

Management Report  
for  
City of Saint Peter, Minnesota  
December 31, 2014

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PRINCIPALS

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To the City Council and Management  
City of Saint Peter, Minnesota

We have prepared this management report in conjunction with our audit of the City of Saint Peter, Minnesota's (the City) financial statements for the year ended December 31, 2014. 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
- Governmental Funds Overview
- Enterprise Funds Overview
- Government-Wide Financial Statements
- Legislative Updates
- Accounting and Auditing Updates

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

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

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

Minneapolis, Minnesota  
June 16, 2015

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## AUDIT SUMMARY

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

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

We have audited the financial statements of the governmental activities, the business-type activities, the discretely presented component units, each major fund, and the aggregate remaining fund information of the City as of and for the year ended December 31, 2014, and the related notes to basic financial statements. Professional standards require that we provide you with information about our responsibilities under auditing standards generally accepted in the United States of America, *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 to you the following information related to our audit.

### **AUDITOR'S RESPONSIBILITY FOR COMPONENT UNITS**

Our responsibility is to express opinions on the City's financial statements based on our audit. We did not audit the discretely presented component units' financial statements. This includes the financial statements of the River's Edge Hospital and Clinic and the financial statements of the Housing and Redevelopment Authority (HRA). Those statements were audited by other auditors whose reports have been furnished to us. Our opinion on the basic financial statements, insofar as it relates to the amounts included for these organizations as component units of the City, is based solely on the reports of the other auditors.

### **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, 2014:

- We issued an unmodified opinion on the City's basic financial statements.
- We reported one finding related to our testing of internal controls over financial reporting. We reported that due to the small number of office staff, the City has a limited segregation of duties in several areas, which we consider a significant deficiency in internal controls.
- The results of our testing disclosed no instances of noncompliance that are required to be reported under *Government Auditing Standards*.
- We reported that the Schedule of Expenditures of Federal Awards is fairly stated, in all material respects, in relation to the basic financial statements.

- The results of our tests indicate that the City has complied, in all material respects, with the types of compliance requirements that could have a direct and material effect on each of its major federal programs.
- We reported no deficiencies in the City's internal controls over compliance with the types of compliance requirements that could have a direct and material effect on each of its major federal programs.
- We reported no findings based on our testing of the City's compliance with Minnesota laws and regulations.

#### **SIGNIFICANT ACCOUNTING POLICIES**

Management is responsible for the selection and use of appropriate accounting policies. The significant accounting policies used by the City are described in Note 1 of the notes to basic financial statements. No new accounting policies were adopted and the application of existing policies was not changed during the fiscal year ended December 31, 2014.

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

#### **ACCOUNTING ESTIMATES AND MANAGEMENT JUDGMENTS**

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

- **Depreciation** – Management's estimates of depreciation expense are based on the estimated useful lives of the assets.
- **Self-Insurance Reserves** – Management's estimates of costs for unreported claims are based on the past history of claims reported.
- **Compensated Absences** – Management's estimate based on current rates of pay and sick leave balances.
- **Land Held for Resale** – Management's estimate is based on net realizable value (lower of cost or estimated sales price).
- **Allowance for Doubtful Accounts** – Management's estimate of the allowance for doubtful accounts is based on historical water and sewer revenues, historical loss levels, and an analysis of the collectability of individual accounts.

We evaluated the key factors and assumptions used by management in the areas discussed above in determining that they are reasonable in relation to the financial statements taken as a whole.

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

#### **CORRECTED AND UNCORRECTED MISSTATEMENTS**

Professional standards require us to accumulate all known and likely misstatements identified during the audit, other than those that are trivial, and communicate them to the appropriate level of management.

We proposed two uncorrected audit adjustments to the financial statements. The adjustments are as follows:

- Net other post-employment benefit (OPEB) liability of \$13,259.
- Federal Insurance Contributions Act (FICA) liability on the related compensated absences liability of \$56,504.

Management has determined that the effects of the uncorrected adjustments are immaterial, both individually and in the aggregate, to the financial statements taken as a whole. In addition, none of the misstatements detected as a result of audit procedures and corrected by management were material, either individually or in the aggregate, to each opinion unit's financial statements taken as a whole.

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

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

#### **DISAGREEMENTS WITH MANAGEMENT**

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

#### **MANAGEMENT REPRESENTATIONS**

We have requested certain representations from management that are included in the management representation letter dated June 16, 2015.

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

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

#### **OTHER AUDIT FINDINGS OR ISSUES**

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

#### **OTHER MATTERS**

We applied certain limited procedures to Management's Discussion and Analysis, and the Schedule of Funding Progress, and Schedule of Contributions for the Saint Peter Fire Department Relief Association, which are required supplementary information (RSI) that supplements the basic financial statements. Our procedures consisted of inquiries of management regarding the methods of preparing the information and comparing the information for consistency with management's responses to our inquiries, the basic financial statements, and other knowledge we obtained during our audit of the basic financial statements. We did not audit the RSI and do not express an opinion or provide any assurance on the RSI.

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

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

## GOVERNMENTAL FUNDS OVERVIEW

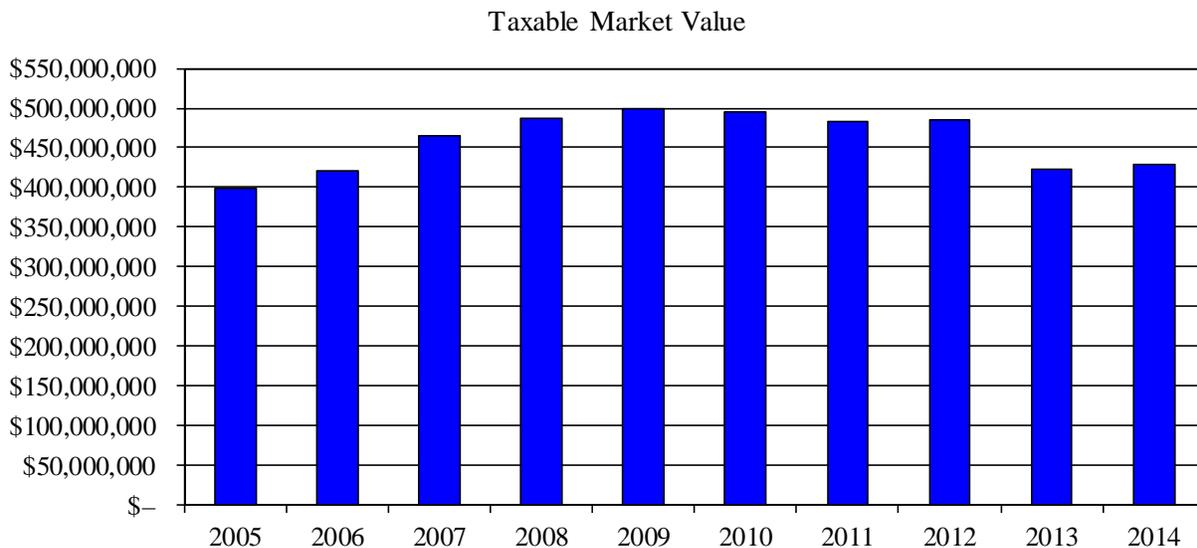
This section of the report provides you with an overview of the financial trends and activities of the City's governmental funds, which includes the General, special revenue, debt service, and capital project funds. These funds are used to account for the basic services the City provides to all of its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

### PROPERTY TAXES

Minnesota cities rely heavily on local property tax levies to support their governmental fund activities. For the 2013 fiscal year, local property tax levies provided 41.1 percent of the total governmental fund revenues for cities over 2,500 in population, and 35.5 percent for cities under 2,500 in population. Property tax levies certified by Minnesota cities for 2014 increased about 1.6 percent over 2013, compared to an increase of 2.3 percent the prior year. This moderate increase was due in part to a one-year levy limit for 2014 imposed on cities over 2,500 in population.

The total market value of Minnesota cities increased about 1.1 percent for the 2014 levy year, ending a four-year trend of declining market values that began in 2010 and peaked with a state-wide decline of about 8.8 percent for levy year 2012. Market values showed modest increases in all property categories for 2014, with the largest gains in agricultural and non-homestead residential properties. Because the assessed valuation used for levying property taxes is based on values from the previous fiscal year (e.g. the market value for taxes payable in 2014 is based on estimated values as of January 1, 2013), market value improvement has lagged behind recent upturns in the housing market and the economy in general.

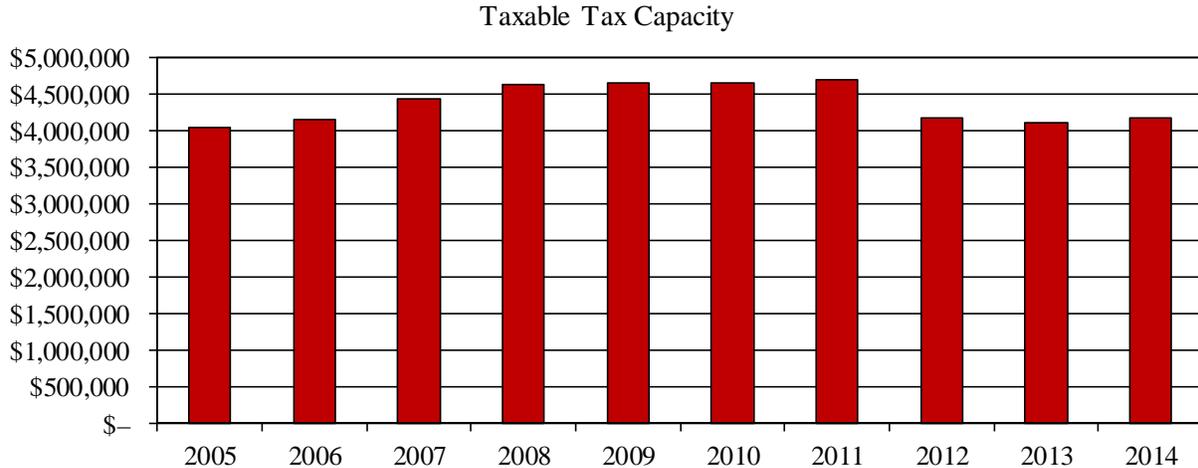
The City's taxable market value decreased 12.8 percent for taxes payable in 2013 and increased 1.0 percent for taxes payable in 2014. The following graph shows the City's changes in taxable market value over the past 10 years:



The data in this graph does not include the drop in taxable market value as a result of the legislative change to the Market Value Homestead Credit (MVHC) Program in fiscal 2012.

