Management Letter

City of Cannon Falls
Cannon Falls, Minnesota

For the Year Ended
December 31, 2015

ABDO EICK & MEYERS LLP
Certified Public Accountants & Consultants

People + Process. Going Beyond the Numbers

ABDO
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MEYERS LLP
Certified Public Accountants & Consultants

April 20, 2016

Management, Honorable Mayor and City Council
City of Cannon Falls, Minnesota

We have audited the financial statements of the governmental activities, the business-type activities, the discretely presented component unit, each major fund and the aggregate remaining fund information of the City of Cannon Falls, Minnesota (the City), for the year ended December 31, 2015. Professional standards require that we provide you with information about our responsibilities under generally accepted auditing standards and *Government Auditing Standards,* as well as certain information related to the planned scope and timing of our audit. We have communicated such information in our letter to you dated December 7, 2015. Professional standards also require that we communicate to you the following information related to our audit.

Our Responsibility Under Auditing Standards Generally Accepted in the United States of America and *Government Auditing Standards*

As stated in our engagement letter, our responsibility, as described by professional standards, is to express opinions about whether the financial statements prepared by management with your oversight are fairly presented, in all material respects, in conformity with accounting principles generally accepted in the United States of America. Our audit of the financial statements does not relieve you or management of your responsibilities.

Our responsibility is to plan and perform the audit to obtain reasonable, but not absolute, assurance that the financial statements are free of material misstatement. As part of our audit, we considered the internal control of the City. Such considerations were solely for the purpose of determining our audit procedures and not to provide any assurance concerning such internal control. We are responsible for communicating significant matters related to the audit that are, in our professional judgment, relevant to your responsibilities in overseeing the financial reporting process. However, we are not required to design procedures specifically to identify such matters.

Significant Audit Findings

In planning and performing our audit of the financial statements, we considered the City's internal control over financial reporting (internal control) to determine the audit procedures that are appropriate in the circumstances for the purpose of expressing our opinions on the financial statements, but not for the purpose of expressing an opinion on the effectiveness of the City's internal control. Accordingly, we do not express an opinion on the effectiveness of the City's internal control.

A *deficiency in internal control* exists when the design or operation of a control does not allow management or employees, in the normal course of performing their assigned functions, to prevent, or detect and correct, misstatements on a timely basis. A *material weakness* is a deficiency, or a combination of deficiencies, in internal control such that there is a reasonable possibility that a material misstatement of the entity's financial statements will not be prevented, or detected and corrected on a timely basis. A *significant deficiency* is a deficiency, or a combination of deficiencies, in internal control that is less severe than a material weakness, yet important enough to merit attention by those charged with governance.

Our consideration of internal control was for the limited purpose described in the first paragraph of this section and was not designed to identify all deficiencies in internal control that might be material weaknesses or significant deficiencies and therefore, material weaknesses or significant deficiencies may exist that were not identified. Given these limitations, during our audit we did not identify any deficiencies in internal control that we consider to be material weaknesses. However, material weaknesses may exist that have not been identified. We did identify a certain deficiency in internal control, described below as item 2015-001 that we consider to be a significant deficiency.

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2015-001 Preparation of financial statements

Condition: As in prior years, we were requested to draft the audited financial statements and related footnote disclosures as part of our regular audit services. Recent auditing standards require auditors to communicate this situation to the City Council as an internal control deficiency. Ultimately, it is management's responsibility to provide for the preparation of your statements and footnotes, and the responsibility of the auditor to determine the fairness of presentation of those statements. It is our responsibility to inform you that this deficiency could result in a material misstatement to the financial statements that could have been prevented or detected by your management. Essentially, the auditors cannot be part of your internal control process.

Criteria: Internal controls should be in place to provide reasonable assurance over financial reporting.

Cause: From a practical standpoint we do both for you at the same time in connection with our audit. This is not unusual for us to do with an organization of your size.

Effect: The effectiveness of the internal control system relies on enforcement by management. The effect of deficiencies in internal controls can result in undetected errors in financial reporting.

Recommendation: It is your responsibility to make the ultimate decision to accept this degree of risk associated with this condition because of cost or other considerations. As in prior years, we have instructed management to review a draft of the auditor prepared financials in detail for their accuracy; we have answered any questions they might have, and have encouraged research of any accounting guidance in connection with the adequacy and appropriateness of classification of disclosure in your statements. We are satisfied that the appropriate steps have been taken to provide you with the completed financial statements. While the City is reviewing the financial statements, we recommend that a disclosure checklist be utilized to ensure all required disclosures are presented and the City should agree its financial software to the numbers reported in the financial statements.

Management response:

For now, the City's management accepts the degree of risk associated with this condition and thoroughly reviews a draft of the financial statements.

Compliance

As part of obtaining reasonable assurance about whether the City's financial statements are free of material misstatement, we performed tests of its compliance with certain provisions of laws, regulations, contracts, grant agreements, and other matters noncompliance with which could have a direct and material effect on the determination of financial statement amounts. However, providing an opinion on compliance with those provisions was not an objective of our audit. While our audit provides a reasonable basis for our opinion, it does not provide a legal determination on the City's compliance with those requirements. The results of our tests disclosed no instances of noncompliance or other matters that are required to be reported in accordance with *Government Auditing Standards* or Minnesota statutes.

Qualitative Aspects of Accounting Practices

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 to the financial statements. As described in Note 9 to the financial statements, the City changed accounting policies related to accounting and financial reporting for pensions by adopting Statement of Governmental Accounting Standards (GASB) Statements No. 68 and 71 in 2015. Accordingly, the cumulative effect of the accounting change as of the beginning of the year is disclosed in Note 9. 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 except for the prior period restatement in Note 9.

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 on capital assets, allocation of payroll and compensated absences, evaluating a liability for other post-employment benefits and the liability for the City's pensions.

- Management's estimate of depreciation is based on estimated useful lives of the assets. Depreciation is calculated using the straight-line method.

- Allocations of gross wages and payroll benefits are approved by the City Council within the City's budget and are derived from each employee's estimated time to be spent servicing the respective functions of the City. These allocations are also used in allocating accrued compensated absences payable.

- The City's liability for other post-employment benefits was estimated to be zero primarily based on the assumption that employees, whom participate in the health insurance plan, are receiving no implicit benefit since premiums are scaled based on age.

- Management's estimate of its pension liability is based on several factors including, but not limited to, anticipated investment return rate, retirement age for active employees, life expectancy, salary increases and form of annuity payment upon retirement.

We evaluated the key factors and assumptions used to develop these estimates in determining that they are reasonable in relation to the financial statements taken as a whole. The disclosures in the financial statements are neutral, consistent, and clear. Certain financial statement disclosures are particularly sensitive because of their significance to financial statement users.

Difficulties Encountered in Performing the Audit

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

Corrected and Uncorrected Misstatements

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

Disagreements with Management

For purposes of this letter, 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 April 20, 2016.

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 the required supplementary information (RSI) (Management's Discussion and Analysis, the Schedules of Employer's Share of the Net Pension Liability, the Schedule of Changes in Net Pension Liability (Asset) and Related Ratios, and the Schedules of Employer's Contributions), which is information 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 supplementary information (combining and individual fund financial statements and schedules), which accompany the financial statements but 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, which accompanies 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.

Financial Position and Results of Operations

Our principal observations and recommendations are summarized on the following pages. These recommendations resulted from our observations made in connection with our audit of the City's financial statements for the year ended December 31, 2015.

General Fund

The General fund is used to account for resources traditionally associated with government, which are not required legally or by sound principal management to be accounted for in another fund. The General fund balance increased $234,399 from 2014 to end the year at $2,167,014. We recommend the unassigned fund balance be maintained at a level sufficient to fund operations until the major revenue sources are received in June. The City's unassigned fund balance is 61 percent of the 2016 budgeted expenditures. The City's fund balance policy for the General fund identifies a minimum unassigned fund balance of 40 - 50 percent of the following year's budgeted expenditures. The City's ending fund balance is above this target level as shown in the chart on the following page.

The purposes and benefits of a fund balance are as follows:

- Expenditures are incurred somewhat evenly throughout the year. However, property tax and state aid revenues are not received until the second half of the year. An adequate fund balance will provide the cash flow required to finance the General fund expenditures until these revenue sources are received.

