Management Report

for

City of Prior Lake, Minnesota

December 31, 2016

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MMKR
CERTIFIED PUBLIC ACCOUNTANTS

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To the City Council and Management
City of Prior Lake, Minnesota

We have prepared this management report in conjunction with our audit of the City of Prior Lake, Minnesota's (the City) financial statements for the year ended December 31, 2016. 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 1, 2017

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AUDIT SUMMARY

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

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

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

PLANNED SCOPE AND TIMING OF THE AUDIT

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

AUDIT OPINION AND FINDINGS

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

- We have issued an unmodified opinion on the City's basic financial statements.
- We reported no deficiencies in the City's internal control over financial reporting that we considered to be material weaknesses.
- The results of our testing disclosed no instances of noncompliance required to be reported under *Government Auditing Standards*.
- We reported one finding based on our testing of the City's compliance with Minnesota laws and regulations:

    1) The City had cash in excess of federal depository insurance with one investment broker as of December 31, 2016, which was not adequately covered by pledged collateral with a market value of 110 percent of the excess, as required by state statutes. As a result, $408,416 of the City's deposits were exposed to custodial credit risk at year-end. Subsequent to year-end, the City has requested that the broker sweep funds into the money market account on a daily basis.

FOLLOW-UP ON PRIOR YEAR FINDINGS AND RECOMMENDATIONS

As a part of our audit of the City's financial statements for the year ended December 31, 2016, we performed procedures to follow-up on the findings and recommendations that resulted from our prior year audit. We reported the following findings that were corrected by the City in the current year:

- The City had certificates of deposit in excess of federal depository insurance at two depositories as of December 31, 2015, and the excess deposits were not adequately covered by pledged collateral with a market value of 110 percent of the excess, as required by state statutes. This particular oversight was corrected in early 2016, but the City has a similar collateral finding again in the current year with a different broker as explained on the previous page.

SIGNIFICANT ACCOUNTING POLICIES

Management is responsible for the selection and use of appropriate accounting policies. The significant accounting policies used by the City are described in Note 1 of the notes to basic financial statements.

No new accounting policies were adopted and the application of existing policies was not changed during the year ended December 31, 2016. We noted no transactions entered into by the City during the year for which there is a lack of authoritative guidance or consensus. All significant transactions have been recognized in the financial statements in the proper period.

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.

- **Compensated Absences –** Estimates for compensated absences payable are based on current sick and vacation leave balances.

- **Net Other Post-Employment Benefit (OPEB) and Net Pension Liabilities –** The City has recorded liabilities and activity for other post-employment benefits (OPEB) and pension benefits. These obligations are calculated using actuarial methodologies described in Governmental Accounting Standards Board (GASB) Statement Nos. 45 and 68. These actuarial calculations include significant assumptions, including projected changes, healthcare insurance costs, investment returns, retirement ages, proportionate share, and employee turnover.

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

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

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 clearly 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 1, 2017.

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

We were engaged to report on the supplemental information accompanying the financial statements which is not RSI. With respect to this 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 and other information sections which accompany the financial statements but are not RSI. Such information has not been subjected to the auditing procedures applied in the audit of the basic financial statements and, accordingly, we do not express an opinion or provide any assurance on it.

GOVERNMENTAL FUNDS OVERVIEW

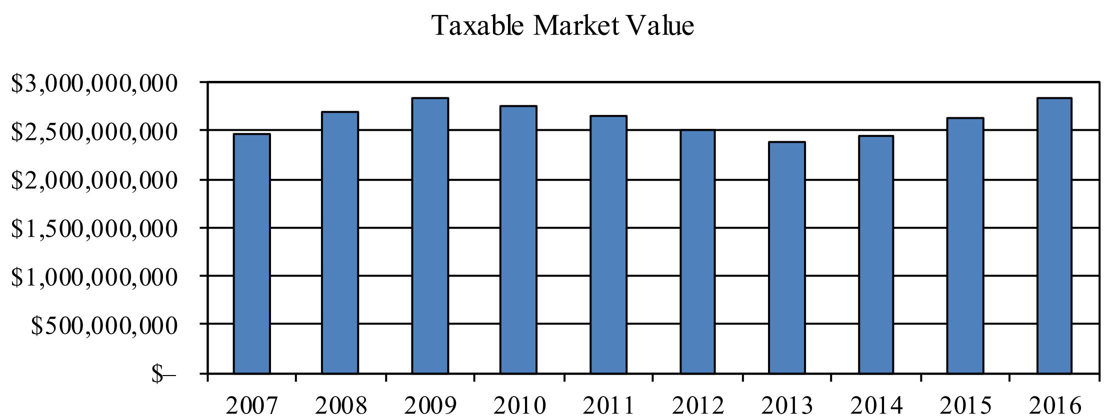
This section of the report provides you with an overview of the financial trends and activities of the City's governmental funds, which includes the General, special revenue, debt service, and capital project funds. These funds are used to account for the basic services the City provides to all of its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

PROPERTY TAXES

Minnesota cities rely heavily on local property tax levies to support their governmental fund activities. For the 2015 fiscal year, local ad valorem property tax levies provided 39.8 percent of the total governmental fund revenues for cities over 2,500 in population, and 35.6 percent for cities under 2,500 in population. Property tax levies certified by Minnesota cities for 2016 increased about 4.8 percent over 2015, compared to an increase of 4.0 percent the prior year.