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 1.5 percent for taxes payable in 2013 and increased by 1.7 percent for taxes payable in 2014.

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



The significant drop in taxable tax capacity is the result of the legislative change to the MVHC Program in fiscal 2012.

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 rates.

Rates expressed as a percentage of net tax capacity				
	All Cities State-Wide		City of Saint Peter	
	2013	2014	2013	2014
<b>Average tax rate</b>				
City	48.8	48.8	<b>50.7</b>	<b>51.1</b>
County	48.5	47.6	<b>52.0</b>	<b>51.2</b>
School	28.5	28.9	<b>16.8</b>	<b>17.2</b>
Special taxing	7.2	7.3	<b>0.5</b>	<b>0.5</b>
<b>Total</b>	<b>133.0</b>	<b>132.6</b>	<b>120.0</b>	<b>120.0</b>

The City's portion of the average property tax rate for city residents has historically been higher than state-wide averages.

## 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.

<b>Governmental Funds Revenue per Capita</b>						
With State-Wide Averages by Population Class						
Year	State-Wide			City of Saint Peter		
	December 31, 2013			2012	2013	2014
Population	2,500–10,000	10,000–20,000	20,000–100,000	11,503	11,445	11,445
Property taxes	\$ 422	\$ 388	\$ 423	\$ 193	\$ 197	\$ 204
Tax increments	30	42	40	59	59	59
Franchise and other taxes	31	39	34	11	11	12
Special assessments	63	58	72	13	9	44
Licenses and permits	27	26	38	14	17	28
Intergovernmental revenues	253	268	148	391	334	449
Charges for services	109	84	91	32	35	41
Other	56	33	30	118	96	86
<b>Total revenue</b>	<b>\$ 991</b>	<b>\$ 938</b>	<b>\$ 876</b>	<b>\$ 830</b>	<b>\$ 757</b>	<b>\$ 922</b>

The City's lower than average tax revenue is primarily the result of the City relying on enterprise fund activities to finance the City's activities. This is due to the large amount of nontaxable property within the City.

In 2014, governmental funds revenue per capita increased \$165 per capita. The largest increases were in intergovernmental revenues and special assessments. Intergovernmental revenue is high as a result of more highway project federal and state aids in the current year.

It is important to note that this table does not include operating transfers, which are used by the City to support governmental fund activities. This information is not included in the table as the comparable information is not available.

## 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, and are often funded by specific sources that have benefited from the expenditure, such as special assessment improvement projects.
- **Debt Service** – Although the expenditures for debt service may be relatively consistent over the term of the respective debt, the funding source is the important factor. Some debt may be repaid through specific sources such as special assessments or redevelopment funding, while other debt may be repaid with general property taxes.

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

<b>Governmental Funds Expenditures per Capita</b>								
With State-Wide Averages by Population Class								
Year	State-Wide			City of Saint Peter				
	December 31, 2013			2012	2013	2014		
Population	2,500–10,000	10,000–20,000	20,000–100,000	11,503	11,445	11,445		
<b>Current</b>								
General government	\$ 129	\$ 100	\$ 83	\$ 99	\$ 102	\$ 104		
Public safety	244	235	239	208	218	228		
Street maintenance and lighting	123	121	91	103	110	109		
Parks and recreation	83	99	85	126	132	136		
All other	66	73	91	58	66	65		
	<u>\$ 645</u>	<u>\$ 628</u>	<u>\$ 589</u>	<u>\$ 594</u>	<u>\$ 628</u>	<u>\$ 642</u>		
Capital outlay and construction	<u>\$ 303</u>	<u>\$ 288</u>	<u>\$ 219</u>	<u>\$ 176</u>	<u>\$ 411</u>	<u>\$ 432</u>		
<b>Debt service</b>								
Principal	\$ 164	\$ 133	\$ 102	\$ 108	\$ 122	\$ 90		
Interest and fiscal	55	43	39	27	24	30		
	<u>\$ 219</u>	<u>\$ 176</u>	<u>\$ 141</u>	<u>\$ 135</u>	<u>\$ 146</u>	<u>\$ 120</u>		

The City's governmental funds current per capita expenditures increased by \$14 per capita in fiscal 2014. This increase was spread across all functions. Debt service costs decreased \$26 due to declines in scheduled debt payments.

**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, 2014, presented both by fund balance classification and by fund:

<b>Governmental Funds Change in Fund Balance</b>			
	Fund Balance as of December 31,		Increase (Decrease)
	<u>2013</u>	<u>2014</u>	
Fund balances of governmental funds			
Total by classification			
Nonspendable	\$ 10,183	\$ 3,942	\$ (6,241)
Restricted	6,673,510	5,236,855	(1,436,655)
Committed	1,015,420	1,041,022	25,602
Assigned	336,914	336,979	65
Unassigned	<u>2,875,406</u>	<u>3,238,045</u>	<u>362,639</u>
Total governmental funds	<u>\$ 10,911,433</u>	<u>\$ 9,856,843</u>	<u>\$ (1,054,590)</u>
Total by fund			
General	\$ 3,746,297	\$ 3,775,595	\$ 29,298
Capital Projects – Permanent Improvement	3,414,224	1,340,368	(2,073,856)
Nonmajor	<u>3,750,912</u>	<u>4,740,880</u>	<u>989,968</u>
Total governmental funds	<u>\$ 10,911,433</u>	<u>\$ 9,856,843</u>	<u>\$ (1,054,590)</u>

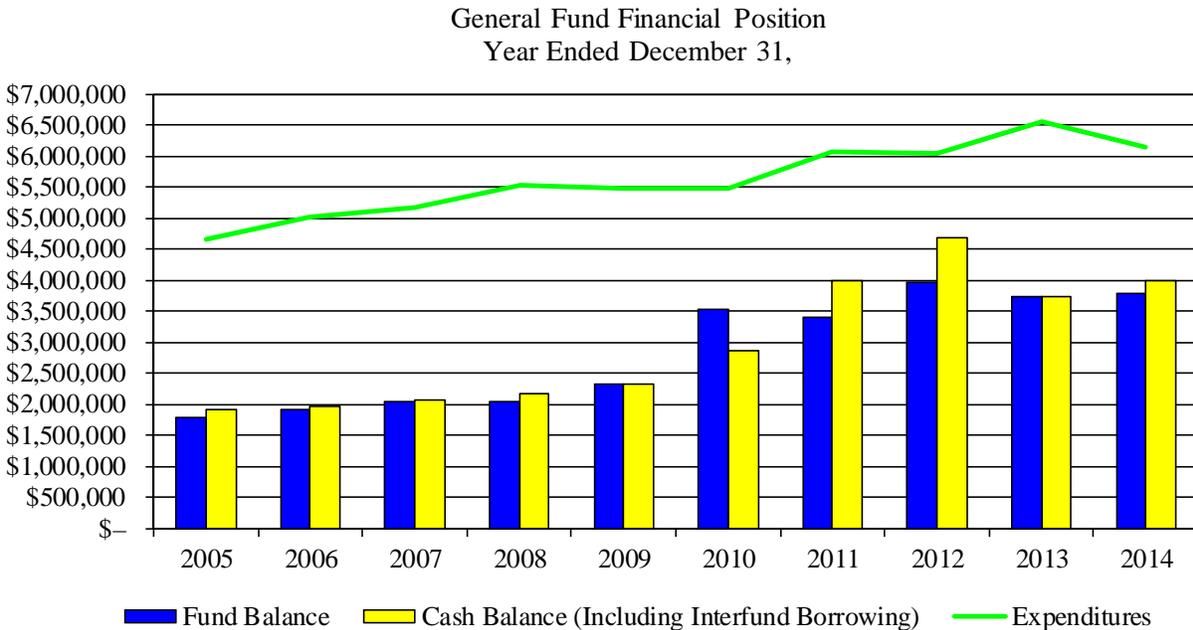
In total, the fund balances of the City’s governmental funds decreased by \$1,054,590 during the year ended December 31, 2014. The majority of this decrease was in the Capital Projects – Permanent Improvement Fund totaling \$2,073,856. This decrease was mainly due to the spend down of the Municipal State Aid Bonds on the Washington Avenue Street Improvement Project.

## FINANCIAL TRENDS AND CONDITIONS

### 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, street and highway maintenance, parks and recreation, and economic development.

The graph below illustrates the change in the General Fund financial position over the last ten years. We have also included a line representing annual expenditures to reflect the change in the size of the General Fund operation over the same period.



The City's General Fund cash and investment, and fund balance increased in the current year. The total fund balance at December 31, 2014 was \$3,775,595 an increase of \$29,298 which was consistent with the budgeted decrease of \$38,545.