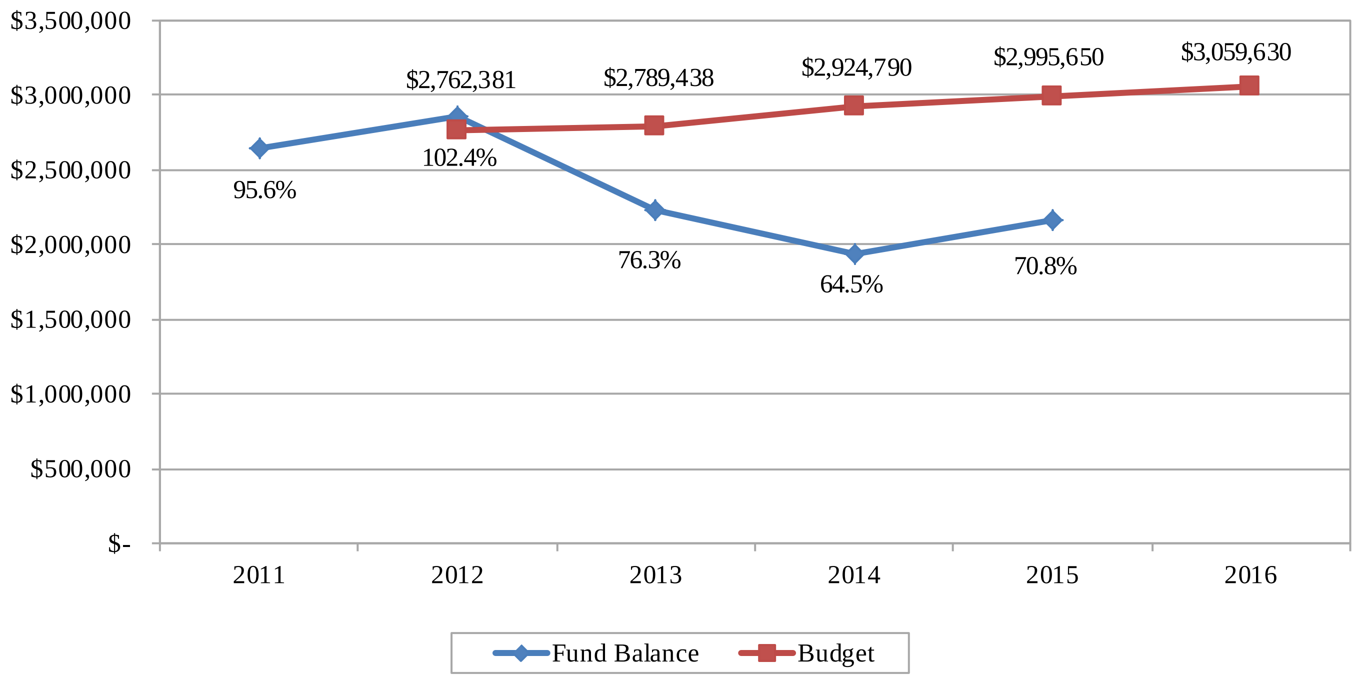
- Expenditures not anticipated at the time the annual budget was adopted may need immediate City Council action. These would include capital outlay replacement, lawsuits and other items. An adequate fund balance will provide the financing needed for such expenditures.

- A strong fund balance will assist the City in obtaining, maintaining or improving its bond rating. The result will be better interest rates in future bond sales.

A table summarizing the General fund balance in relation to budget follows:

Year	Fund Balance December 31	Budget Year	General Fund Budget	Percent of Fund Balance to Budget
2011	2,639,666	2012	2,762,381	95.6 %
2012	2,855,251	2013	2,789,438	102.4
2013	2,232,959	2014	2,924,790	76.3
2014	1,932,615	2015	2,995,650	64.5
2015	2,167,014	2016	3,059,630	70.8

Fund Balance as a Percent of Next Year's Budget



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A summary of 2015 General fund revenue and expenditures is as follows:

	Original Budgeted Amounts	Final Budgeted Amounts	Actual Amounts	Variance with Final Budget
Revenues	$ 2,946,200	$ 2,946,200	$ 3,072,143	$ 125,943
Expenditures	2,887,450	2,887,450	2,780,161	107,289
Excess of revenues over expenditures	58,750	58,750	291,982	233,232
Other financing sources (uses)				
Transfers in	49,450	49,450	41,253	(8,197)
Sale of capital assets	-	-	9,364	9,364
Transfers out	(108,200)	(108,200)	(108,200)	-
Total other financing sources (uses)	(58,750)	(58,750)	(57,583)	1,167
Net change in fund balances	-	-	234,399	234,399
Fund balances, January 1	1,932,615	1,932,615	1,932,615	-
Fund balances, December 31	$ 1,932,615	$ 1,932,615	$ 2,167,014	$ 234,399

The City's General fund budget was not amended during 2015. Compared to the final budget, revenues were in excess of budget by $125,943 and expenditures were under budget by $107,289.

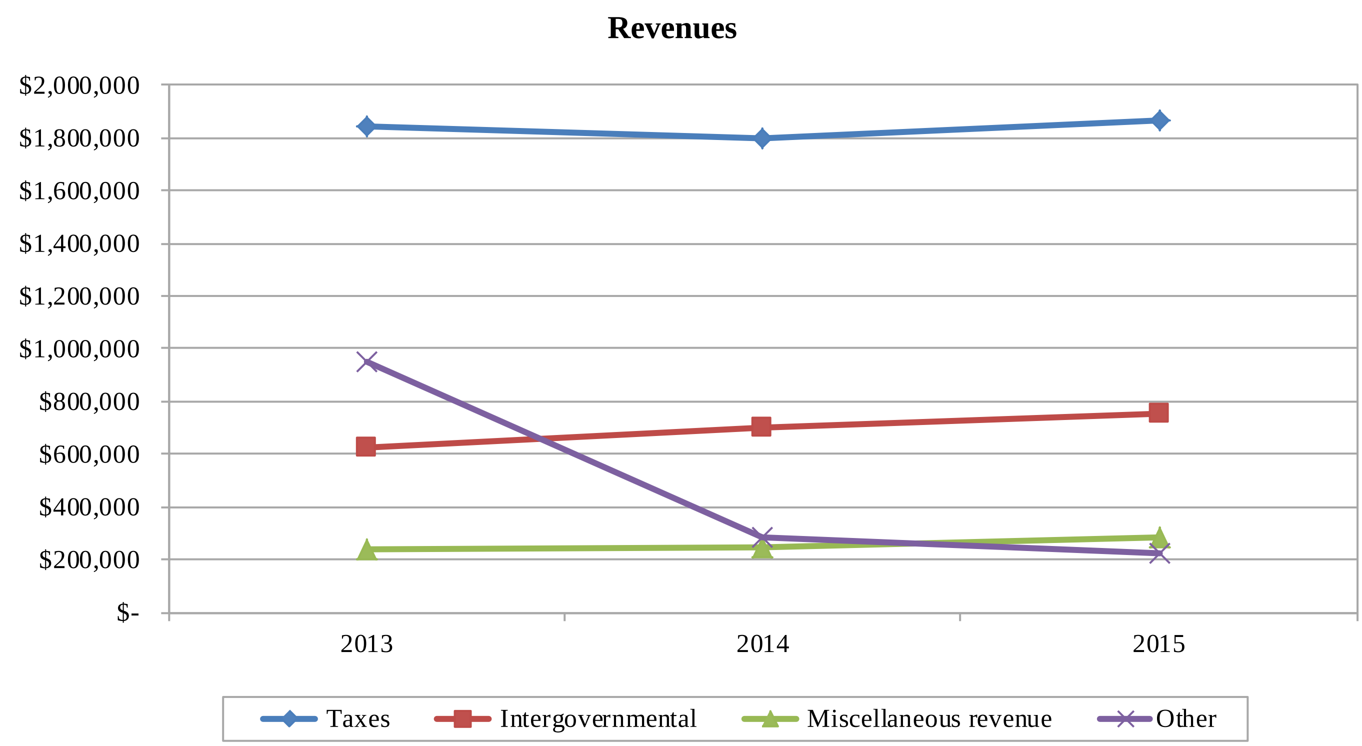
- The largest revenue variance was from intergovernmental revenue, which was $68,593 over budget due to unanticipated grants revenues received related to the small cities assistance program monies from the State.

- The largest variances in expenditures included current general government and current public safety. Current general government expenditures were under budget by $36,665 due to administrative expenditures and legal expenditures being under budget. Current public safety expenditures were under budget by $67,094 due to police protection personnel service being under budget and building inspection being under budget.