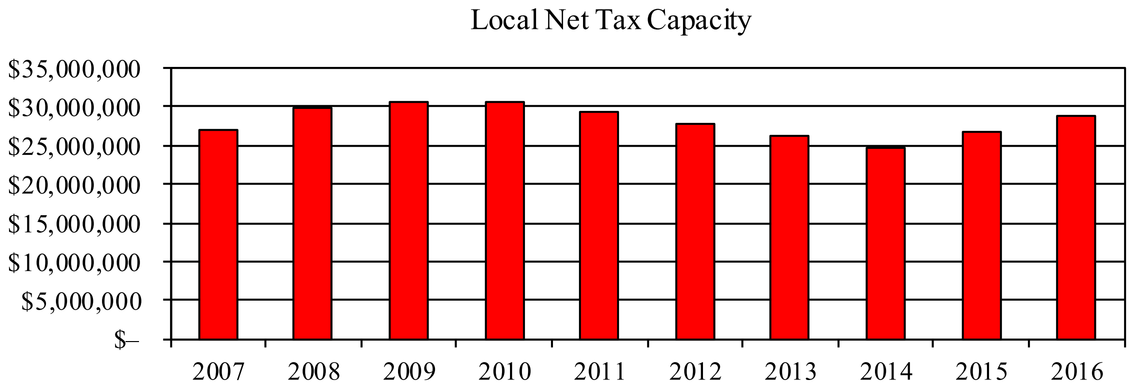
The total market value of property in Minnesota cities increased about 5.7 percent for the 2016 levy year. While the percentage of market value growth was less than the 8.5 percent increase for levy year 2015, it was considerably larger than the 1.1 percent growth experienced in levy year 2014. Market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

The City's taxable market value increased 7.2 percent for taxes payable in 2015 and 8.4 percent for taxes payable in 2016. The following graph shows the City's changes in taxable market value over the past 10 years:



Tax capacity is considered the actual base available for taxation. It is calculated by applying the state's property classification system to each property's market value. Each property classification, such as commercial or residential, has a different calculation and uses different rates. Consequently, a city's total tax capacity will change at a different rate than its total market value, as tax capacity is affected by the proportion of the City's tax base that is in each property classification from year-to-year, as well as legislative changes to tax rates. The City's tax capacity increased 7.4 percent and 8.3 percent for taxes payable in 2015 and 2016, respectively.

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



The city portion of the average state-wide and metro area tax rates for 2016 both showed small decreases from the prior year, as levy increases were offset by improvements in property tax capacities. The following table presents the average tax rates applied to city residents for each of the last two levy years, along with comparative state-wide and metro area rates:

Rates expressed as a percentage of net tax capacity

	All Cities State-Wide		Seven-County Metro Area		City of Prior Lake	
	2015	2016	2015	2016	2015	2016
Average tax rate						
City	46.9	46.5	43.4	43.0	32.0	32.0
County	44.7	44.1	42.9	42.3	36.6	36.2
School	27.1	27.5	28.3	28.6	32.7	32.9
Special taxing	6.9	6.9	8.8	8.7	7.3	7.2
Total	125.6	125.0	123.4	122.6	108.6	108.3

The City's portion of the total tax rate is below both the state-wide and metro area averages, as presented in the table above. The school rate within the City exceeds the state-wide and the metro area averages. The average tax rate in total is below these averages.

GOVERNMENTAL FUND BALANCES

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

Governmental Funds Change in Fund Balance

	Fund Balance as of December 31, 2016	Fund Balance as of December 31, 2015	Increase (Decrease)
Fund balances of governmental funds			
Total by classification			
Nonspendable	$ –	$ 9,150	$ (9,150)
Restricted	10,474,448	9,469,229	1,005,219
Assigned	9,755,914	10,107,820	(351,906)
Unassigned	6,634,264	6,039,025	595,239
Total – governmental funds	$ 26,864,626	$ 25,625,224	$ 1,239,402
Total by fund			
General	$ 6,684,920	$ 6,124,751	$ 560,169
DAG Special Revenue	687,724	743,774	(56,050)
Debt Service	9,407,774	7,559,836	1,847,938
Construction	3,326,863	4,234,770	(907,907)
Special revenue nonmajor funds	1,518,303	883,083	635,220
Capital projects nonmajor funds	5,239,042	6,079,010	(839,968)
Total – governmental funds	$ 26,864,626	$ 25,625,224	$ 1,239,402

In total, the fund balances of the City's governmental funds increased by $1,239,402 during the year ended December 31, 2016. Debt Service Fund balance increased due to the issuance of the refunding portion of the 2016A General Obligation Improvement Bonds that will refund the 2007A General Obligation Water Treatment Plant Revenue Bonds. Construction Fund balance decreased due to further spending of capital outlay on the previously issued bonds. Special Revenue Fund balances increased due to the significant amount of dedication revenue received for various new developments during 2016. Capital Projects Fund balances decreased due to the significant amount of transfers out related to the Stemmer Ridge Road Project in the Construction Fund.

GOVERNMENTAL FUNDS REVENUE AND EXPENDITURES

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

We have included the most recent comparative state-wide averages available from the Office of the State Auditor to provide a benchmark for interpreting the City's data. The amounts received from the typical major sources of governmental fund revenue will naturally vary between cities based on factors such as a city's stage of development, location, size and density of its population, property values, services it provides, and other attributes. It will also differ from year-to-year due to the effect of inflation and changes in its operation. Also, certain data 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 the City. We intend for this type of comparative and trend information to complement, rather than duplicate, information in the management's discussion and analysis. An inherent difficulty in presenting per capita information is the accuracy of the population count, which for most years is based on estimates.

