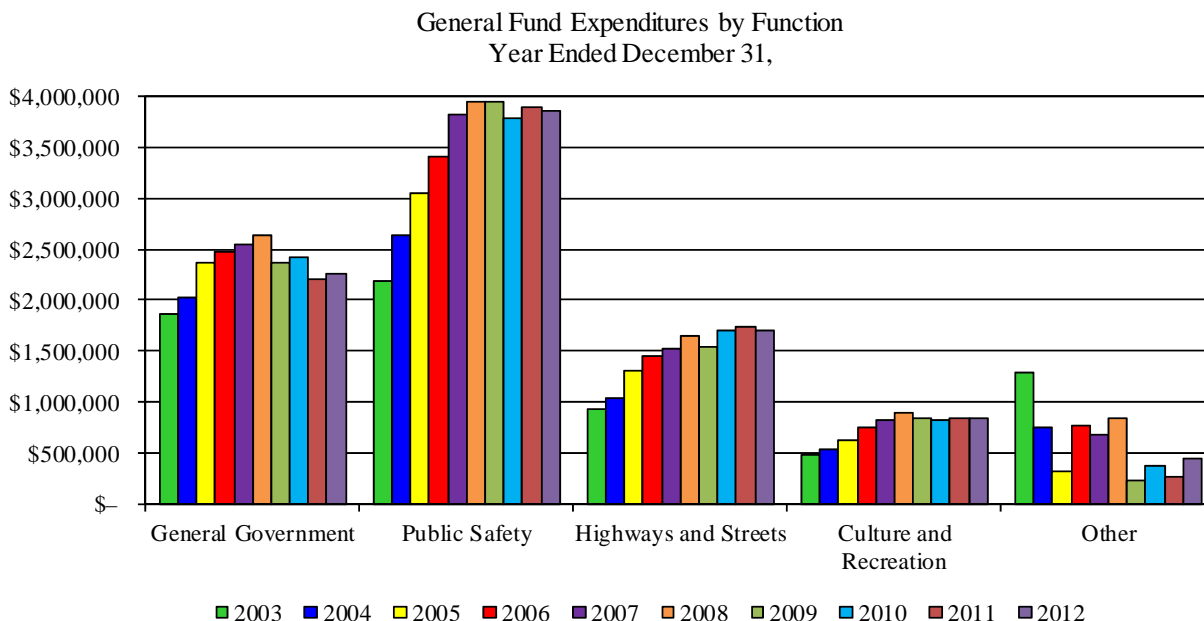
During 2012, tax sources reflect an increase of \$398,951 while the decrease in the other category was primarily due to reduced charges for services of \$556,183. Property tax revenue increased \$284,683, due to the elimination of MVHC aid subtraction.

The following graph reflects the City's General Fund expenditures, budget and actual, for 2012:



General Fund expenditures totaled \$9,098,542 in 2012, an increase of \$157,311 (or 1.8 percent) from the prior year, and were \$40,820 (or 0.4 percent) under the final budget. During the year, the City amended the final expenditure budget for open positions that were not filled during the year and for department efforts to control costs. Actual expenditures were also close to final amounts approved in the 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 decreased in all categories presented above, with the exception of general government, which increased \$54,570, and other, which increased \$186,262. The increase in other expenditures includes additional capital outlay of \$209,667 over the prior fiscal year.

ENTERPRISE FUNDS OVERVIEW

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

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

ENTERPRISE FUNDS FINANCIAL POSITION

The following table summarizes the changes in the financial position of the City's enterprise funds during the year ended December 31, 2012, presented both by classification and by fund:

Enterprise Funds Change in Financial Position			
	Net Position as of December 31,		Increase (Decrease)
	<u>2012</u>	<u>2011</u>	
Net position of enterprise funds			
Total by classification			
Net investment in capital assets	\$ 50,843,868	\$ 51,748,092	\$ (904,224)
Unrestricted	<u>27,486,732</u>	<u>23,764,060</u>	<u>3,722,672</u>
Total – enterprise funds	<u>\$ 78,330,600</u>	<u>\$ 75,512,152</u>	<u>\$ 2,818,448</u>
Total by fund			
Water Utility	\$ 39,262,115	\$ 37,201,244	\$ 2,060,871
Sewer Utility	26,660,606	26,100,811	559,795
Street Light Utility	1,673,212	1,654,098	19,114
Recycling Utility	271,232	233,916	37,316
Storm Water Utility	<u>10,463,435</u>	<u>10,322,083</u>	<u>141,352</u>
Total – enterprise funds	<u>\$ 78,330,600</u>	<u>\$ 75,512,152</u>	<u>\$ 2,818,448</u>

In total, the net position of the City's enterprise funds increased by \$2,818,448 during the year ended December 31, 2012. Increases for contributions and positive operating results contributed to the overall increase. Depreciation expense on capital assets in excess of current year additions reduced the overall net investment in capital assets in enterprise fund operations.