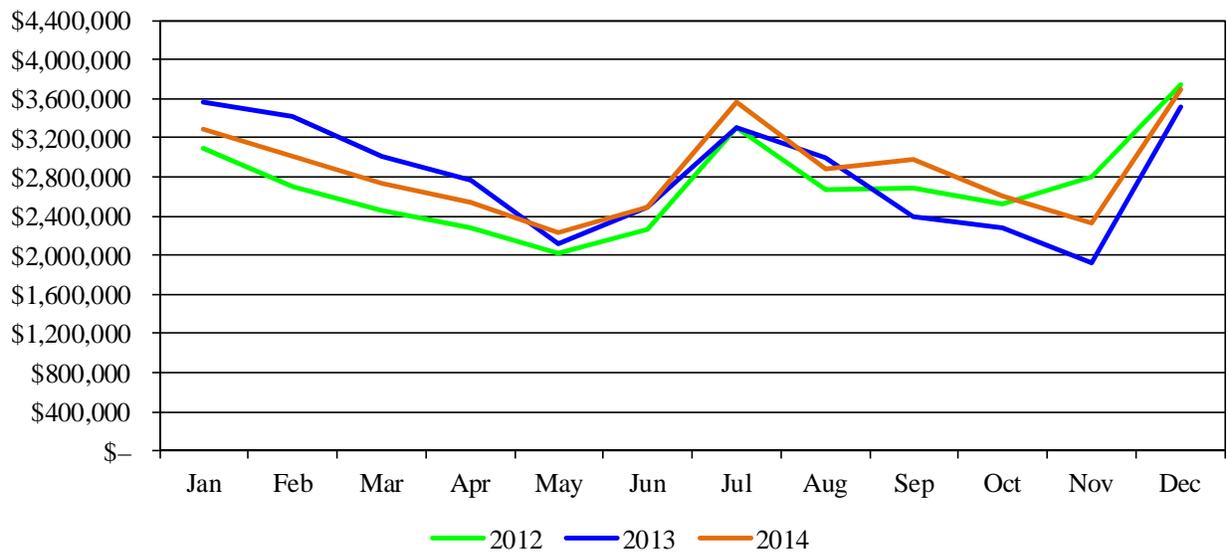
As the graph illustrates, the City has generally been able to maintain healthy cash and fund balance levels as the volume of financial activity has grown. This is an important factor because a government, like any organization, requires a certain amount of equity to operate. A healthy financial position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

The City Council has formally adopted a fund balance policy regarding the fund balance for the General Fund. The policy establishes that the City will strive to maintain an unassigned fund balance in the General Fund in the range of 35 to 50 percent of the following year's budgeted expenditures. At December 31, 2014, the unassigned fund balance of the General Fund was 52.2 percent of the subsequent year's budgeted expenditures.

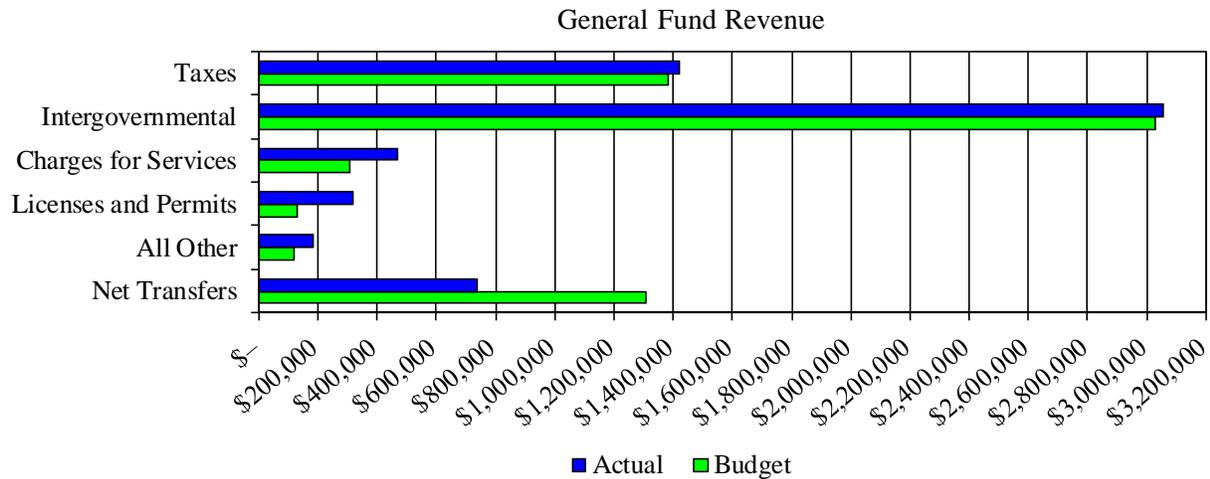
A trend that is typical to Minnesota local governments, especially the General Fund of cities, is the unusual cash flow experienced throughout the year. The City's General Fund cash disbursements are made fairly evenly during the year other than the impact of seasonal services such as snowplowing, street maintenance, and park activities. Cash receipts of the General Fund are quite a different story. Taxes and state aids comprise almost 82 percent of the fund's total annual revenue. Approximately half of these revenues are received by the City in July and the rest in December. Consequently, the City needs to have adequate cash reserves to finance its everyday operations between these payments.

The following graph illustrates the monthly cash flow of the General Fund in recent years (excluding interfund borrowing). Adequate fund balances in the General Fund have provided for positive month-end balances for all three years presented.

General Fund Cash and Investment Flow  
Month-End Balances

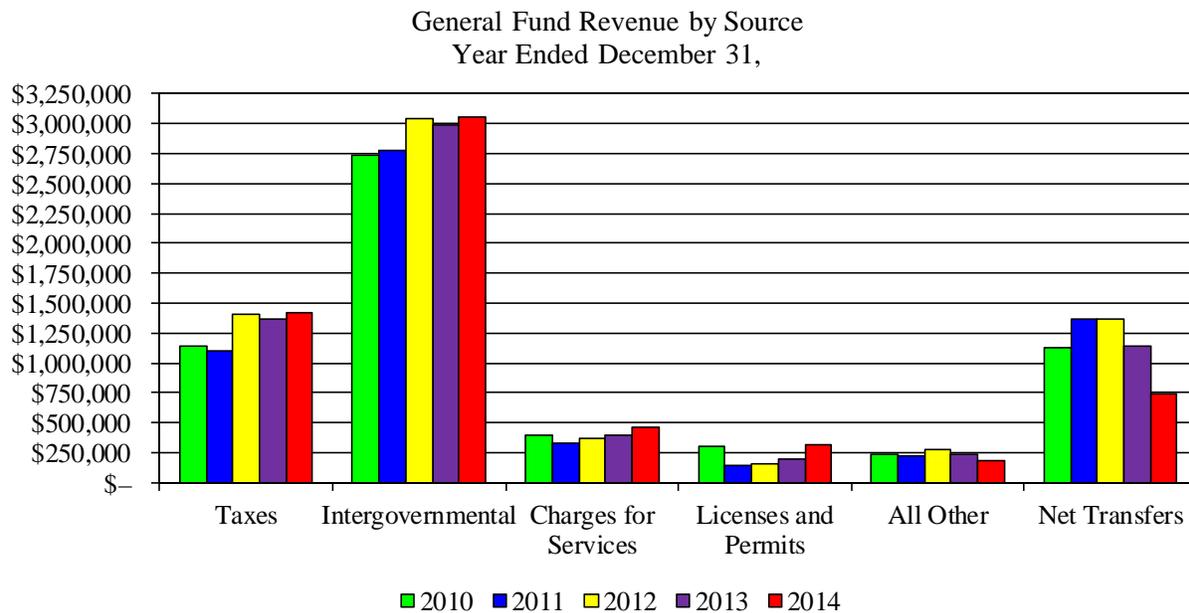


The following graph reflects the City's General Fund revenues and net transfers, budget and actual, for 2014:



Total General Fund revenues and net transfers in 2014 were \$6,178,765, which was \$96,479 less than the final budget. The majority of this variance is in transfers out to other funds, which exceeded budget by about \$700,000 related to a transfer to the Parkland Dedication Capital Project Fund of \$465,000 in the current year.

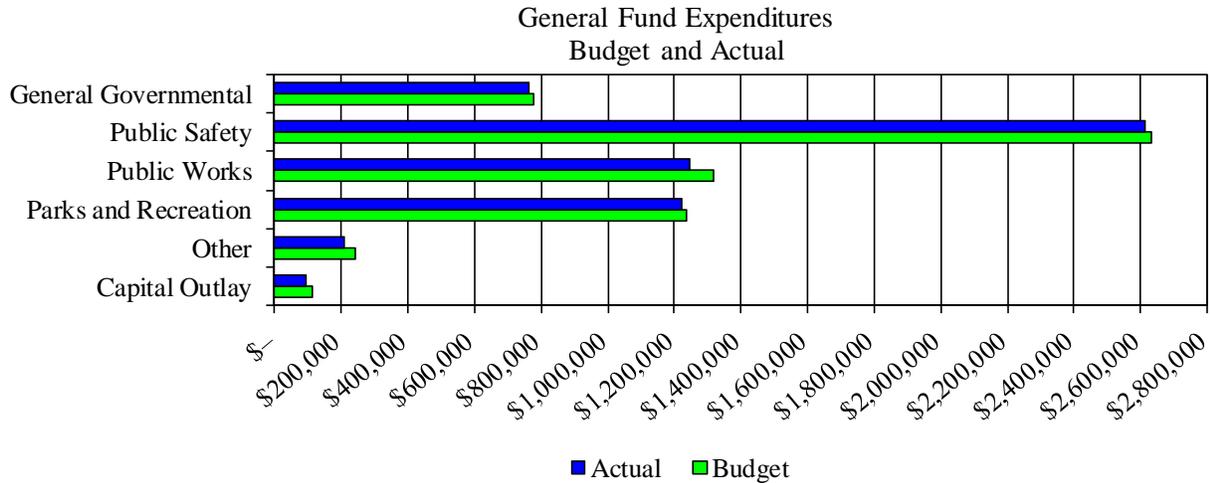
The following graph presents the City's General Fund revenue sources for the last five years:



Revenues and net transfers for the year ended December 31, 2014 decreased by \$150,127. Most of this change was due to an increase in the transfers out to other funds of about \$490,000, mostly related to a transfer to the Parkland Dedication Capital Project Fund in fiscal 2014.