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

	State-Wide			City of Prior Lake		
Year	December 31, 2015			2014	2015	2016
Population	2,500–10,000	10,000–20,000	20,000–100,000	24,911	25,049	25,356
Property taxes	$ 443	$ 414	$ 443	$ 380	$ 414	$ 438
Tax increments	26	33	37	19	19	20
Franchise and other taxes	33	42	39	24	24	26
Special assessments	59	52	59	25	46	34
Licenses and permits	31	31	43	23	23	30
Intergovernmental revenues	285	322	156	82	115	65
Charges for services	110	85	94	111	100	132
Other	69	62	58	49	34	24
Total revenue	$ 1,056	$ 1,041	$ 929	$ 713	$ 775	$ 769

In total, the City's governmental fund revenues for 2016 were $19,472,948, an increase of $61,549 (0.3 percent) from the prior year. On a per capita basis, the City received $769 in governmental fund revenue for 2016, a decrease of $6 from the prior year. In general, the City has generated less governmental fund revenue per capita than the state-wide averages. Most of this relates to lower than average revenues in many of the development categories, including tax increment and special assessments.

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 comparative state-wide averages, are presented in the following table:

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

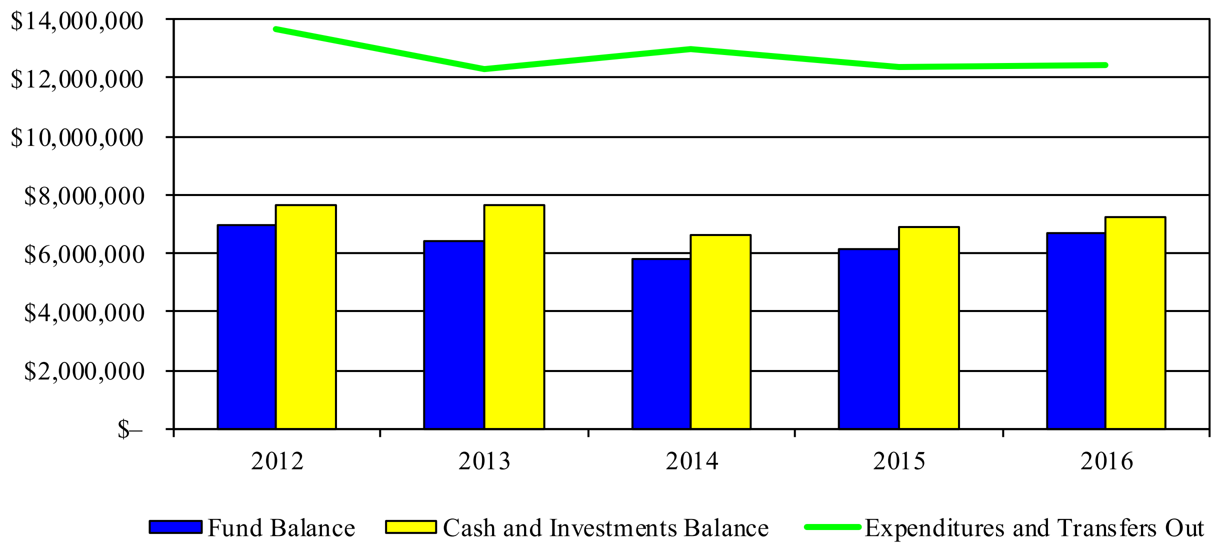
	State-Wide			City of Prior Lake		
Year	December 31, 2015			2014	2015	2016
Population	2,500–10,000	10,000–20,000	20,000–100,000	24,911	25,049	25,356
Current						
General government	$ 134	$ 109	$ 89	$ 113	$ 105	$ 100
Public safety	255	244	261	190	192	200
Streets and highways	119	117	99	75	83	74
Culture and recreation	88	108	94	71	67	63
All other	64	70	89	5	7	6
	660	648	632	454	454	443
Capital outlay and construction	372	389	286	254	567	312
Debt service						
Principal	181	178	117	128	128	150
Interest and fiscal charge	51	40	33	50	59	54
	232	218	150	178	187	204
Total expenditures	$ 1,264	$ 1,255	$ 1,068	$ 886	$ 1,208	$ 959

Total expenditures in the City's governmental funds for 2016 were $24,314,339, a decrease of $5,967,182 (19.7 percent) from the prior year. On a per capita basis, the City expended a total of $959 in 2016. Capital outlay expenditures decreased $255 per capita from the prior year due to significant street construction and equipment replacement expenditures in 2015. Debt service expenditures for 2016 were $17 per capita higher than the prior year, mainly due to the payment of principal and interest on bonds issued in 2015.