A comparison between 2013, 2014 and 2015 revenues, transfers and other sources is presented below:

Source	2013	2014	2015	Percent of Total	Per Capita
Taxes	$ 1,846,845	$ 1,800,086	$ 1,863,901	59.7 %	$ 454
Licenses and permits	71,262	56,111	50,558	1.6	12
Intergovernmental	624,612	699,899	752,049	24.1	183
Charges for services	57,127	55,950	64,676	2.1	16
Fines and forfeitures	25,584	31,044	27,967	0.9	7
Special assessments	11,790	11,667	23,712	0.8	6
Interest on investments	(13,283)	22,958	7,269	0.2	2
Miscellaneous revenue	236,030	242,839	282,011	9.0	69
Sale of capital assets	276,735	11,550	9,364	0.3	2
Transfers in	535,726	92,100	41,253	1.3	10
Total revenues, transfers and other sources	$ 3,672,428	$ 3,024,204	$ 3,122,760	100.0 %	$ 761

A graphical presentation of 2013, 2014 and 2015 revenues, transfers and other sources totals follows:



Some of the line items with significant changes are highlighted below:

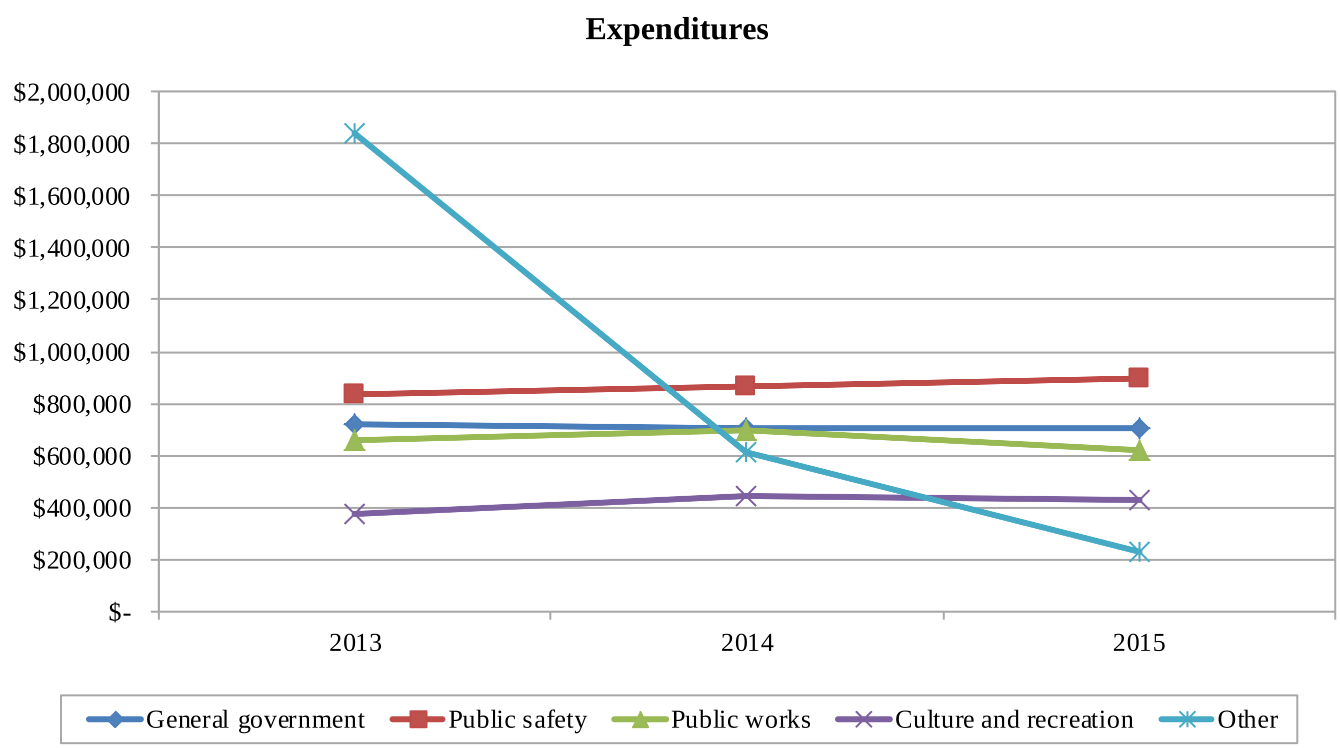
- Tax revenues increased in 2015, mostly due to the levy in the General fund increasing by nearly $80,000.
- Intergovernmental revenues increased in 2015 due to the City receiving $51,210 in small cities assistance program monies from the State.

A comparison between 2013, 2014 and 2015 expenditures and transfers is presented below:

Program	2013	2014	2015	Percent of Total	Per Capita	Peer Group Per Capita
Current						
General government	$ 719,780	$ 706,782	$ 706,510	24.5 %	$ 172	$ 130
Public safety	838,592	868,011	900,181	31.2	219	231
Public works	660,860	696,150	619,303	21.4	151	120
Culture and recreation	373,832	443,055	429,881	14.9	105	58
Miscellaneous	48,235	71,455	86,700	3.0	21	15
Total current	2,641,299	2,785,453	2,742,575	95.0	668	554
Capital outlay	1,655,210	17,660	18,626	0.6	5	32
Debt service	30,010	28,167	18,960	0.7	5	-
Transfers out	105,293	493,268	108,200	3.7	26	-
Total expenditures and transfers	$ 4,431,812	$ 3,324,548	$ 2,888,361	100.0 %	$ 704	$ 586

The above chart compares the amount the City spends per capita in comparison to a peer group. We have compiled a peer group average derived from 2014 information we have requested from the Office of the State Auditor and the compiled data for Cities of the 4th class which have populations of 2,500-10,000.

A graphical presentation of 2013, 2014 and 2015 expenditures and transfers totals by program follows:



Some of the line items with significant changes are highlighted below:

- Transfers out decreased due to transfers out to fund the construction of the library and close the fund in 2014.

Special Revenue Funds

Special revenue funds are used to account for specific revenues that are legally restricted to expenditures for particular purposes. A summary of the special revenue funds and fund balances is shown below:

Fund	Fund Balances December 31, 2015	Fund Balances December 31, 2014	Increase (Decrease)
Nonmajor			
Library	$ 67,816	$ 50,651	$ 17,165
Cable Public Television	112,542	104,828	7,714
Fire Department Operations	2,713	17,148	(14,435)
Total	$ 183,071	$ 172,627	$ 10,444

Capital Projects Funds

A two year comparison of year end fund balances for all capital project funds follows:

Fund	Fund Balances December 31, 2015	Fund Balances December 31, 2014	Increase (Decrease)
Nonmajor			
Public Improvement Revolving	$ 143,488	$ 153,969	$ (10,481)
Street Capital	16,147	10,997	5,150
Public Works Capital	60,053	9,682	50,371
Police Capital	28,029	4,768	23,261
Fire Capital	169,343	150,766	18,577
Administration Capital	39,532	27,232	12,300
Park Capital	43,107	57,427	(14,320)
Library Capital	44,138	41,963	2,175
2011 West Side Reconstruction Project	-	(39,098)	39,098
2013 Eastside Improvement Project	21,546	70,449	(48,903)
Park Board	30,556	46,670	(16,114)
Tax Increment Financing District No. 2-1	-	20,363	(20,363)
HWY 20 Clinic Access Road	(137,187)	(137,187)	-
318th Street Construction Project	-	(8,036)	8,036
2016 Street Improvement - Westside Phase II	(29,959)	-	(29,959)
Total capital projects funds	$ 428,793	$ 409,965	$ 18,828

All the deficits should be monitored by the City and management should develop funding plans to ensure deficits will be eliminated in future years.

Debt Service Funds

Debt Service funds are a type of governmental fund to account for the accumulation of resources for the payment of interest and principal on debt (other than enterprise fund debt).

Debt Service funds may have one or a combination of the following revenue sources pledged to retire debt as follows:

- Property taxes - Primarily for general City benefit projects such as parks and municipal buildings. Property taxes may also be used to fund special assessment bonds which are not fully assessed.
- Tax increments - Pledged exclusively for tax increment/economic development districts.
- Capitalized interest portion of bond proceeds - After the sale of bonds, the project may not produce revenue (tax increments or special assessments) for a period of one to two years. Bonds are issued with this timing difference considered in the form of capitalized interest.
- Special assessments - Charges to benefited properties for various improvements.