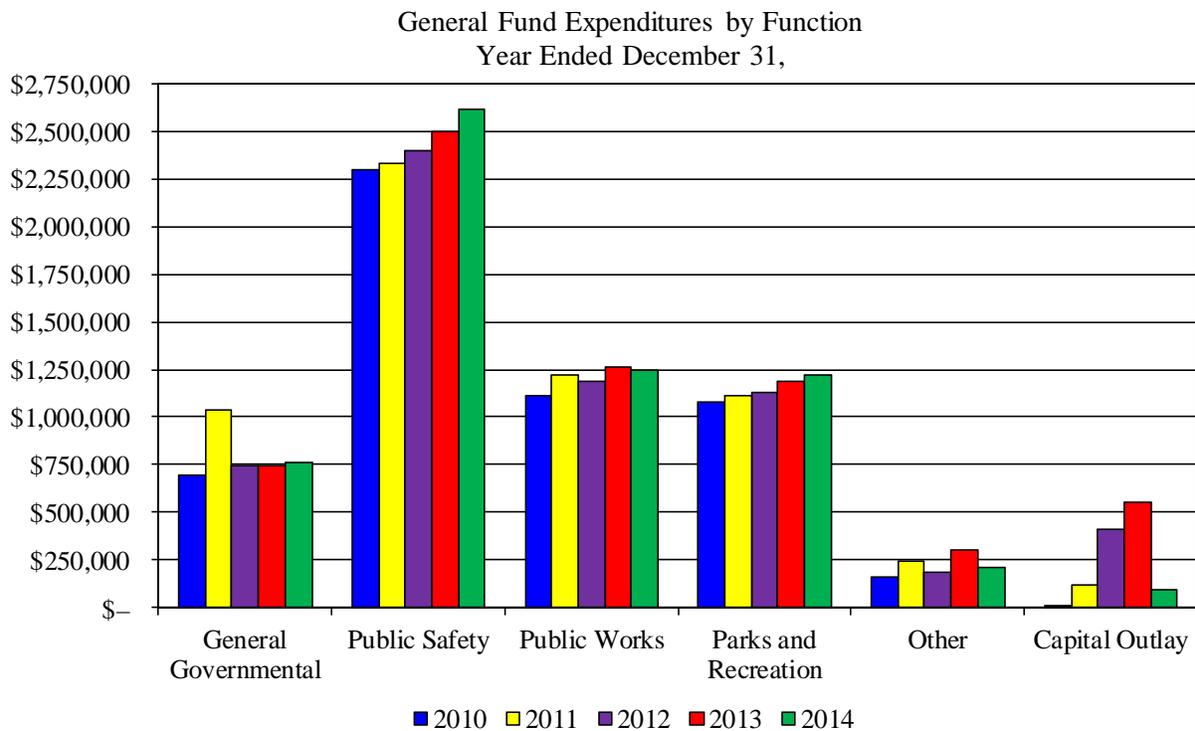
Due to the large amount of tax exempt property in the City, the City has historically relied heavily on intergovernmental revenue (mainly state aid) and transfers from its enterprise funds to help support General Fund operations.

The following illustrations provide the components of the City's General Fund spending for 2014 compared to budget:



Total General Fund expenditures for 2014 were \$6,149,467, which was \$164,322 less than the budget. All functions were under budget in the current year.

The following graph presents the components of the City's General Fund spending for the past five years:



In 2014, total General Fund expenditures decreased by \$396,891. Capital outlay decreased by \$462,289 mainly due to the emergency radio system and park land purchases that were made in the prior 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.

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

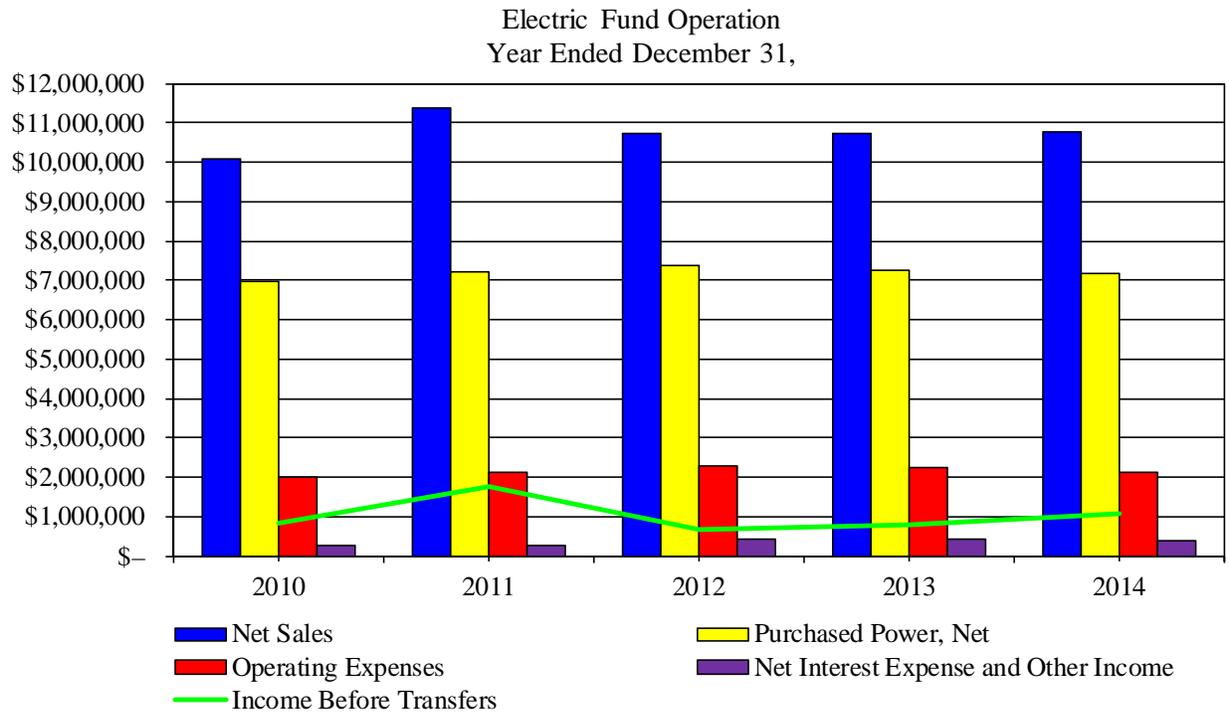
### ENTERPRISE FUNDS FINANCIAL POSITION

The following table summarizes the changes in the financial position of the City's enterprise funds during the years ended December 31, 2014 and 2013, presented both by classification and by fund:

<b>Enterprise Funds Change in Financial Position</b>			
	Net Position as of December 31,		Increase (Decrease)
	2013	2014	
Net position of enterprise funds			
Total by classification			
Net investment in capital assets	\$ 44,773,771	\$ 44,999,081	\$ 225,310
Restricted for debt service	1,168,228	1,168,228	-
Restricted for capital replacement	485,506	533,955	48,449
Unrestricted	4,499,956	4,654,770	154,814
<b>Total enterprise funds</b>	<b>\$ 50,927,461</b>	<b>\$ 51,356,034</b>	<b>\$ 428,573</b>
Total by fund			
Electric	\$ 16,359,251	\$ 16,684,308	\$ 325,057
Water	9,446,289	9,177,541	(268,748)
Environmental Services	273,296	280,697	7,401
Wastewater	17,136,240	17,536,568	400,328
Heartland Transit	19,176	147,924	128,748
Storm Water	5,264,527	5,188,290	(76,237)
Telecommunications Conduit	243,616	229,733	(13,883)
Long-Term Care Facility	(765,663)	(758,003)	7,660
Medical Office Building	2,950,729	2,868,976	(81,753)
<b>Total enterprise funds</b>	<b>\$ 50,927,461</b>	<b>\$ 51,356,034</b>	<b>\$ 428,573</b>

**ELECTRIC FUND**

The following graph presents five years of comparative data for the City’s Electric Fund:

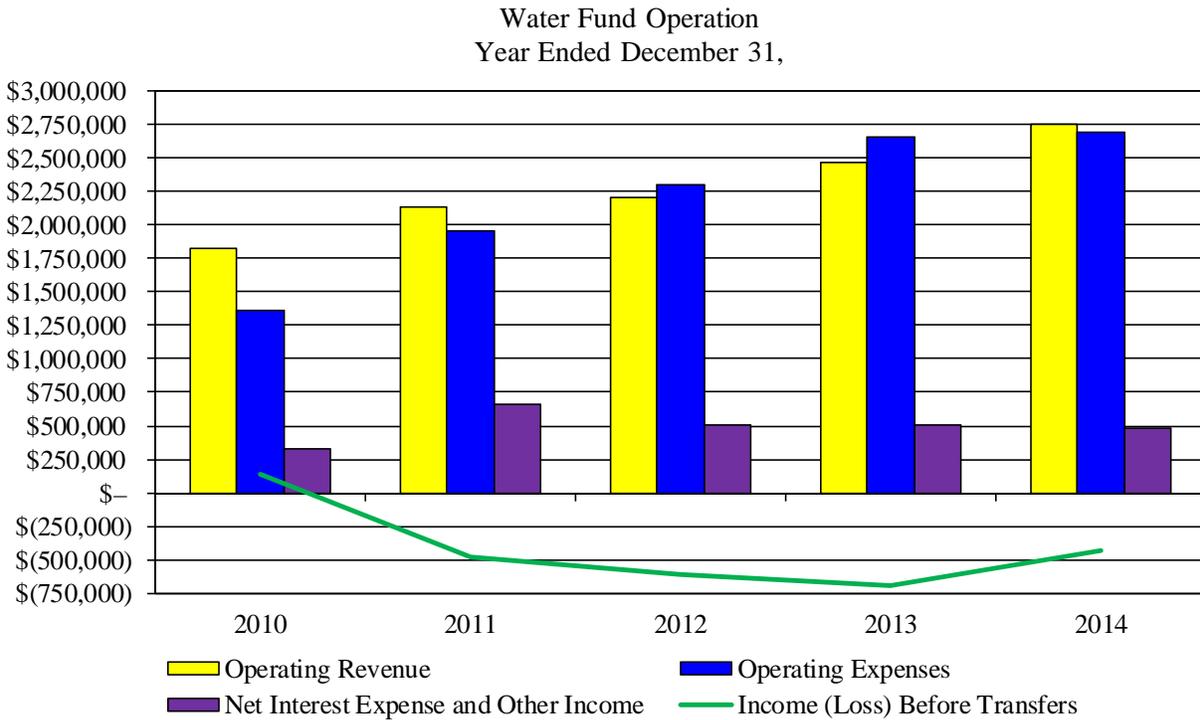


At December 31, 2014, the Electric Fund had a total net position of \$16,684,308, of which \$1,061,428 was restricted for debt service; \$13,237,600 was the net investment in capital assets; and \$2,385,280 was unrestricted. The Electric Fund ended the year with working capital of \$1,728,280.