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

General Fund Financial Position
Year Ended December 31,

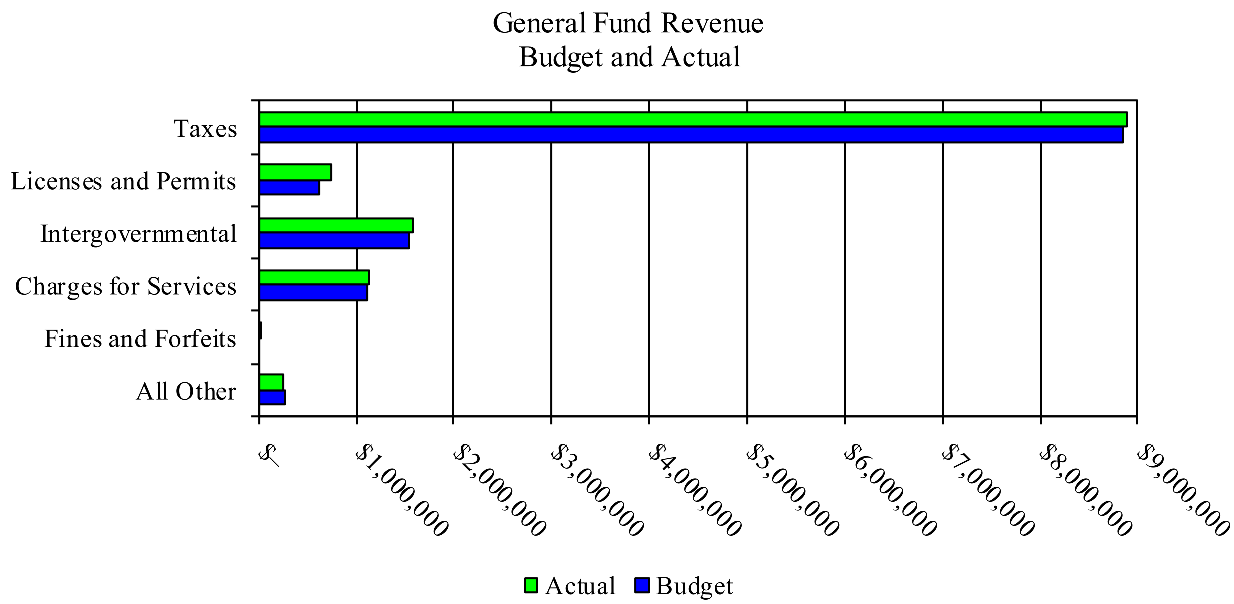


The City's General Fund cash and investments balance at December 31, 2016 was $7,211,301, an increase of $308,375. Total fund balance at December 31, 2016 was $6,684,920, which is an increase of $560,169 from the prior year.

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.

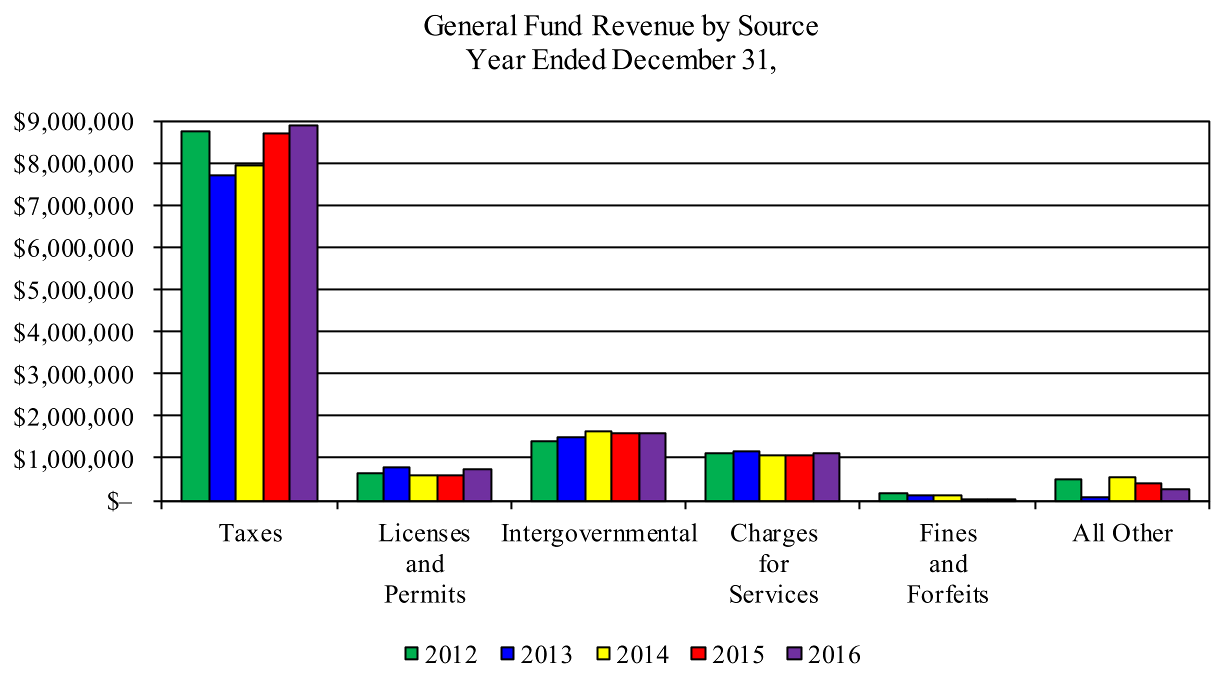
The City has formally adopted a fund balance policy regarding the minimum unrestricted fund balance for the General Fund. The policy establishes that the City will strive to maintain an unrestricted General Fund balance (which includes committed, assigned, and unassigned classifications) between 40 and 50 percent of the subsequent year's General Fund budgeted expenditures and transfers out. At December 31, 2016, the unrestricted fund balance of the General Fund was 50.8 percent of the subsequent year's budgeted expenditures and transfers out.