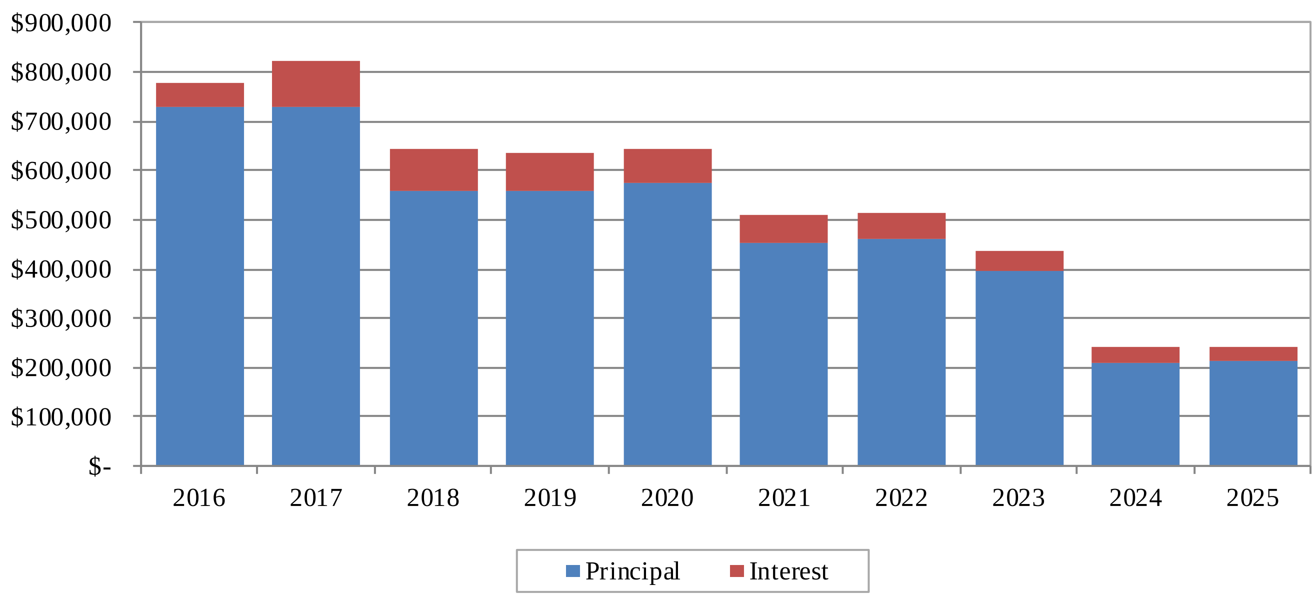
In addition to the above pledged assets, other funding sources may be received by Debt Service funds as follows:

- Residual project proceeds from the related capital projects fund
- Investment earnings
- State or federal grants
- Transfers from other funds

A comparison of the assets of each fund and the remaining bonds outstanding at year end are as follows:

Description	Total Cash	Total Assets	Bonds Outstanding	Maturity Date
2011A G.O. Improvement Bonds	$ 372,420	$ 825,368	$ 1,230,000	02/01/27
2012A G.O. Improvement Bonds	19,722	41,722	514,000	02/01/22
2012B G.O. Refunding Bonds	112,900	693,977	2,430,000	02/01/23
2013A G.O. Improvement Bonds	367,765	822,225	1,410,000	02/01/34
Total	$ 872,807	$ 2,383,292	$ 5,584,000	

Scheduled Governmental Debt Service for the Next Ten Years



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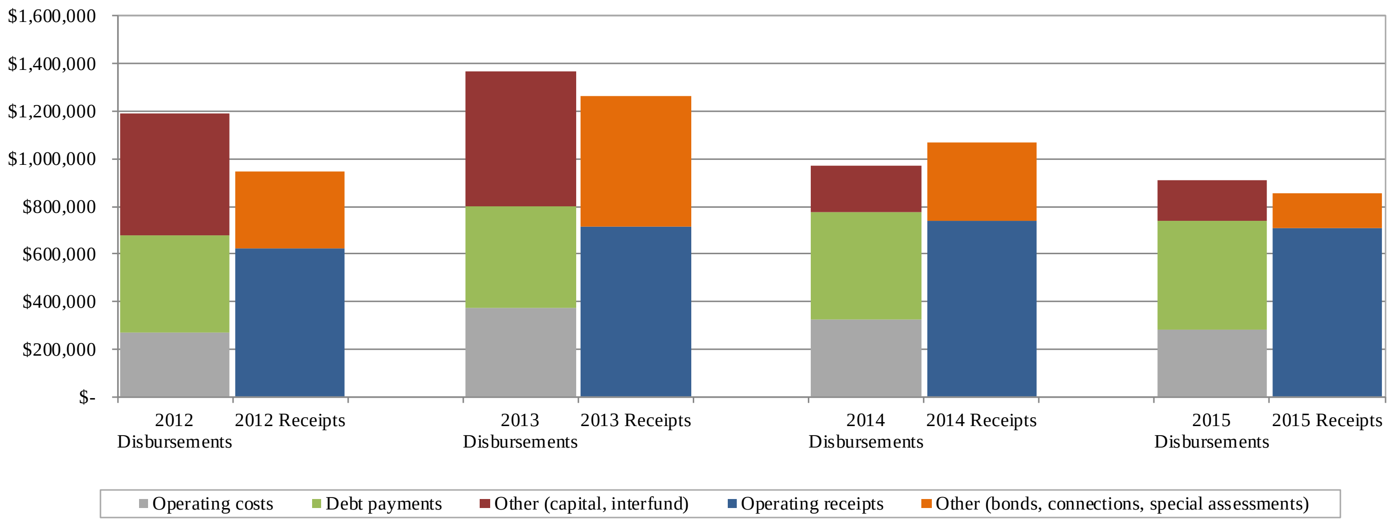
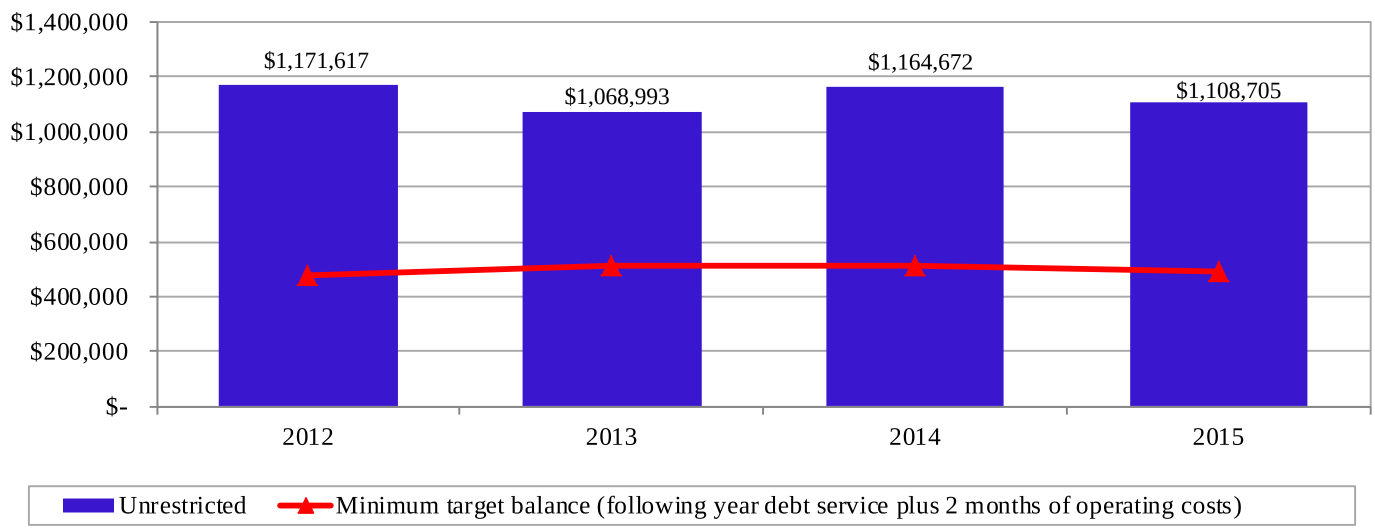
Enterprise Funds

Enterprise funds are used to account for operations that are financed and operated in a manner similar to private business enterprises- where the intent is that the costs of providing goods or services to the general public on a continuing basis be financed or recovered primarily through user charges. The results of the operations in terms of cash flow and the breakdown of the cash balances for the past four years are as follows:

Water Utility Fund Cash Flow



Water Utility Fund Cash Balance



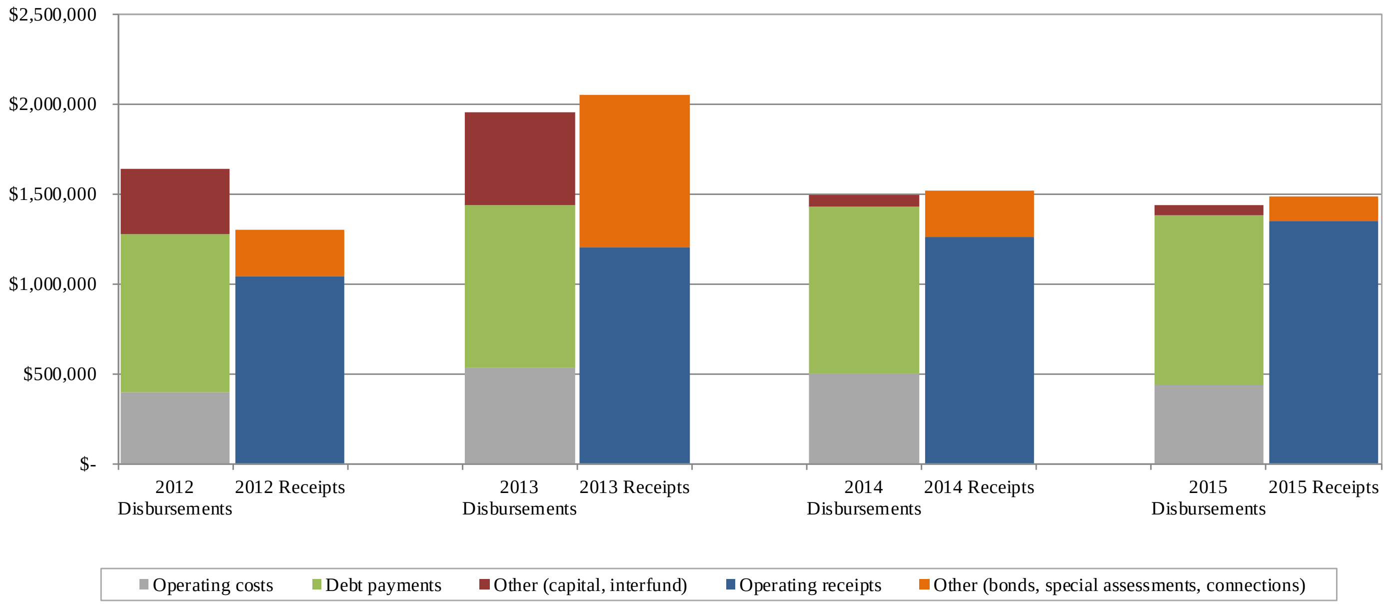
	2012	2013	2014	2015
Bonds payable	$ 3,746,617	$ 3,719,699	$ 3,012,871	$ 3,012,871