The Electric Fund operating revenue was \$10,776,761 for 2014, an increase of \$50,732 (0.5 percent). Purchased power decreased \$112,256, or 1.5 percent. Operating expenses (excluding purchased power) decreased by \$83,564 (3.8 percent) in 2014 mainly due to a decreases in repairs and maintenance.

## WATER FUND

The following graph presents selected data for the City's Water Fund for the past five years:



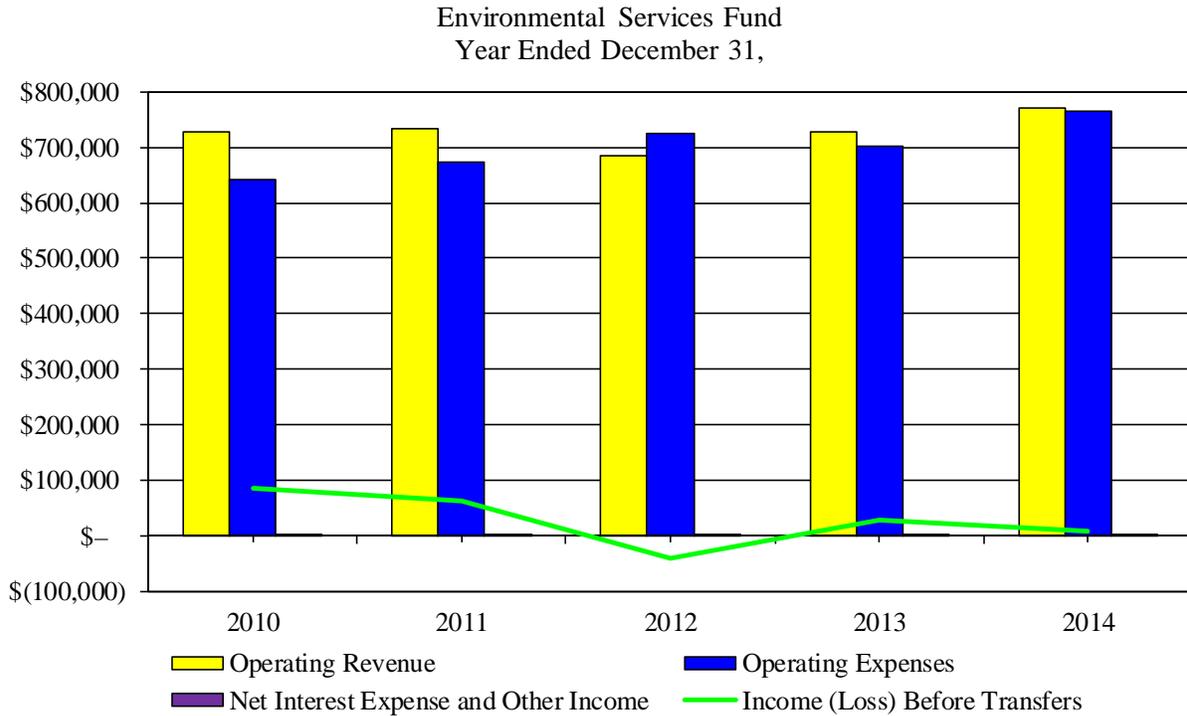
At December 31, 2014, the Water Fund had a total net position of \$9,177,541, of which \$8,045,275 was the net investment in capital assets and \$1,132,266 was unrestricted. The Water Fund ended the year with working capital of \$269,191.

The Water Fund operating revenue was \$2,745,745 for 2014, an increase of \$281,391, or 11.4 percent, which was primarily the result of an increase in the water rates. Operating expenses increased by \$35,946, or 1.4 percent.

Although this fund is in a positive financial position, we suggest that the City continue to review the water rates on an annual basis. Water rates are generally designed to cover operating costs and provide an accumulation of resources for significant repairs and replacements, and an operating cushion for potential negative years in financial operations.

**ENVIRONMENTAL SERVICES FUND**

The following graph presents selected data for the City’s Environmental Services Fund for the past five years:

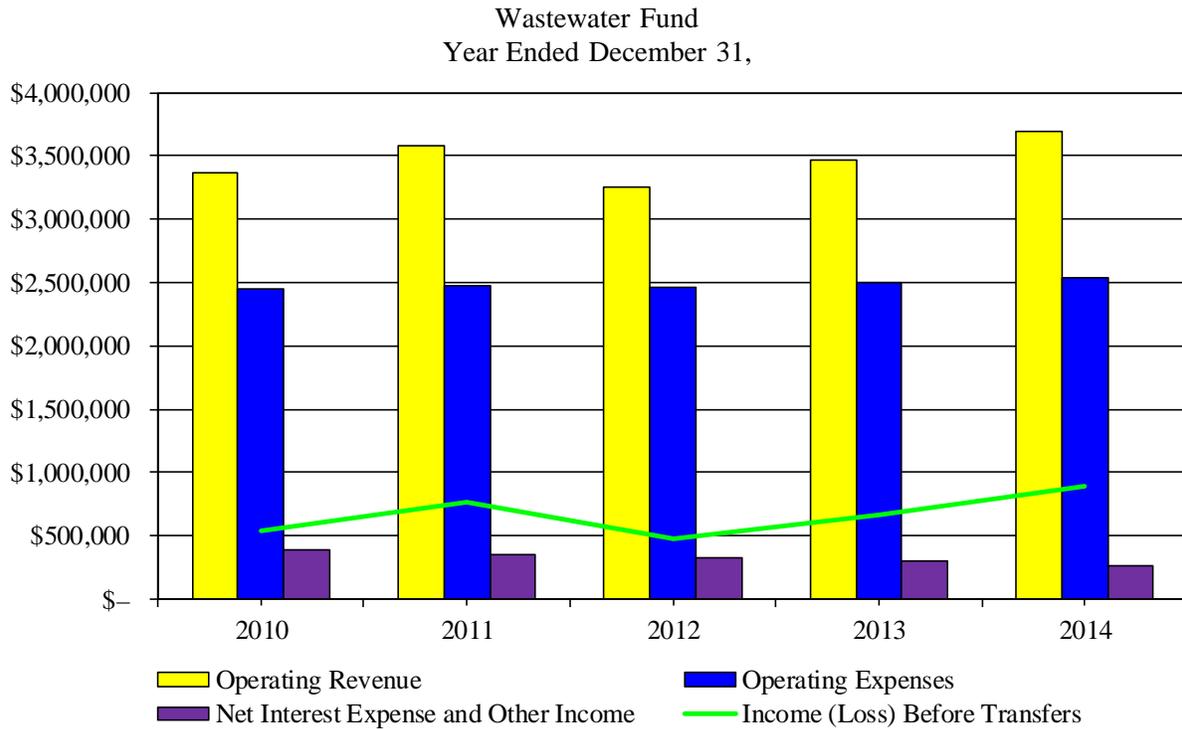


At December 31, 2014, the Environmental Services Fund had a total net position of \$280,697, of which \$63,695 was the net investment in capital assets and \$217,002 was unrestricted. The Environmental Services Fund ended the year with working capital of \$229,045.

The Environmental Services Fund operating revenue was \$769,938 for 2014, an increase of \$42,324 (5.8 percent). Operating expenses increased about \$62,708 (8.9 percent) compared to the prior year.

**WASTEWATER FUND**

The following graph presents selected data for the City’s Wastewater Fund for the past five years:

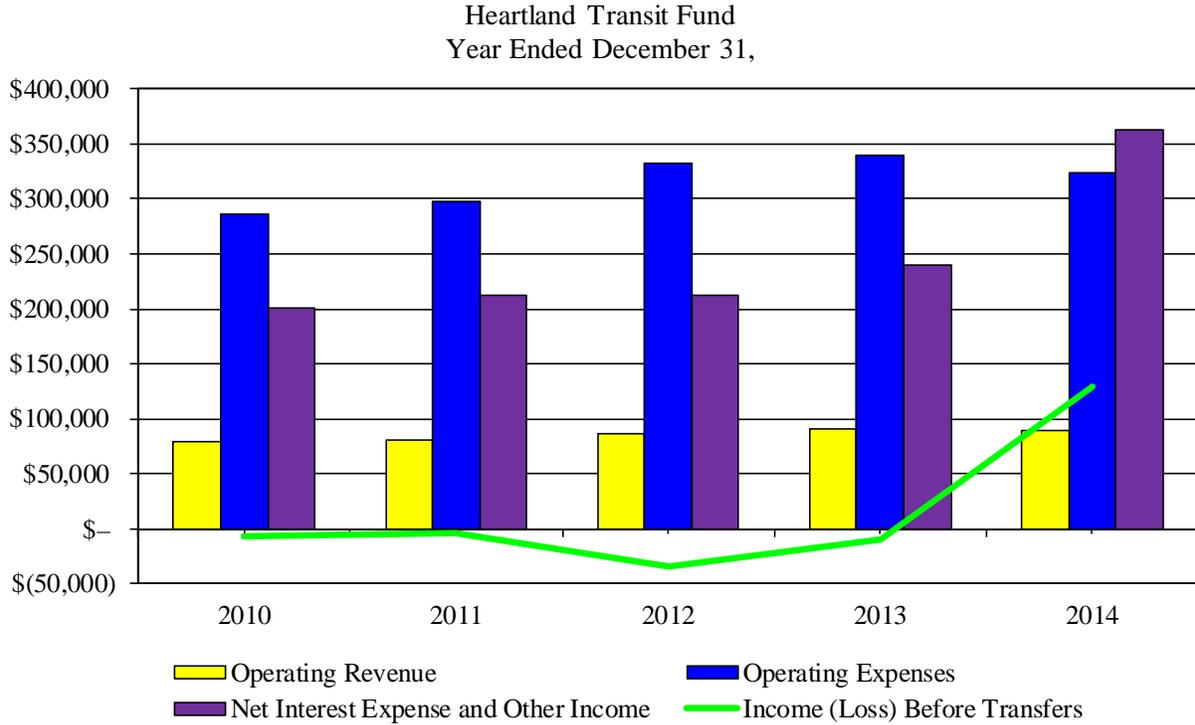


At December 31, 2014, the Wastewater Fund had a total net position of \$17,536,568, of which \$16,649,989 was the net investment in capital assets; \$533,955 was restricted; and \$352,624 was unrestricted. The Wastewater Fund ended the year with a deficit working capital balance of (\$295,806).