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

	2008	2009	2010	2011	2012
Utility enterprise funds					
Water					
Operating revenue	\$ 1,539,665	\$ 1,693,581	\$ 1,633,461	\$ 1,821,386	\$ 2,131,460
Operating expenses	<u>1,247,248</u>	<u>1,291,952</u>	<u>1,295,721</u>	<u>1,358,050</u>	<u>1,228,012</u>
Operating income	<u>\$ 292,417</u>	<u>\$ 401,629</u>	<u>\$ 337,740</u>	<u>\$ 463,336</u>	<u>\$ 903,448</u>
Operating income as a % of operating revenue	<u>19.0 %</u>	<u>23.7 %</u>	<u>20.7 %</u>	<u>25.4 %</u>	<u>42.4 %</u>
Sewer					
Operating revenue	\$ 1,208,843	\$ 1,214,953	\$ 1,261,609	\$ 1,236,771	\$ 1,324,342
Operating expenses	<u>883,214</u>	<u>1,076,451</u>	<u>1,101,554</u>	<u>1,149,318</u>	<u>1,152,760</u>
Operating income	<u>\$ 325,629</u>	<u>\$ 138,502</u>	<u>\$ 160,055</u>	<u>\$ 87,453</u>	<u>\$ 171,582</u>
Operating income as a % of operating revenue	<u>26.9 %</u>	<u>11.4 %</u>	<u>12.7 %</u>	<u>7.1 %</u>	<u>13.0 %</u>
Street Light					
Operating revenue	\$ 183,560	\$ 172,897	\$ 179,272	\$ 178,850	\$ 179,124
Operating expenses	<u>123,839</u>	<u>148,140</u>	<u>158,369</u>	<u>163,758</u>	<u>165,651</u>
Operating income	<u>\$ 59,721</u>	<u>\$ 24,757</u>	<u>\$ 20,903</u>	<u>\$ 15,092</u>	<u>\$ 13,473</u>
Operating income as a % of operating revenue	<u>32.5 %</u>	<u>14.3 %</u>	<u>11.7 %</u>	<u>8.4 %</u>	<u>7.5 %</u>
Recycling					
Operating revenue	\$ 332,682	\$ 284,515	\$ 294,617	\$ 297,226	\$ 296,358
Operating expenses	<u>300,755</u>	<u>298,631</u>	<u>307,662</u>	<u>302,947</u>	<u>302,936</u>
Operating income (loss)	<u>\$ 31,927</u>	<u>\$ (14,116)</u>	<u>\$ (13,045)</u>	<u>\$ (5,721)</u>	<u>\$ (6,578)</u>
Operating income as a % of operating revenue	<u>9.6 %</u>	<u>(5.0) %</u>	<u>(4.4) %</u>	<u>(1.9) %</u>	<u>(2.2) %</u>
Storm Water					
Operating revenue	\$ 566,506	\$ 578,666	\$ 617,598	\$ 617,579	\$ 647,169
Operating expenses	<u>300,444</u>	<u>358,522</u>	<u>350,521</u>	<u>410,666</u>	<u>496,309</u>
Operating income	<u>\$ 266,062</u>	<u>\$ 220,144</u>	<u>\$ 267,077</u>	<u>\$ 206,913</u>	<u>\$ 150,860</u>
Operating income as a % of operating revenue	<u>47.0 %</u>	<u>38.0 %</u>	<u>43.2 %</u>	<u>33.5 %</u>	<u>23.3 %</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, 2012, with the exception of the recycling fund. This loss was covered by the County Recycling Grant which typically subsidizes these operations.

The most significant change in operating income results compared to prior year occurred in the Water Utility Fund. The increase in Water Utility Fund operating revenue is a combination of a 2 percent rate increase along with an increase in usage as a result of the dry watering season.