Some of the items with significant changes in the above charts are highlighted below:

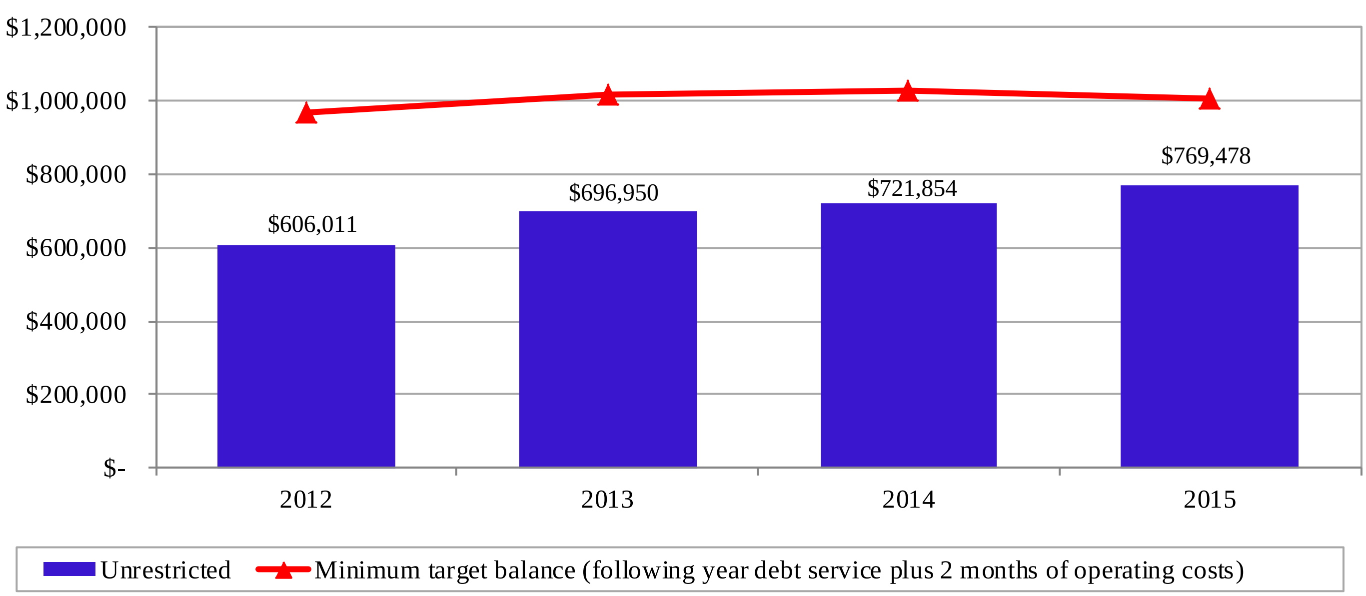
- Operating receipts (blue) have been sufficient to cover operating costs (grey) the past four years. However, operating receipts have not been sufficient to covered debt payments (green) in any of the four years presented. This signifies the need for cash from connections and special assessments (included in orange) and utilizing cash reserves to cover costs related to capital.

We recommend the City review rates annually to determine if operating revenues will cover operating costs, annual scheduled debt payments, and future projects.

Disposal Fund Cash Flow



Disposal Fund Cash Balance



	2012	2013	2014	2015
Bonds payable	$ 7,738,327	$ 7,724,310	$ 7,026,107	$ 6,289,904

Some of the items with significant changes in the above charts are highlighted below:

- Operating receipts (blue) have been sufficient to cover operating costs (grey) the past four years. However, operating receipts have not been sufficiently covered debt payments (green) in any of the four years presented. This signifies the need for cash from connections and special assessments (included in orange) and utilizing cash reserves to cover capital costs.

We recommend the City review rates annually to determine if operating revenues will cover operating costs, annual scheduled debt payments, and future projects.

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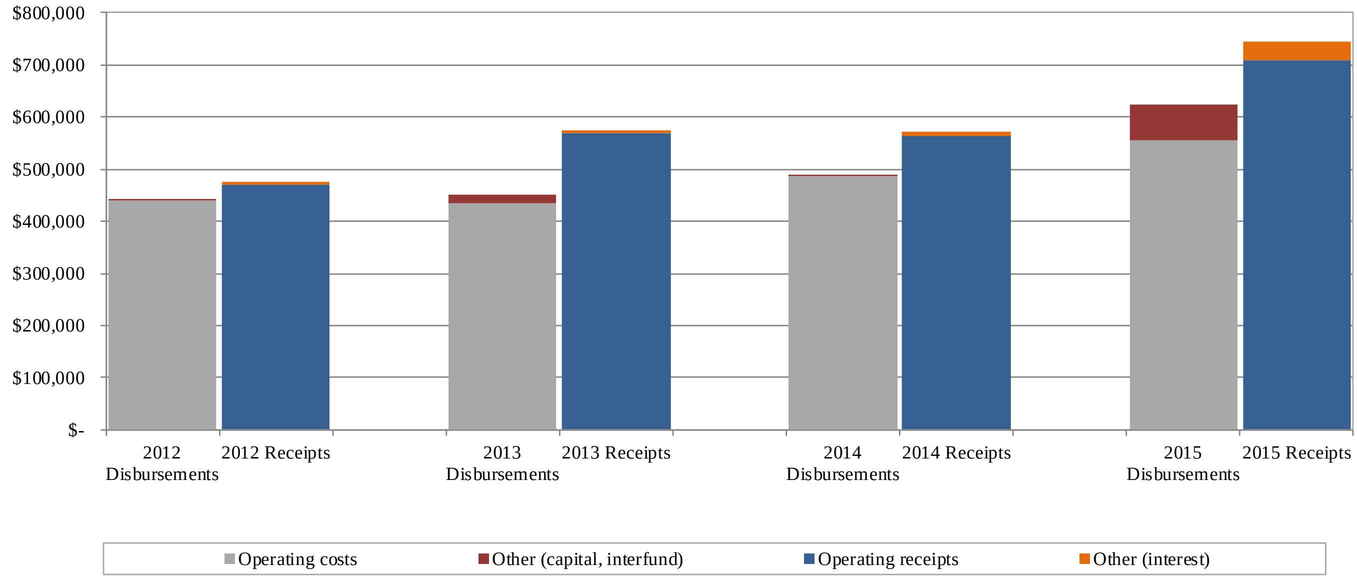
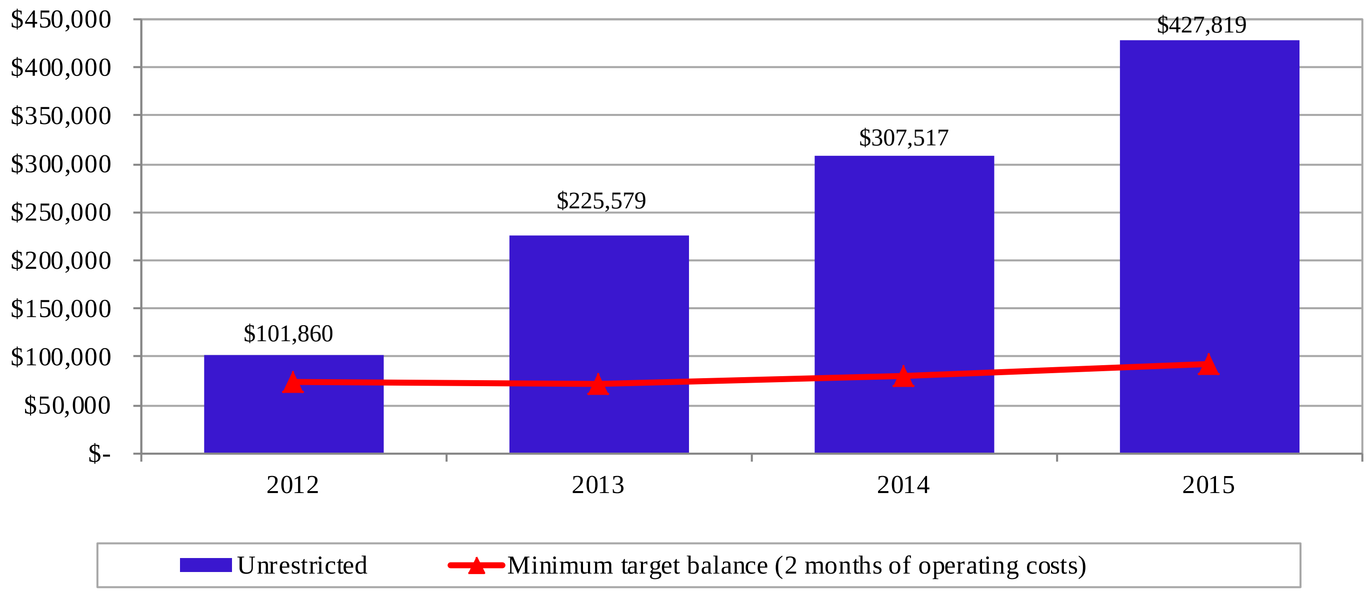
Ambulance Fund Cash Flow