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



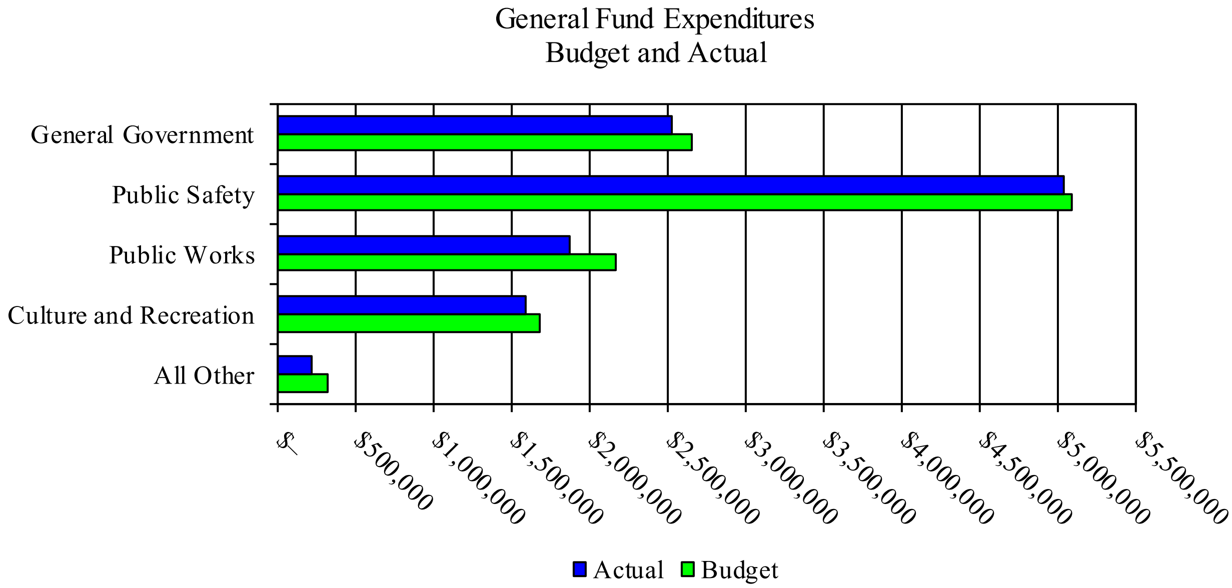
General Fund revenue for 2016 was $12,605,187, which was $192,089 (1.5 percent) more than budget mainly due to the City having more developments than expected leading to more building permits.

The following graph presents the City's General Fund revenue by source for the last five years. The graph reflects the City's increased reliance on property tax revenue in recent years.



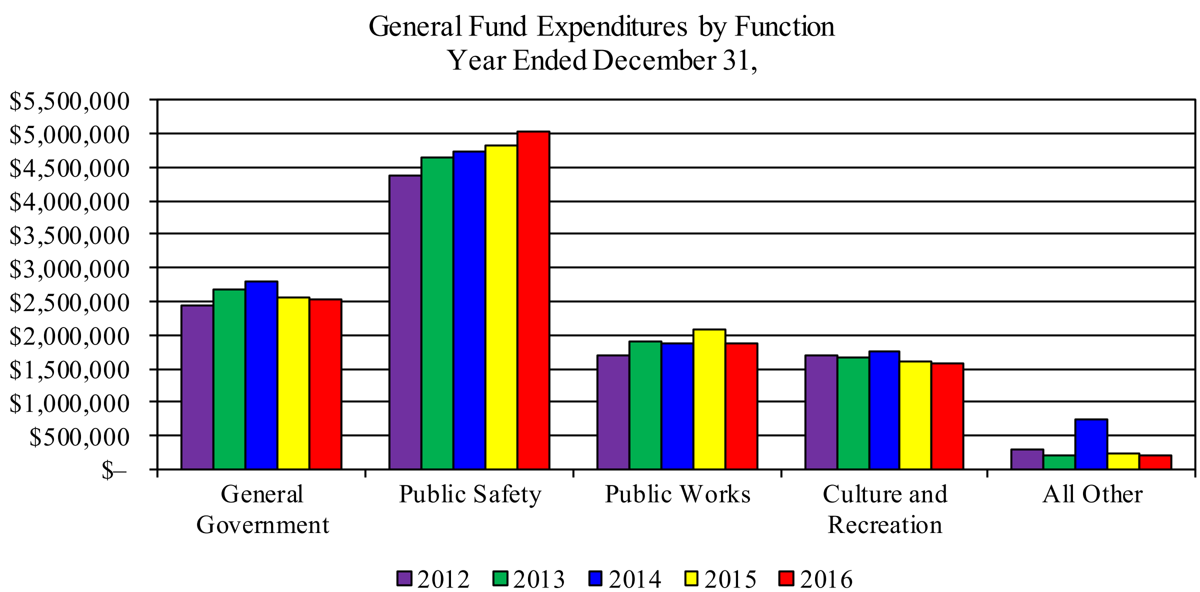
Total General Fund revenue for 2016 was $275,918 (2.2 percent) higher than last year. Tax revenue increased by $193,786, or 2.2 percent, related to the increased tax levy. Licenses and permits were $164,360 higher than last year due to the City having more developments leading to increased building permits during 2016. In 2016, the "all other" revenue category was lower than the prior year by $177,408 (41.7 percent) mainly due to the City recording its League of Minnesota Cities Insurance Trust property dividend in the new Insurance Internal Service Fund instead of the General Fund.

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



Total General Fund expenditures for 2016 were $11,258,561, which was $665,458 (5.6 percent) under budget. General government expenditures were $122,193 under budget mostly due to the City budgeting for more in litigation costs than were actually incurred during the year. Public works expenditures were $298,853 under budget, due mostly to anticipated projects that did not occur in 2016 as well as recording various other projects to other program functions. The All Other category expenditures were $102,859 under budget, mainly in capital outlay as some projects didn't spend their entire budget.

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



Total General Fund expenditures for 2016 were $49,009 (0.4 percent) lower than the previous year. Public safety expenditures increased $213,828 due to a fully staffed department, working more overtime hours, and a general wage rate increase. Public works expenditures offset the increase in public safety expenditures by $202,775 due to fewer projects during 2016 and the recording of other expenditures to other program functions. Each other program function remained relatively similar to the previous 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, Sewer, and Water Quality Funds.