The Wastewater Fund operating revenue was \$3,689,500 for 2014, an increase of \$215,982, or 6.2 percent, mainly due to an increase in rates. Operating expenses increased \$30,681.

**HEARTLAND TRANSIT FUND**

The following graph presents selected data for the City’s Heartland Transit Fund for the past five years:

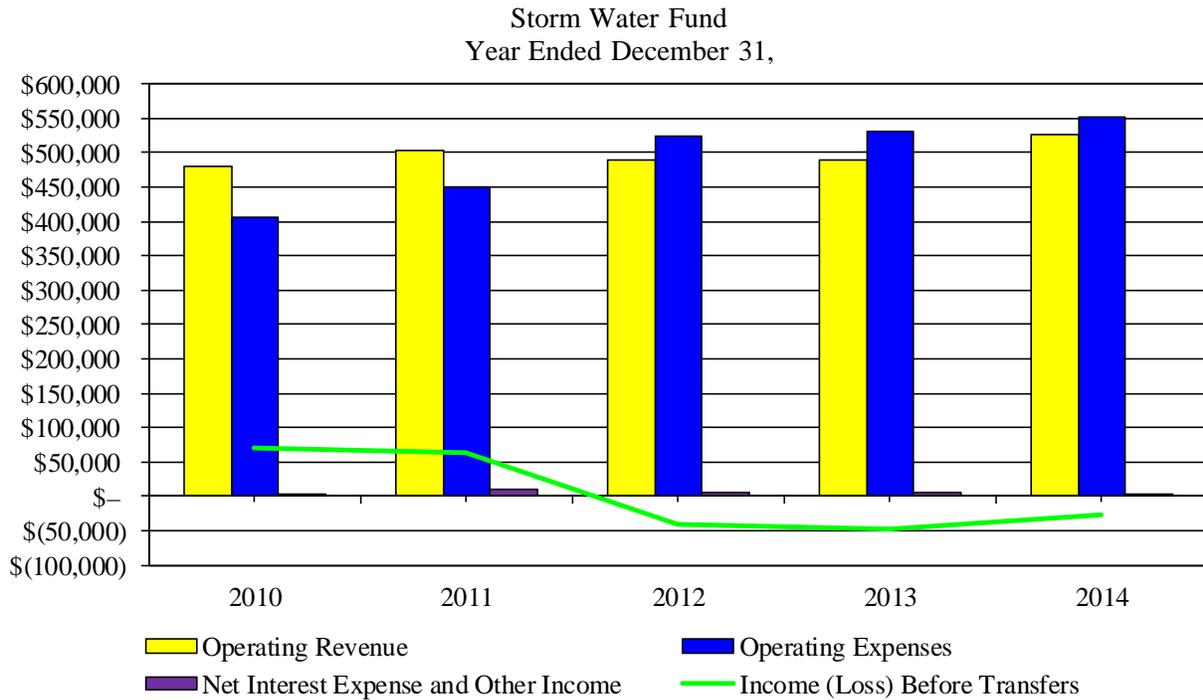


At December 31, 2014, the Heartland Transit Fund had a total net position of \$147,924, of which \$139,010 was the net investment in capital assets and a balance of \$8,914 was unrestricted. The Heartland Transit Fund ended the year with a working capital balance of \$11,454.

The Heartland Transit Fund operating revenue was \$89,151 for 2014, a decrease of \$1,450. Operating expenses decreased by \$16,597.

**STORM WATER FUND**

The following graph presents selected data for the City’s Storm Water Fund for the past five years:



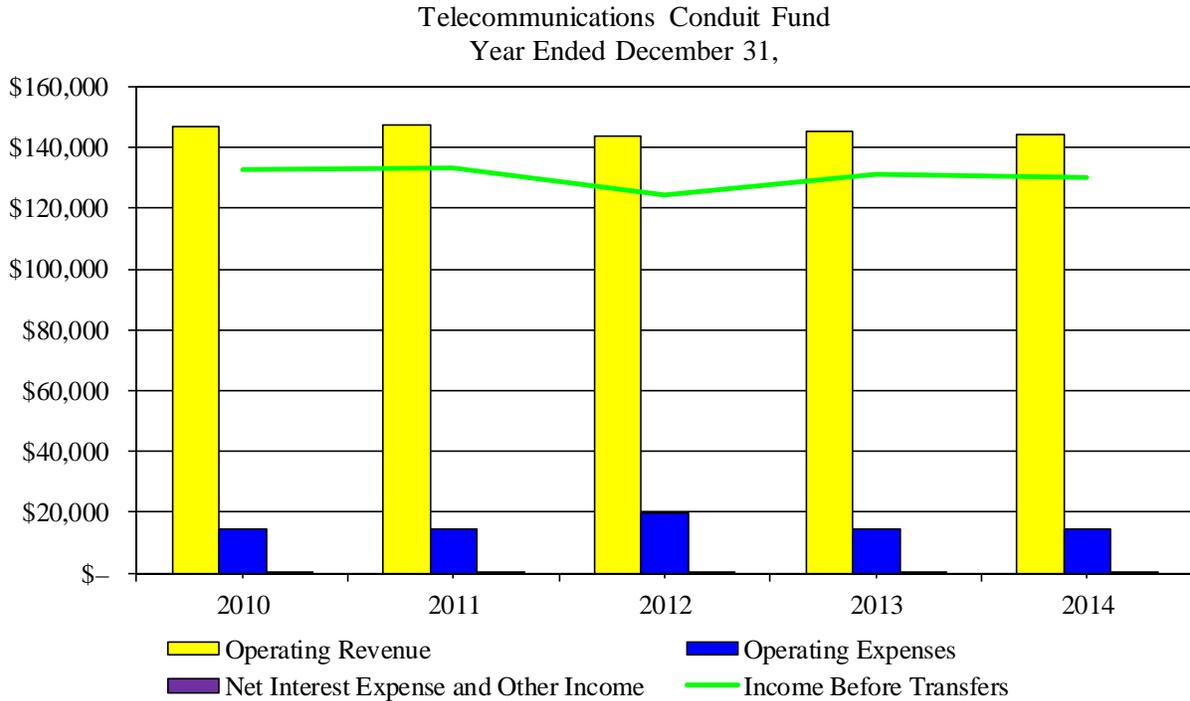
At December 31, 2014, the Storm Water Fund had a total net position of \$5,188,290, of which \$4,742,964 was the net investment in capital assets and \$445,326 is considered unrestricted. The Storm Water Fund ended the year with working capital of \$430,932.

The Storm Water Fund operating revenue was \$526,528 for 2014, an increase of \$37,390. Operating expenses increased \$20,177.

Although this fund is in a positive financial position, we suggest that the City continue to review the storm water rates on an annual basis. Storm water rates are generally designed to cover operating costs and provide an accumulation of resources for significant repairs and replacements, and an operating cushion for potential negative years in financial operations.

**TELECOMMUNICATIONS CONDUIT FUND**

The following graph presents selected data for the City’s Telecommunications Conduit Fund for the past five years:

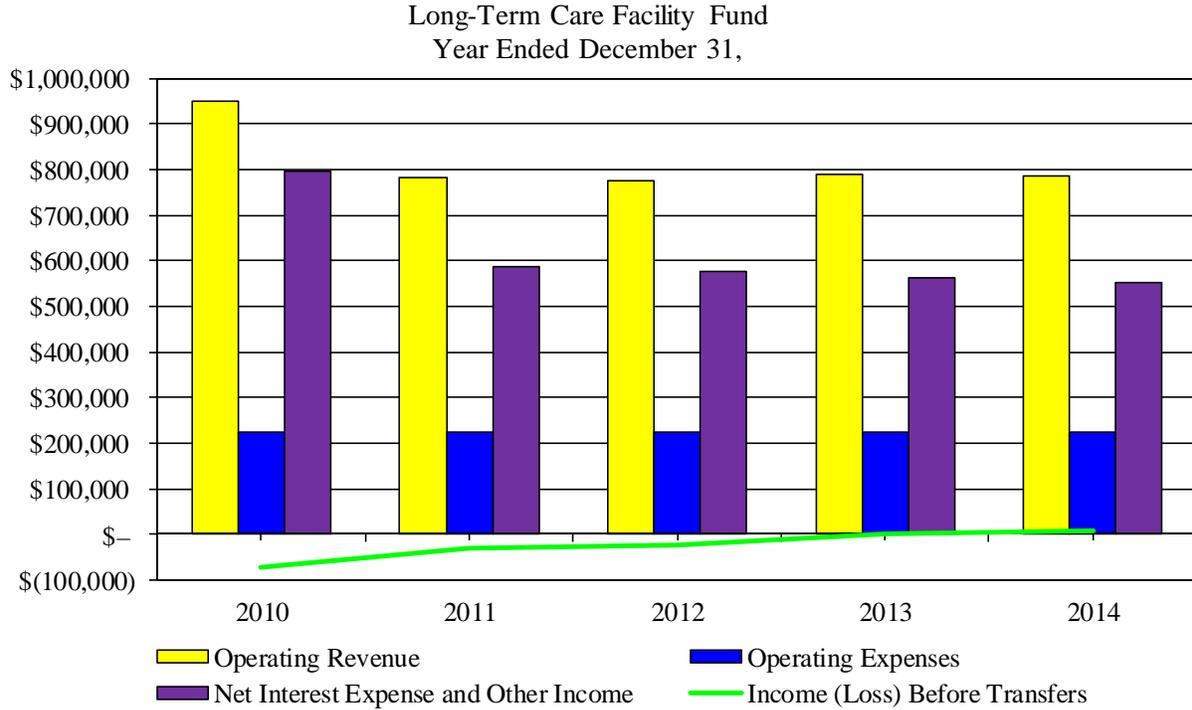


At December 31, 2014, the Telecommunications Conduit Fund had a total net position of \$229,733, of which \$225,556 was the net investment in capital assets and \$4,177 was considered unrestricted. The Telecommunications Conduit Fund ended the year with working capital of \$4,177.