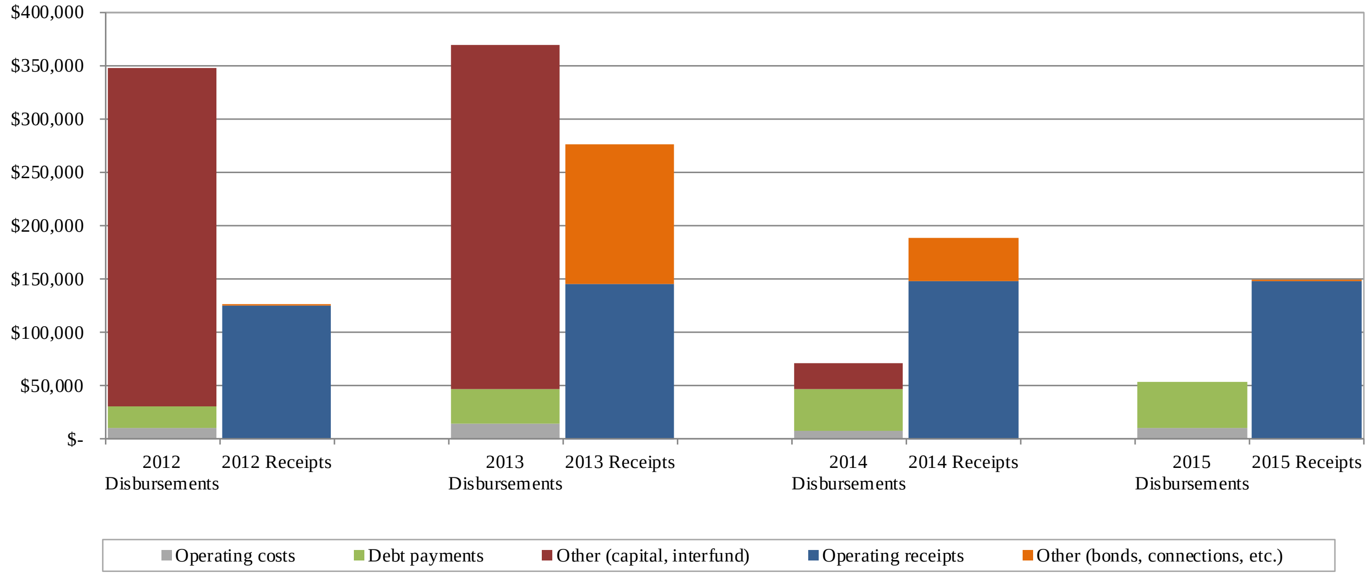
Ambulance Fund Cash Balance



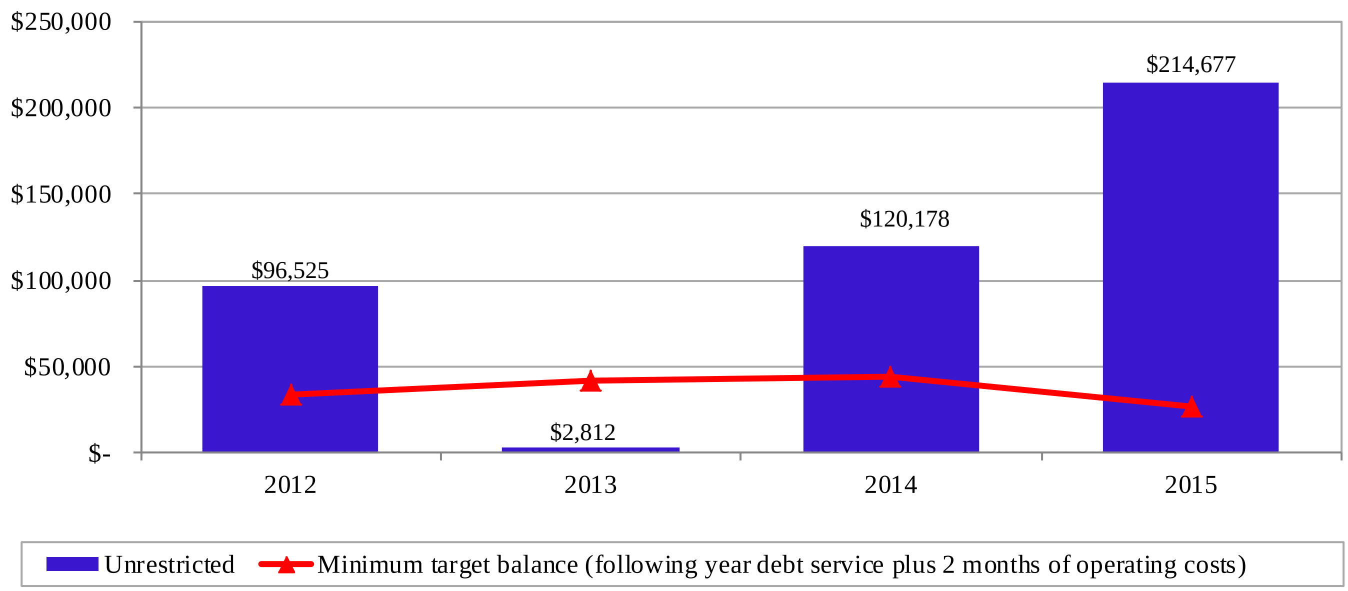
Some of the items with significant changes in the above charts are highlighted below:

- Operating receipts (blue) have been sufficient alone to cover operating costs (grey) in all of the four years presented.
- The cash balance has been steadily growing over the past 4 years.

Storm Water Fund Cash Flow



Storm Water Fund Cash Balance



	2012	2013	2014	2015
Bonds payable	$ 324,900	$ 442,817	$ 425,135	$ 425,135

Some of the items with significant changes in the above charts are highlighted below:

- Operating receipts (blue) were sufficient alone to cover operating costs (grey) and debt payments (green) in all four years presented.
- Cash increased in 2014 and 2015 due to comparable operating receipts and a decrease in capital expenditures.

We recommend the City review rates annually to determine if operating revenues will cover operating costs, annual scheduled debt payments, and future projects.