ENTERPRISE FUNDS FINANCIAL POSITION

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

Enterprise Funds Change in Financial Position

	Net Position as of December 31,		Increase
	2016	2015	(Decrease)
Net position of enterprise funds			
Total by classification			
Investment in capital assets	$ 51,075,358	$ 47,805,809	$ 3,269,549
Unrestricted	4,309,353	3,881,319	428,034
Total – enterprise funds	$ 55,384,711	$ 51,687,128	$ 3,697,583
Total by fund			
Water	$ 32,804,990	$ 30,730,432	$ 2,074,558
Sewer	20,723,278	19,327,366	1,395,912
Water Quality	1,856,443	1,629,330	227,113
Total – enterprise funds	$ 55,384,711	$ 51,687,128	$ 3,697,583

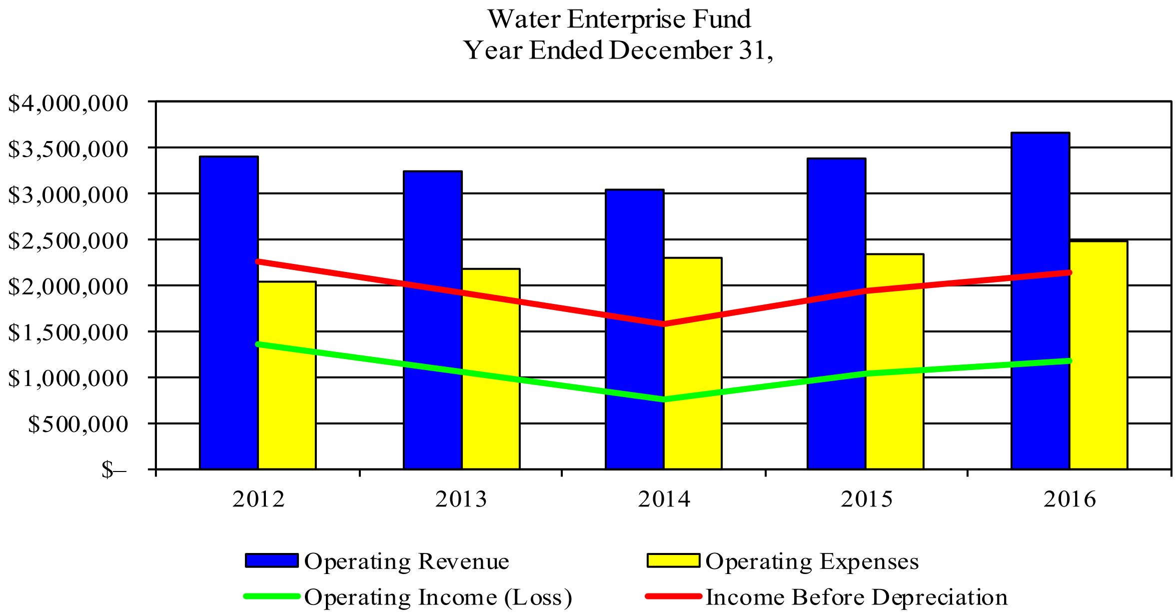
INTERNAL SERVICE FUND

During the year ended December 31, 2011, the City established a Compensated Absences Internal Service Fund to finance the compensated absence obligations of the governmental funds of the City. At December 31, 2016, this fund had assets totaling $304,563, while liabilities totaled $872,720, leaving a deficit net position balance of ($568,157). We recommend that the City continue to include the financing of these obligations as part of its long range financial plans.

During the year ended December 31, 2016, the City established an Insurance Internal Service Fund to account for risk management activities, including worker's compensation, volunteer accident, and property/casualty insurance. At December 31, 2016, this fund had assets totaling $84,203 and no liabilities, leading to a net position balance of $84,203.

WATER ENTERPRISE FUND

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



The Water Fund ended 2016 with net position of $32,804,990, an increase of $2,074,558 from the prior year. Of this, $30,568,185 represents the investment in capital assets, leaving $2,236,805 in unrestricted net position. The Water Fund had transfers out totaling $1,742,896 in 2016 to support other funds, pay debt service, and provide for construction projects.

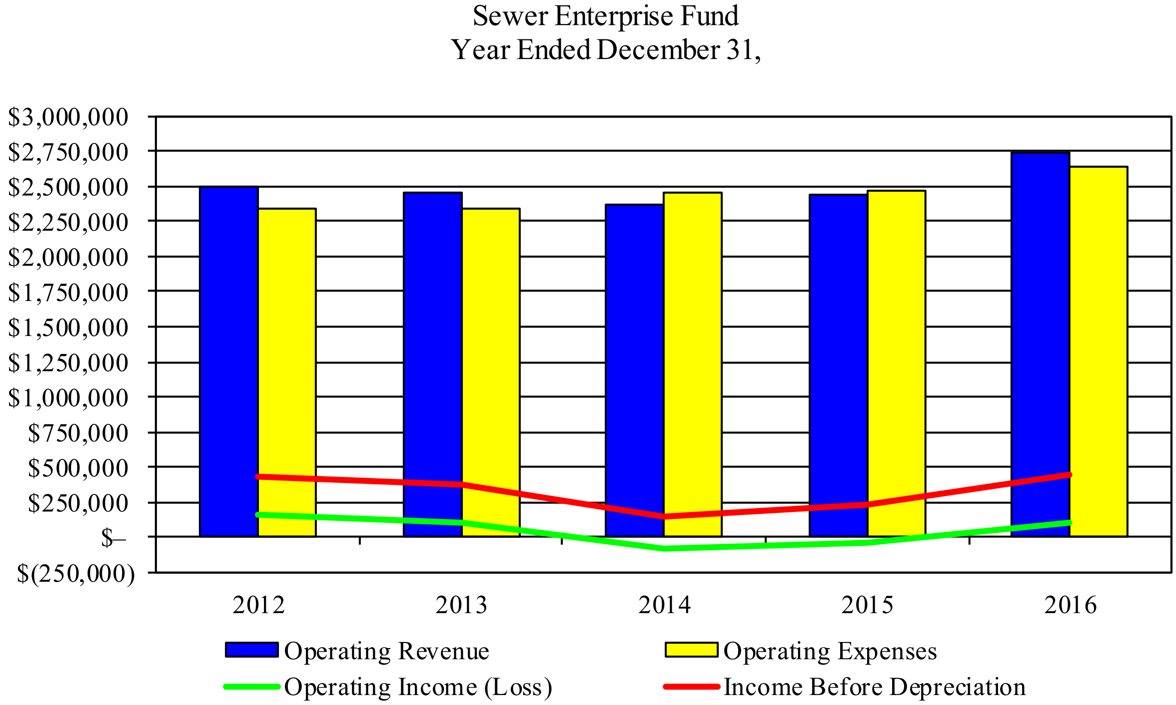
Operating revenue in the Water Fund was $3,674,099, an increase of 8.4 percent from the prior year. This increase was due to a combination of increased rates and water usage in 2016.