The Telecommunications Conduit Fund operating revenue was \$144,071 for 2014, a decrease of \$1,148. Operating expenses were consistent with the prior year.

**LONG-TERM CARE FACILITY FUND**

The following graph presents selected data for the City’s Long-Term Care Facility Fund for the past five years:

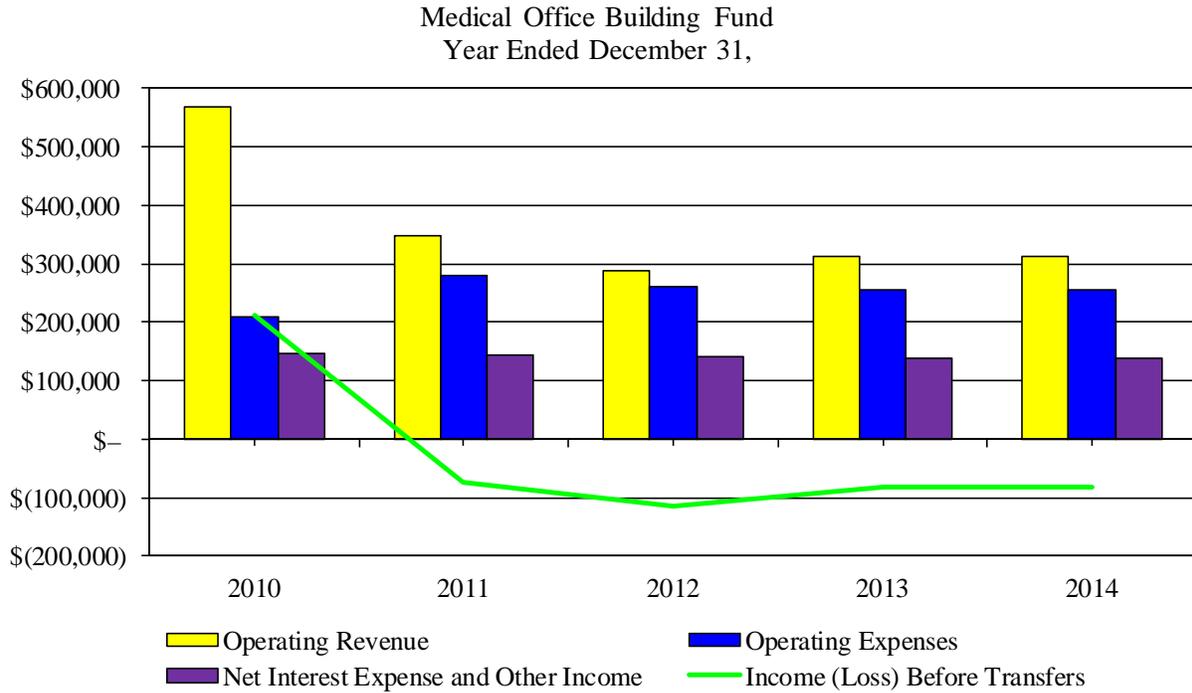


At December 31, 2014, the Long-Term Care Facility Fund had a total net position deficit of (\$758,003), of which a deficit of (\$860,144) was the net investment in capital assets; \$106,800 was restricted for debt service; and a deficit of (\$4,659) was considered unrestricted.

The Long-Term Care Facility Fund is used to collect lease revenue and pay debt service on the long-term care facility.

**MEDICAL OFFICE BUILDING FUND**

The following table presents selected data for the City’s Medical Office Building Fund for the past five years:



At December 31, 2014, the Medical Office Building Fund had a total net position of \$2,868,976, of which \$2,755,136 was the net investment in capital assets and \$113,840 was unrestricted.

The Medical Office Building Fund is used to account for the construction of the new medical office building which opened in 2009. This fund is also used to collect lease revenue and pay debt service on this same facility.

In fiscal 2010, this fund received one-time revenue for construction improvements.

## DEBT SERVICE

The following chart shows outstanding debt per capita for the City's governmental activities and comparable state-wide averages:

Outstanding Debt per Capita Governmental Activities With State-Wide Comparable Information					
Bond Type	State-Wide as of December 31,		City of Saint Peter as of December 31,		
	2012	2013	2012	2013	2014
General obligation	\$ 465	\$ 460	\$ 237	\$ 246	\$ 233
Tax increment	111	100	362	392	341
Special assessment	503	497	3	-	-
G.O. revenue	384	374	13	412	412
Revenue	268	264	-	-	-
Other	14	10	-	-	-
Governmental activities total	<u>\$ 1,745</u>	<u>\$ 1,705</u>	<u>\$ 615</u>	<u>\$ 1,050</u>	<u>\$ 986</u>

The following chart shows outstanding debt per capita for the City's enterprise funds and comparable state-wide averages:

Outstanding Debt per Capita Enterprise Funds With State-Wide Comparable Information					
Fund	State-Wide as of December 31,		City of Saint Peter as of December 31,		
	2012	2013	2012	2013	2014
Electric	\$ 472	\$ 435	\$ 902	\$ 844	\$ 777
Water	196	216	1,713	1,669	1,621
Wastewater	213	220	1,115	1,015	917
Storm water	31	29	30	24	17
Total enterprise funds	<u>\$ 912</u>	<u>\$ 900</u>	<u>\$ 3,760</u>	<u>\$ 3,552</u>	<u>\$ 3,333</u>
Entity-wide totals	<u>\$ 2,657</u>	<u>\$ 2,605</u>	<u>\$ 4,375</u>	<u>\$ 4,602</u>	<u>\$ 4,319</u>

As can be seen in the table above, the City has more outstanding debt per capita than the average Minnesota city. This higher than average debt balance is mostly related to balances within the Water and Wastewater Funds, which are related to recent capital improvements in these funds.

## 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, 2014 and 2013, for governmental activities and business-type activities:

	As of December 31,		Increase (Decrease)
	2013	2014	
Net position			
Governmental activities			
Net investment in capital assets	\$ 22,362,975	\$ 22,738,954	\$ 375,979
Restricted	5,637,742	7,380,664	1,742,922
Unrestricted	4,192,596	4,524,783	332,187
Total governmental activities	<u>32,193,313</u>	<u>34,644,401</u>	2,451,088
Business-type activities			
Net investment in capital assets	44,773,771	44,999,081	225,310
Restricted	1,653,734	1,702,183	48,449
Unrestricted	4,499,956	4,654,770	154,814
Total business-type activities	<u>50,927,461</u>	<u>51,356,034</u>	428,573
Total net position	<u>\$ 83,120,774</u>	<u>\$ 86,000,435</u>	<u>\$ 2,879,661</u>

Much of the City's net position is restricted by virtue of external restrictions (statutory reserves) or by the nature of the fund it is in. Further, a significant portion of net position has been identified as invested in capital assets, net of related debt, which leaves the balance to unrestricted.

## 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 position. 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, 2014 and 2013:

	2013	2014		Net Difference
	Net Difference	Expenses	Program Revenues	
Net (expense) revenue				
Governmental activities				
General government	\$ (508,197)	\$ 1,218,160	\$ 553,320	\$ (664,840)
Public safety	(2,055,101)	2,783,733	818,497	(1,965,236)
Public works	(2,164,262)	2,124,676	1,510,374	(614,302)
Parks and recreation	(1,649,312)	1,878,985	175,181	(1,703,804)
Economic development	(366,154)	1,206,489	319,452	(887,037)
Interest on long-term debt	(254,363)	365,185	-	(365,185)
Business-type activities				
Electric	781,269	9,721,539	10,951,169	1,229,630
Water	(698,944)	3,185,809	2,746,501	(439,308)
Environmental services	26,424	764,224	770,264	6,040
Wastewater	666,581	2,802,964	3,694,706	891,742
Transit	(9,385)	323,696	452,289	128,593
Storm water	(50,005)	557,035	526,571	(30,464)
Telecommunications conduit	130,955	14,264	144,071	129,807
Long-term care facility	(883)	778,850	785,719	6,869
Medical office building	(83,095)	394,395	311,715	(82,680)
	(6,234,472)	\$ 28,120,004	\$ 23,759,829	(4,360,175)
General revenues				
Taxes	3,025,371			3,111,353
Unrestricted grants and contributions	2,870,895			3,279,707
Investment earnings	71,690			117,387
Other revenues	84,761			87,100
Gain on sale of assets	78,067			644,289
Total general revenues	6,130,784			7,239,836
Change in net position	\$ (103,688)			\$ 2,879,661

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 if 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.

## LEGISLATIVE UPDATES

The 2014 legislative session began with a projected budget excess for the remainder of the biennium of \$1.09 billion, later revised upward to a projected excess of \$1.23 billion in the February 2014 economic forecast. The Legislature utilized a portion of the projected excess to bolster the state's financial condition; repaying \$246 million "borrowed" from K-12 education through previous financing shifts, and using \$150 million to replenish the state "Rainy Day Fund" budget reserve. The Legislature also approved increases to future funding for local government aid, and expanded the sales tax exemption approved for cities in 2013 to include joint powers entities and other instrumentalities of local government.

The following is a summary of recent legislation affecting Minnesota cities in 2014 and into the future:

**Local Government Aid (LGA)** – The Legislature completely overhauled the LGA formula for fiscal year 2014 and thereafter, creating a three-tiered formula that includes separate "need factor" calculations for cities with populations under 2,500, between 2,500 and 10,000, or over 10,000. The new formula simplified the LGA calculation, and reduced the volatility of the LGA distribution by limiting the amount it may decline in a given year. Under the new formula, the minimum LGA 2014 distribution for each city was an amount equal to their 2013 LGA. Beginning in 2015, any reduction to a city's calculated LGA distribution will be limited to the lesser of \$10 per capita, or 5 percent of their previous year net tax levy. For cities that gain under the new formula, the increases will be distributed proportionate to their unmet need, as determined by the new "need factor" calculations. The state-wide LGA appropriation was \$507.6 million for fiscal 2014, \$516.9 million for 2015, and \$519.4 million for fiscal 2016 and thereafter.