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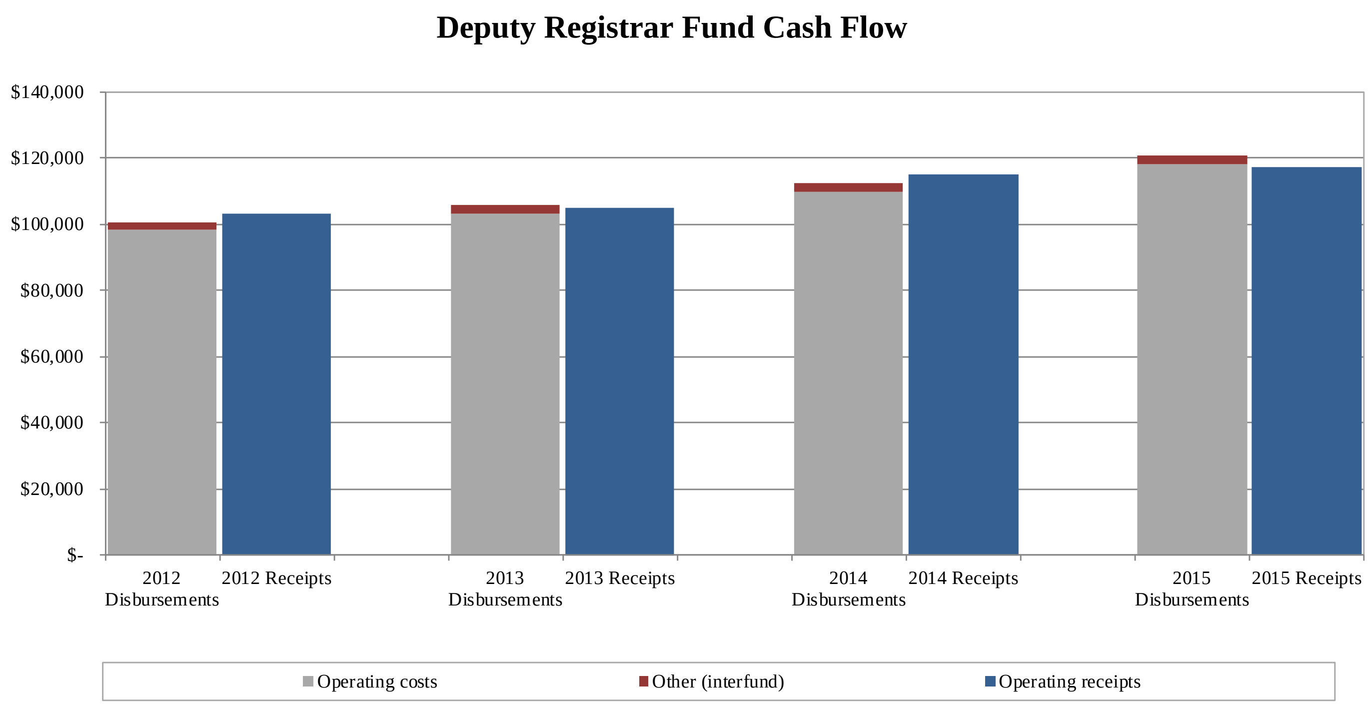

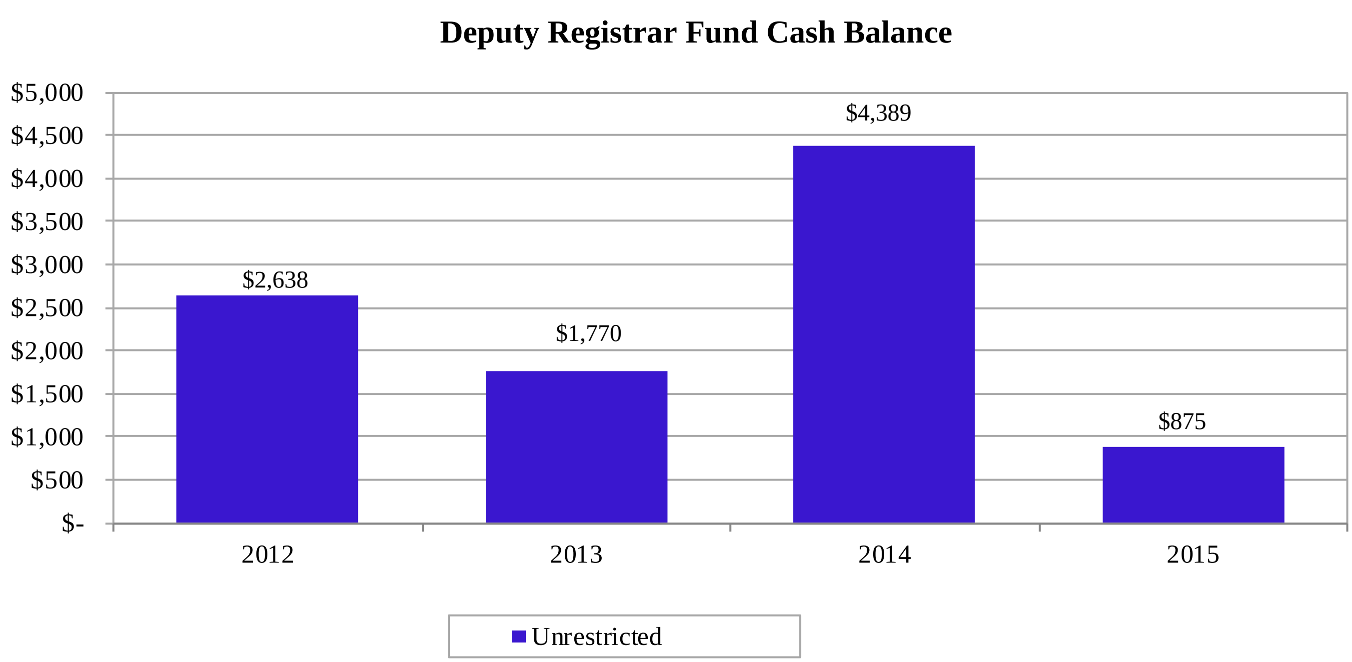

Some of the items with significant changes in the above charts are highlighted below:

- Operating receipts (blue) were sufficient alone to cover operating costs (grey) in 2012, 2013, and 2014.
- The fund has transferred out $2,575, $2,650, $2,750 and $2,750 in 2012, 2013, 2014 and 2015, respectively to the General fund.

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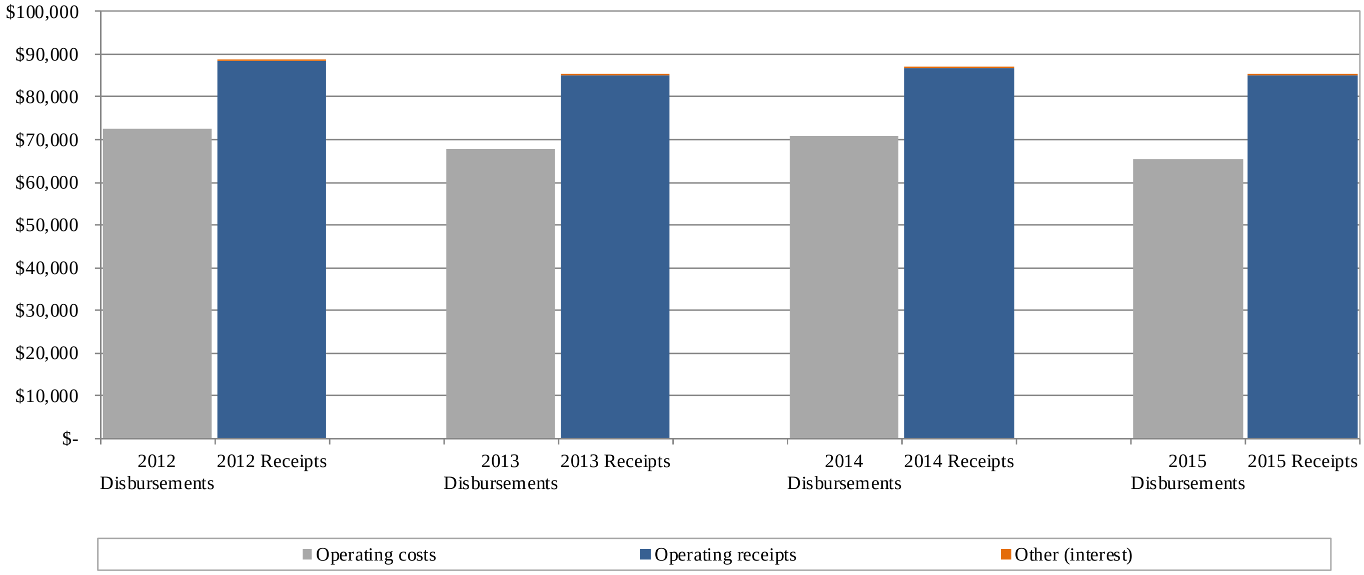
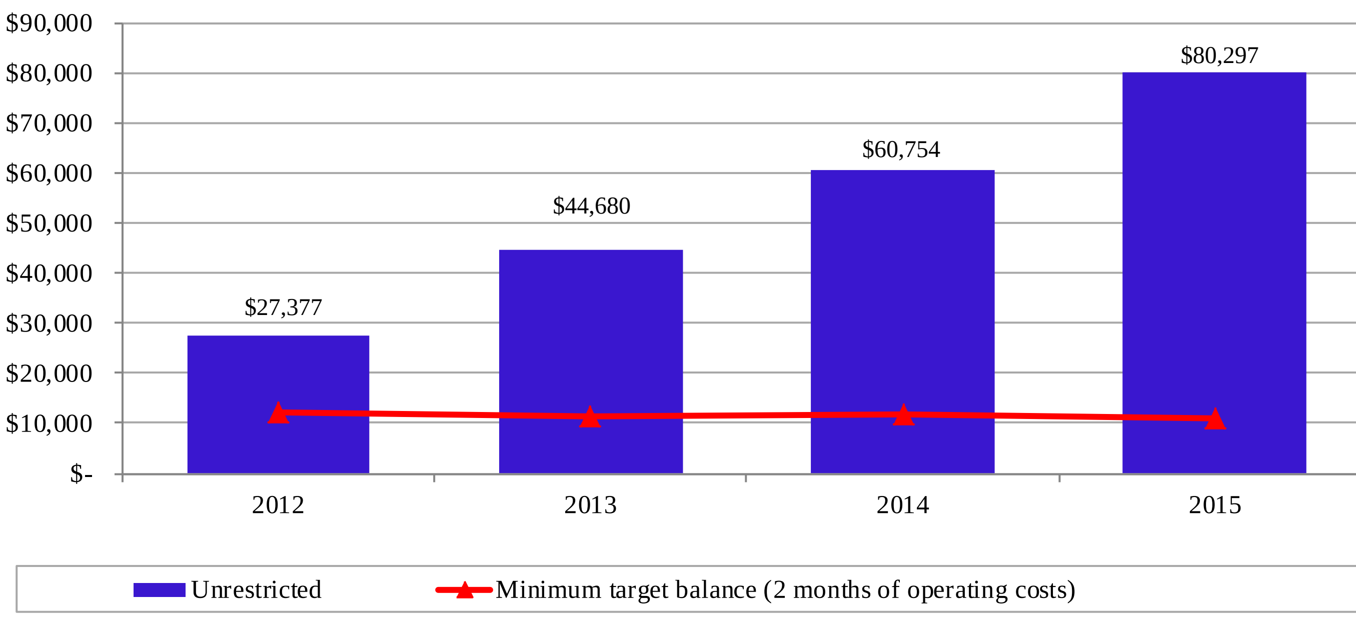
Recycling Fund Cash Flow