Water Fund operating expenses for 2016 were $2,493,541, an increase of $146,387 (6.2 percent) from the previous year. The largest factors contributing to the change were increases in utilities of $48,525 and personal services of $49,342 related to the Public Employees Retirement Association (PERA) pension expense allocation.

State and federal grant, interest, and miscellaneous income, which are not included in the table above, totaled $16,948, $35,216, and $6,525, respectively, in 2016. After including this revenue, the Water Fund reflected income before contributions and transfers of $1,239,247.

SEWER ENTERPRISE FUND

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



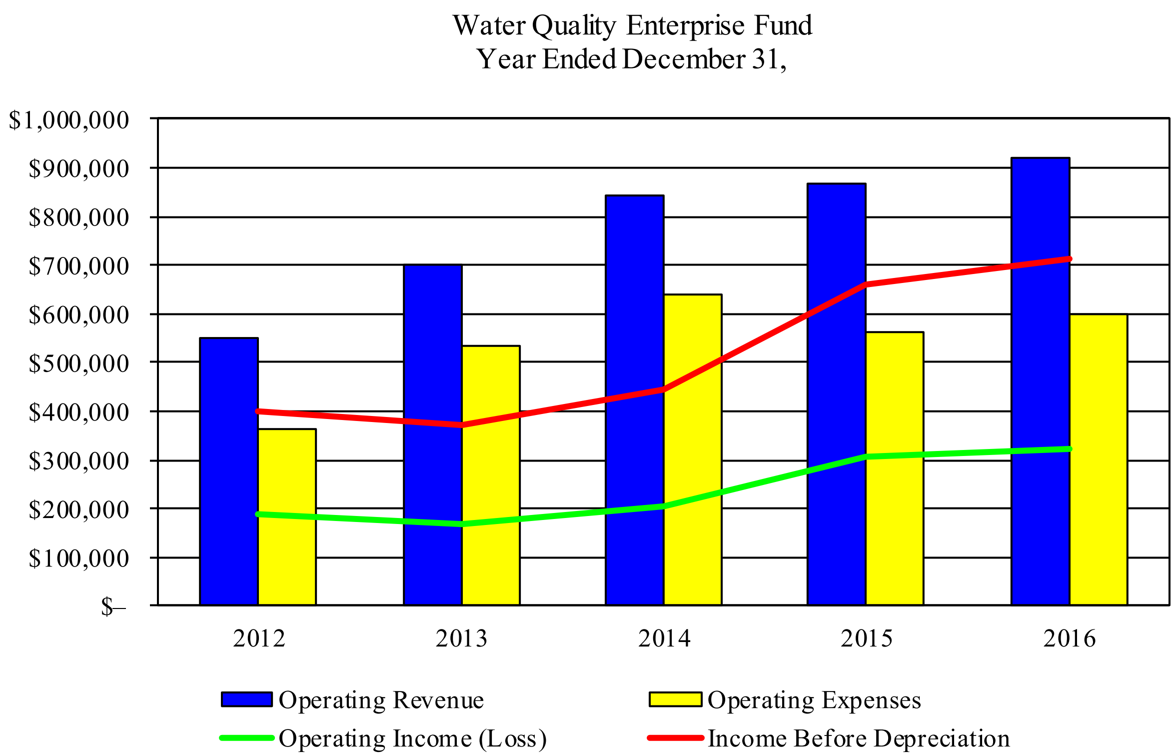
The Sewer Fund ended 2016 with net position of $20,723,278, an increase of $1,395,912 from the prior year. Of this, $19,422,492 represents the City's investment in capital assets, leaving $1,300,786 in unrestricted net position. The Sewer Fund had transfers out totaling $631,004 in 2016 to support other funds, pay debt service, and provide for construction projects.

Operating revenue in the Sewer Fund was $2,741,578, an increase of $308,653 (12.7 percent) from the prior year, mainly related to increased rates and increased sewer treatments. Sewer Fund operating expenses for 2016 were $2,635,304, an increase of $166,372 (6.7 percent). The largest factors contributing to the change were increases in disposal charges of $94,472 and personal services of $78,707 related to the PERA pension expense allocation, increased full time wages, and additional compensated absences paid during 2016.

State and federal grant, interest, and miscellaneous income, which are not included in the table above, totaled $59,465, $20,473, and $3,180, respectively, in 2016. After including this revenue, the Sewer Fund reflected income before contributions and transfers of $189,392.