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 City's net position as of December 31, 2012 and 2011 for governmental activities and business-type activities:

	As of December 31,		Increase (Decrease)
	2012	2011	
Net position			
Governmental activities			
Net investment in capital assets	\$ 41,998,822	\$ 39,794,321	\$ 2,204,501
Restricted	14,632,006	22,103,948	(7,471,942)
Unrestricted	7,298,825	14,433,838	(7,135,013)
Total governmental activities	<u>63,929,653</u>	<u>76,332,107</u>	<u>(12,402,454)</u>
Business-type activities			
Net investment in capital assets	50,843,868	51,748,092	(904,224)
Unrestricted	27,486,732	23,764,060	3,722,672
Total business-type activities	<u>78,330,600</u>	<u>75,512,152</u>	<u>2,818,448</u>
Total net position	<u>\$ 142,260,253</u>	<u>\$ 151,844,259</u>	<u>\$ (9,584,006)</u>

The decrease in the restricted net position of governmental activities is consistent with our earlier discussion of the City's approved expenditures within tax increment district 14 for The COR (Center Of Ramsey) development project. The decrease in the unrestricted net position was also for development costs within The COR, financed with tax increment financing bonds. The increase in the net investment in capital assets for governmental activities reflects the City's continued investment in capital asset infrastructure.

The change in the net position for business-type activities is consistent with our earlier discussion for the utility operations which are presented under the same full accrual basis of accounting.

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, 2012 and 2011:

	2012		2011	
	Expenses	Program Revenues	Net Change	Net Change
Net (expense) revenue				
Governmental activities				
General government	\$ 18,976,842	\$ 3,993,400	\$ (14,983,442)	\$ (4,533,124)
Public safety	4,218,066	1,422,763	(2,795,303)	(3,166,148)
Highways and streets	5,659,428	2,095,402	(3,564,026)	(1,875,242)
Culture and recreation	1,216,583	667,197	(549,386)	(1,223,948)
Interest and fiscal charges	2,555,567	–	(2,555,567)	(1,302,228)
Business-type activities				
Water utility	1,228,012	3,152,893	1,924,881	546,685
Sewer utility	1,152,760	1,625,013	472,253	92,453
Street light utility	165,651	179,124	13,473	15,092
Recycling utility	302,936	346,523	43,587	44,558
Storm water utility	496,309	647,169	150,860	206,913
Total net (expense) revenue	<u>\$ 35,972,154</u>	<u>\$ 14,129,484</u>	(21,842,670)	(11,194,989)
General revenues				
Property taxes			11,454,519	11,671,760
General grants and contributions			9,175	120,932
Investment earnings			794,970	1,364,014
Sale of capital assets			–	14,716
Total general revenues			<u>12,258,664</u>	<u>13,171,422</u>
Change in net position			<u>\$ (9,584,006)</u>	<u>\$ 1,976,433</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 City's governmental operations tend to rely more heavily on general revenues, such as property taxes and unrestricted grants. In contrast, the City's business-type activities tend to rely more heavily on program revenues like charges for services (sales) and program specific grants to cover expenses. This is critical given the current external downward pressures on general revenue sources such as taxes and state aids.

ACCOUNTING AND AUDITING UPDATES

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. 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. 65 – ITEMS PREVIOUSLY REPORTED AS ASSETS AND LIABILITIES

This statement establishes accounting and financial reporting standards that reclassify, as deferred outflows of resources or deferred inflows of resources, certain items previously reported as assets and liabilities; and recognizes, as outflows or inflows of resources, certain items previously reported as assets and liabilities. This statement also provides financial reporting guidance related to the impact of the financial statement elements deferred outflows of resources and deferred inflows of resources, such as changes in the determination of the major fund calculations and limiting the use of the term *deferred* in financial statement presentations. The provisions of this statement are effective for financial statements for periods beginning after December 15, 2012. Earlier application is encouraged.