**Sales Tax Exemption** – Cities are exempted from paying sales tax on qualifying purchases, effective for purchases made on or after January 1, 2014. Purchases of goods or services by an exempt local government for a publically provided liquor store, gas or electric utility, golf course, marina, campground, café, laundromat, solid waste hauling or recycling operation, or landfill will remain taxable. The definition of "cities" for this statute include both home-rule and statutory cities.

The 2014 Legislature extended the definition of tax exempt local government to include all special district; city, county, or township instrumentalities; economic development authorities; housing and redevelopment authorities; and all joint power boards or organizations. However, this expanded exemption list is not effective until January 1, 2016.

**Proposed Property Tax Levy Certification Date** – The deadline for cities to certify their proposed annual tax levies was extended from September 15 to September 30.

**Agricultural Homestead Market Value Credit** – The rate of agricultural homestead market value was increased to a maximum of \$490 at a market value of \$270,000 and over.

**Capital Investment Act Requirements** – The Legislature approved capital improvement projects totaling about \$1.1 billion under two separate capital investment (bonding) acts. Both require that, to the extent practicable, a public entity receiving an appropriation of public money for a project under these acts must assure those facilities are built with American-made steel.

**Authority to Inspect Public Buildings and State-Licensed Facilities** – A formal delegation process was established that must be used by the state Department of Labor and Industry (DLI) when delegating the authority to inspect public buildings and state-licensed facilities to local building officials. The new provisions did not alter the circumstances under which the DLI is required to delegate this authority in most circumstances, only the process to be followed. However, for certain smaller construction projects designated as "reserved projects," the DLI is now required to delegate inspection authority to any municipality with a designated building official without going through the formal delegation process.

**Open Meeting Law** – A change was made to the Open Meeting Law to clarify that the use of social media by members of a public body does not violate the Open Meeting Law if the use is limited to exchanges open to the public. The new statute specifically excludes email but does not otherwise define the term social media.

**Deputy Registrar Residency** – The statutory requirement that an individual appointed as deputy registrar for a statutory or home-rule charter city be a resident of the county in which the city is located was repealed.

**Local Campaign Finance** – Changes were made to increase the campaign contribution limits for local elections. For candidates in a territory with a population of 100,000 or less, the contribution limits were raised to \$600 in an election year and \$250 in a non-election year. For candidates in a territory with a population over 100,000, the limits were raised to \$1,000 in an election year and \$250 in a non-election year. In addition, all campaign finance reports required to be filed with a local government must now be published on the local government's website, if the local government maintains a website.

**Data Practices** – Several changes were made to address unauthorized access of private data by public employees, requiring local governments to: establish security measures to help ensure private data is only accessible to public employees whose work assignment reasonably requires access to the data, and that the data is only being accessed by those individuals for the purposes of their work assignment; follow the data breach reporting requirements that were previously only applicable to state agencies; and perform annual security assessments of personal information maintained by the entity. The statute also states that accessing private data without authorization is a misdemeanor, and willful violation by a public employee constitutes just cause for suspension without pay or dismissal.

**Part-Time Peace Officers** – A change in the statutes now prohibits law enforcement agencies from hiring new part-time peace officers, existing part-time peace officers from transferring to new agencies, and the Peace Officer Standards and Training Board from licensing new part-time peace officers. Part-time peace officers that are currently employed may continue to serve indefinitely with their current employer, but must turn in their license upon leaving their current place of employment or otherwise becoming unemployed.

**Responsible Contractor Requirement** – Contractors who bid on public contracts in excess of \$50,000 are now required to certify that they are a "responsible bidder" in order to be awarded a contract as the lowest responsible bidder or best value alternative. A responsible contractor must be in compliance with various state and federal requirements for income tax, workers' compensation, unemployment insurance, minimum wage, and safety. City solicitations for bid must include: the definition of "responsible contractor," which may include criteria in addition to the statutory requirements established by the city, or reference to the statutory definition; a statement that a contractor failing to meet the criteria or verify compliance is ineligible to be awarded or perform work on the contract; a statement that submitting a false verification renders the contractor ineligible and can result in termination of the contract; and a statement requiring the contractor to provide copies of verification forms for all subcontractors upon request. Cities are not obligated to verify any of the information in the contractor verification; and have no liability if reasonably relying on the certification when awarding the contract, or declining to award the contract based on a reasonable determination that a contractor failed to verify compliance.

**Disaster Assistance Contingency Fund** – A new state account was created to provide emergency cash flow for local governments located in counties declared federal disaster areas. The fund may be used to meet non-federal fund matching requirements to speed the availability of federal funds.

**Pensions** – A number of changes to the Public Employees Retirement Association (PERA) General Plan were adopted, including:

- The minimum salary threshold for inclusion into the PERA General Plan was changed from \$425 in any one month to \$5,100 on any year for non-school employees or \$3,800 in any year for school employees.
- Employers are required to provide written notice to any employee excluded from membership in the PERA General Plan within two weeks of the determination on a form prescribed by the PERA executive director.
- PERA contribution rates for both employees and employers were increased by 0.25 percent of salary effective January 1, 2015.

## ACCOUNTING AND AUDITING UPDATES

### **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 No. 50, as they relate to pensions that are provided through pension plans administered as trusts or equivalent arrangements that meet certain criteria. The requirements of GASB Statement Nos. 27 and No. 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 expenses/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 non-employer 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 the Teachers' Retirement Association (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. 72 – FAIR VALUE MEASURE AND APPLICATION**

GASB Statement No. 72 addresses accounting and financial reporting issues related to fair value measurements. The requirements of this statement are intended to enhance comparability among government financial statements by requiring certain assets and liabilities be reported at fair value, using a consistent definition of fair value and accepted valuation techniques. The requirements of this statement are effective for financial statements for periods beginning after June 15, 2015, with earlier application encouraged.

GASB Statement No. 72 defines fair value as the price that would be received to sell an asset or paid to transfer a liability in an orderly transaction between market participants at the measurement date. Fair value measurements are generally assumed to take place in the government's principal or most advantageous market, taking into account the highest and best use for a nonfinancial asset, and assuming market participants would act in their economic best interest. The statement requires a government to use measurement techniques that are appropriate under the circumstances and for which sufficient data are available to measure fair value; consistent with a market, (replacement) cost, or income approach. It also establishes a hierarchy of inputs to be used in valuation techniques.

The statement establishes or clarifies the applicability of fair value measurement for certain assets and liabilities. Fair value is generally required for investments, defined as securities or other assets held primarily for the purpose of generating income, or which have a present service capacity based solely on their ability to generate cash. The statement requires measurement at acquisition value for donated capital assets, donated works of art, historical treasures, and capital assets received through a service concession arrangement. The statement also outlines the required financial statement disclosures about fair value measurements, valuation techniques, and the hierarchy of inputs used for valuation.

#### **CHANGES TO REQUIREMENTS FOR FEDERAL GRANTS**

In December 2013, the OMB issued *Uniform Administrative Requirements, Cost Principles, and Audit Requirements for Federal Audits*, which supersedes all or parts of eight OMB circulars; consolidating federal cost principles, administrative principles, and audit requirements in one document. The “Super Circular” includes a number of significant changes to the federal Single Audit process, including: an increase in dollar threshold for requiring a Single Audit from \$500,000 to \$750,000; changes to the thresholds and process used for determining major programs; reductions in the percentages of expenditures required to be covered by a Single Audit from 50 percent to 40 percent for high-risk auditees and from 25 percent to 20 percent for low-risk auditees; revised criteria for determining low-risk auditees; and an increase in the threshold for reporting questioned costs from \$10,000 to \$25,000. Auditees are required to implement the administrative requirements of the new “Super Circular” by December 26, 2014. The revised audit requirements will be effective for fiscal year 2015 city audits, with an optional one-year grace period for implementing the new procurement standards included in this guidance.

## **COSO INTERNAL CONTROL FRAMEWORK**

The clarified auditing standards applicable to governmental audits incorporate a definition of internal control that is based on the internal control integrated framework developed and issued in 1992 by the Committee of Sponsoring Organizations of the Treadway Commission (COSO). In May 2013, COSO issued an updated framework which supersedes the original after December 15, 2014. The new COSO framework retains the basic definition of internal control and its five components established in its original framework, along with the fundamental requirements to consider these five components and to use judgment when assessing and evaluating the effectiveness of a system of internal controls. The new COSO framework enhances and clarifies a number of concepts from the original framework to make it easier to use and apply. One of the more significant enhancements was the establishment of 17 principles, associated with the 5 components of internal control, intended to assist users in understanding the requirements of effective internal control and designing effective systems of internal control.

The 5 components of internal control and 17 underlying principles are as follows:

### **Control Environment –**

1. Organization demonstrates a commitment to integrity and ethical values.
2. Governing body is independent from management and exercises oversight control.
3. Management establishes structure, reporting lines, authority, and responsibilities.
4. Organization demonstrates a commitment to the competence of individuals involved with internal control.
5. Organization holds individuals accountable for internal control responsibilities.

### **Risk Assessment –**

6. Organization specifies clear objectives for the identification and assessment of risks.
7. Organization identifies and analyzes risk.
8. Organization assesses the potential for fraud risks.
9. Organization identifies and assesses significant changes that could impact internal control.

### **Control Activities –**

10. Organization selects and develops control activities to mitigate risks.
11. Organization selects and develops general IT controls.
12. Organization establishes and implements control policies and procedures.

### **Information and Communication –**

13. Organization uses relevant, quality information to support internal control.
14. Organization communicates internal control information internally.
15. Organization communicates internal control information externally.

### **Monitoring –**

16. Organization conducts ongoing and/or separate internal control evaluations.
17. Organization evaluates and communicates deficiencies to responsible parties for corrective action.

COSO defines an effective system of internal control as one that reduces to an acceptable level the risk of failing to achieve an organizational objective in the areas of operations, compliance, or reporting. According to the new framework, an organization can achieve effective internal control by applying all of the principles listed above. To achieve this, each of these five components and the relevant principles must be present and functioning, and the five components must operate in an integrated manner. Local governments should be reviewing their internal control systems to assure these principles have been incorporated and implemented.