WATER QUALITY ENTERPRISE FUND

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



The Water Quality Fund ended 2016 with net position of $1,856,443, an increase of $227,113 from the prior year. Of this, $1,084,681 represents the investment in capital assets, leaving $771,762 in unrestricted net position.

Operating revenue in the Water Quality Fund was $920,128, an increase of $54,884 (6.3 percent) from the prior year due to an increase in the rates in 2016 as well as an adjustment to true-up billings from previous years for various commercial, industrial, and multifamily stormwater accounts that resulted from an internal review of stormwater billing. Water Quality Fund operating expenses for 2016 were $598,972, an increase of $38,152 (6.8 percent) from the previous year, due to general increases in the cost of operations.

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 the City owns and owes at a given point in time, the last day of the fiscal year. Theoretically, net position represents the resources the City has leftover to use for providing services after its debts are settled. However, those resources are not always in spendable form, or there may be restrictions on how some of those resources can be used. Therefore, net position is divided into three components: net investment in capital assets, restricted, and unrestricted.

The following table presents the components of the City's net position as of December 31, 2016 and 2015, for governmental activities and business-type activities:

	As of December 31, 2016	As of December 31, 2015	Increase (Decrease)
Net position			
Governmental activities			
Net investment in capital assets	$ 99,587,768	$ 94,087,717	$ 5,500,051
Restricted	6,282,406	6,836,277	(553,871)
Unrestricted	9,092,499	11,465,626	(2,373,127)
Total governmental activities	114,962,673	112,389,620	2,573,053
Business-type activities			
Net investment in capital assets	51,075,358	47,805,809	3,269,549
Unrestricted	4,309,353	3,881,319	428,034
Total business-type activities	55,384,711	51,687,128	3,697,583
Total net position	$ 170,347,384	$ 164,076,748	$ 6,270,636

The City's total net position at December 31, 2016 was $6,270,636 higher than the total net position reported at the previous year-end. The increase in the net investment in capital assets balance was mostly due to capital outlay and capital contribution activity during fiscal 2016.

At the end of the current fiscal year, the City is able to present positive balances in all three categories of net position, both for the government as a whole, as well as for its separate governmental and business-type activities. The same situation held true for the prior year.

STATEMENT OF ACTIVITIES

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

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

	2016			2015
	Expenses	Program Revenues	Net Change	Net Change
Net (expense) revenue				
Governmental activities				
General government	$ 3,176,442	$ 620,798	$ (2,555,644)	$ (2,475,185)
Public safety	7,583,658	2,567,019	(5,016,639)	(3,404,130)
Public works	4,672,078	5,263,735	591,657	4,707,495
Culture and recreation	2,105,696	1,120,064	(985,632)	(1,958,671)
Economic development	610,584	23,905	(586,679)	(336,873)
Interest on long-term debt	1,294,104	–	(1,294,104)	(1,410,844)
Business-type activities				
Water	2,493,541	4,469,721	1,976,180	1,622,771
Sewer	2,635,304	3,500,099	864,795	235,944
Water quality	598,972	983,481	384,509	346,826
Total net (expense) revenue	$ 25,170,379	$ 18,548,822	(6,621,557)	(2,672,667)
General revenues				
Taxes			12,242,330	11,452,374
Unrestricted grants and contributions			19,864	13,250
Interest income			460,363	526,006
Gain on sale of capital assets			6,163	–
Miscellaneous			163,473	318,328
Special item – transfer of operations			–	(25,200)
Total general revenues			12,892,193	12,284,758
Change in net position			$ 6,270,636	$ 9,612,091

One of the goals of this statement is to provide a side-by-side comparison to illustrate the difference in the way the City's governmental and business-type operations are financed. The table clearly illustrates the dependence of the City's governmental operations on general revenues, such as property taxes and unrestricted grants. It also shows that 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 2016 legislative session, falling in the second half of the state's fiscal biennium, was scheduled to be a short session lasting only 11 weeks. Since biennial budgets are adopted in odd-year legislative sessions, less time is usually needed for the even-year sessions. However, because the 2015 Legislature adjourned without passing funding bills in several significant areas, it was anticipated that the 2016 legislative session would be considerably more active than the typical short session. In spite of this, only a few funding bills were brought forth to the Governor by the end of the 2016 regular legislative session, including a supplemental budget bill and an omnibus tax bill. The Governor chose not to sign the tax bill due to a drafting error that would have resulted in an unintended reduction of state revenues. When the framework for a special session could not be agreed upon, the fiscal year ended without the adoption of a new tax bill, capital bonding bill, or transportation funding package.

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

GASB STATEMENT NO. 81, *IRREVOCABLE SPLIT-INTEREST AGREEMENTS*

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

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

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

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

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

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

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

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

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

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

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

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

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

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

GASB STATEMENT NO. 84, *FIDUCIARY ACTIVITIES*

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

An activity meeting the criteria should be reported in a fiduciary fund in the basic financial statements, which should present a statement of fiduciary net position and a statement of changes in fiduciary net position. This statement describes four fiduciary funds that should be reported, if applicable: (1) pension (and other employee benefit) trust funds, (2) investment trust funds, (3) private-purpose trust funds, and (4) custodial funds. Custodial funds generally should report fiduciary activities that are not held in a trust or equivalent arrangement that meets specific criteria.

A fiduciary component unit, when reported in the fiduciary fund financial statements of a primary government, should combine its information with its component units that are fiduciary component units and aggregate that combined information with the primary government's fiduciary funds.

This statement also provides for recognition of a liability to the beneficiaries in a fiduciary fund when an event has occurred that compels the government to disburse fiduciary resources, defined as when a demand for the resources has been made or when no further action, approval, or condition is required to be taken or met by the beneficiary to release the assets.

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

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