GASB STATEMENT NO. 67 – FINANCIAL REPORTING FOR PENSION PLANS – AN AMENDMENT OF GASB STATEMENT NOS. 25 AND 50

The primary objective of this statement is to improve financial reporting by state and local government pension plans. GASB Statement No. 67 replaces the requirements of GASB Statement Nos. 25 and 50 for pension plans that are administered through trusts or equivalent arrangements that meet the following criteria: contributions from employers and nonemployer contributing entities to the pension plan and earnings on those contributions are irrevocable; pension plan assets are dedicated to providing pensions to plan members in accordance with the benefit terms; and pension plan assets are legally protected from the creditors of employers, nonemployer contributing entities, and the pension plan administrator. If the plan is a defined benefit pension plan, plan assets also are legally protected from creditors of the plan members. The requirements of GASB Statement Nos. 25 and 50 remain applicable to pension plans that are not administered through trusts covered by the scope of this statement and to defined contribution plans that provide post-employment benefits other than pensions. The statement makes a number of changes in the financial statement presentation, measurement, and required disclosures relating to the reporting of these types of pension plans. This statement is effective for financial statements for fiscal years beginning after June 15, 2013. Earlier application is encouraged.

GASB STATEMENT NO. 68 – ACCOUNTING AND FINANCIAL REPORTING FOR PENSIONS – AN AMENDMENT OF GASB STATEMENT NOS. 27 AND 50

The primary objective of this statement is to improve accounting and financial reporting by state and local governments for pensions. This statement replaces the requirements of GASB Statement Nos. 27 and 50, as they relate to pensions that are provided through pension plans administered as trusts or equivalent arrangements that meet certain criteria (as described earlier for GASB Statement No. 67). The requirements of GASB Statement Nos. 27 and 50 remain applicable for pensions that are not covered by the scope of this statement.

This statement establishes standards for measuring and recognizing liabilities, deferred outflows of resources, deferred inflows of resources, and expense/expenditures. In addition, this statement details the recognition and disclosure requirements for employers with liabilities (payables) to a defined benefit pension plan and for employers whose employees are provided with defined contribution pensions. This statement also addresses circumstances in which a nonemployer entity has a legal requirement to make contributions directly to a pension plan. This statement is effective for financial statements for fiscal years beginning after June 15, 2014. Earlier application is encouraged.

Included in this statement are major changes in how employers that participate in cost-sharing pension plans, such as TRA and PERA, account for pension benefit expenses and liabilities. In financial statements prepared using the economic resources measurement focus and accrual basis of accounting (government-wide and proprietary funds), a cost-sharing employer that does not have a special funding situation is required to recognize a liability for its proportionate share of the net pension liability of all employers with benefits provided through the pension plan. A cost-sharing employer is required to recognize pension expense and report deferred outflows of resources and deferred inflows of resources related to pensions for its proportionate share of collective pension expense and collective deferred outflows of resources and deferred inflows of resources related to pensions. In addition, the effects of (1) a change in the employer's proportion of the collective net pension liability and (2) differences during the measurement period between the employer's contributions and its proportionate share of the total of contributions from employers included in the collective net pension liability are required to be determined. These effects are required to be recognized in the employer's pension expense in a systematic and rational manner over a closed period equal to the average of the expected remaining service lives of all active and inactive employees that are provided with pensions through the pension plan.

GASB STATEMENT NO. 69 – GOVERNMENT COMBINATIONS AND DISPOSALS OF GOVERNMENT OPERATIONS

This statement provides accounting and financial reporting guidance, including disclosure requirements, for government combinations and disposals of government operations. Government combinations include mergers, acquisitions, and transfers of operations. Included within the scope of this statement are combinations of governmental entities or combinations of governmental entities, with nongovernmental entities (such as a nonprofit entity) as long as the new or continuing organization is a government. This statement does not apply to combinations in which a government acquires an organization that continues to exist as a separate entity, or acquires an equity interest in an organization that remains legally separate from the acquiring government. A disposal of operations occurs when a government either transfers or sells specific operations. The provisions of this statement are effective for financial statements for periods beginning after December 15, 2013. Earlier application is encouraged.

PROPOSED CHANGES TO REQUIREMENTS FOR FEDERAL GRANTS

The U.S. Office of Management and Budget (OMB) has issued for comment *Proposed OMB Uniform Guidance: Cost Principles, Audit, and Administrative Requirements for Federal Awards*, which proposes broad revisions to OMB Circular A-133 and other key grant reforms. The proposed guidance includes a number of significant changes to the federal Single Audit process, including; an increase in dollar threshold for requiring a Single Audit, changes to the process for determining major programs, a reduction in the percentage of expenditures required to be covered by a Single Audit, revised criteria for determining low-risk auditees, a reduction in the types of compliance requirements to be tested, and an increase in the threshold for reporting questioned costs. The proposed guidance would also consolidate OMB circulars and cost principles; and change certain federal requirements related to indirect costs, time and effort reporting, and grant administration.