Recycling Fund Cash Balance



Some of the items with significant changes in the above charts are highlighted below:

- Operating receipts (blue) were sufficient alone to cover operating costs (grey) in all four years presented.

- The increase in cash over the past four years is a result of operating income earned being continuously higher than disbursements.

Ratio Analysis

The following captures a few ratios from the City's financial statements that give some additional information for trend and peer group analysis. The peer group average is derived from information we have requested from the Office of the State Auditor. Different peer group averages are used for Cities of the 4th Class (population 2,500 – 10,000). The majority of these ratios facilitate the use of economic resources focus and accrual basis of accounting at the government-wide level. A combination of liquidity (ability to pay its most immediate obligations), solvency (ability to pay its long-term obligations), funding (comparison of financial amounts and economic indicators to measure changes in financial capacity over time) and common-size (comparison of financial data with other cities regardless of size) ratios are shown below.

Ratio	Calculation	Source	2012	2013	2014	2015
Debt to assets	Total liabilities/total assets	Government-wide	44%	42%	39%	39%
			33%	*32%*	*32%*	*N/A*
Debt service coverage	Net cash provided by operations/ enterprise fund debt payments	Enterprise funds	86%	85%	94%	104%
			106%	*117%*	*114%*	*N/A*
Debt per capita	Bonded debt/population	Government-wide	$ 5,263	$ 4,988	$ 4,521	$ 3,727
			$ 2,626	*$ 2,656*	*$ 2,506*	*N/A*
Taxes per capita	Tax revenues/population	Government-wide	$ 579	$ 557	$ 411	$ 430
			$ 480	*$ 487*	*$ 484*	*N/A*
Current expenditures per capita	Governmental fund current expenditures/population	Governmental funds	$ 872	$ 791	$ 829	$ 847
			$ 649	*$ 634*	*$ 674*	*N/A*
Capital expenditures per capita	Governmental fund capital expenditures/population	Governmental funds	$ 692	$ 915	$ 179	$ 31
			$ 298	*$ 294*	*$ 320*	*N/A*
Capital assets % left to depreciate - Governmental	Net capital assets/ gross capital assets	Government-wide	71%	71%	69%	66%
			65%	*64%*	*63%*	*N/A*
Capital assets % left to depreciate - Business-type	Net capital assets/ gross capital assets	Government-wide	71%	69%	67%	64%
			63%	*63%*	*61%*	*N/A*

Represents the City of Cannon Falls

Peer Group Ratio

People + Process. Going Beyond the Numbers

Debt-to-Assets Leverage Ratio (Solvency Ratio)

The debt-to-assets leverage ratio is a comparison of a city's total liabilities to its total assets or the percentage of total assets that are provided by creditors. It indicates the degree to which the City's assets are financed through borrowings and other long-term obligations (i.e. a ratio of 50 percent would indicate half of the assets are financed with outstanding debt).

Debt Service Coverage Ratio (Solvency Ratio)

The debt coverage ratio is a comparison of cash generated by operations to total debt service payments (principal and interest) of enterprise funds. This ratio indicates if there are sufficient cash flows from operations to meet Debt Service obligations. Except in cases where other nonoperating revenues (i.e. taxes, assessments, transfers from other funds, etc.) are used to fund Debt Service payments, an acceptable ratio would be above 100 percent.

Bonded Debt per Capita (Funding Ratio)

This dollar amount is arrived at by dividing the total bonded debt by the population of the City and represents the amount of bonded debt obligation for each citizen of the City at the end of the year. The higher the amount, the more resources are needed in the future to retire these obligations through taxes, assessments or user fees.

Taxes per Capita (Funding Ratio)

This dollar amount is arrived at by dividing the total tax revenues by the population of the City and represents the amount of taxes for each citizen of the City for the year. The higher this amount is, the more reliant the City is on taxes to fund its operations.

Current Expenditures per Capita (Funding Ratio)

This dollar amount is arrived at by dividing the total current governmental expenditures by the population of the City and represents the amount of governmental expenditure for each citizen of the City during the year. Since this is generally based on ongoing expenditures, we would expect consistent annual per capita results.

Capital Expenditures per Capita (Funding Ratio)

This dollar amount is arrived at by dividing the total governmental capital outlay expenditures by the population of the City and represents the amount of capital expenditure for each citizen of the City during the year. Since projects are not always recurring, the per capita amount will fluctuate from year to year.

Capital Assets Percentage (Common-size Ratio)

This percentage represents the percent of governmental or business-type capital assets that are left to be depreciated. The lower this percentage, the older the City's capital assets are and may need major repairs or replacements in the near future. A higher percentage may indicate newer assets being constructed or purchased and may coincide with higher debt ratios or bonded debt per capita.

Future Accounting Standard Changes

The following Governmental Accounting Standards Board (GASB) Statements have been issued and may have an impact on future the City financial statements: [(1)]

GASB Statement No. 72 - *Fair Value Measurement and Application*

Summary

This statement addresses accounting and financial reporting issues related to fair value measurements. The definition of fair value is 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. This Statement provides guidance for determining a fair value measurement for financial reporting purposes. This Statement also provides guidance for applying fair value to certain investments and disclosures related to all fair value measurements.

Effective Date and Transition

The requirements of this Statement are effective for financial statements for periods beginning after June 15, 2015. Earlier application is encouraged.

How the Changes in This Statement Will Improve Financial Reporting

The requirements of this Statement will enhance comparability of financial statements among governments by requiring measurement of certain assets and liabilities at fair value using a consistent and more detailed definition of fair value and accepted valuation techniques. This Statement also will enhance fair value application guidance and related disclosures in order to provide information to financial statement users about the impact of fair value measurements on a government's financial position.

GASB Statement No. 73 - *Accounting and financial reporting for pension and related assets that are not within the scope of GASB Statement No. 68, and amendments to certain provisions of GASB Statements No. 67 and No. 68*

Summary

The objective of this Statement is to improve the usefulness of information about pensions included in the general purpose external financial reports of state and local governments for making decisions and assessing accountability. This Statement results from a comprehensive review of the effectiveness of existing standards of accounting and financial reporting for all postemployment benefits with regard to providing decision-useful information, supporting assessments of accountability and interperiod equity, and creating additional transparency.

This Statement establishes requirements for defined benefit pensions that are not within the scope of Statement No. 68, Accounting and Financial Reporting for Pensions, as well as for the assets accumulated for purposes of providing those pensions. In addition, it establishes requirements for defined contribution pensions that are not within the scope of Statement 68. It also amends certain provisions of Statement No. 67, Financial Reporting for Pension Plans, and Statement 68 for pension plans and pensions that are within their respective scopes.

The requirements of this Statement extend the approach to accounting and financial reporting established in Statement 68 to all pensions, with modifications as necessary to reflect that for accounting and financial reporting purposes, any assets accumulated for pensions that are provided through pension plans that are not administered through trusts that meet the criteria specified in Statement 68 should not be considered pension plan assets. It also requires that information similar to that required by Statement 68 be included in notes to financial statements and required supplementary information by all similarly situated employers and nonemployer contributing entities.

This Statement also clarifies the application of certain provisions of Statements 67 and 68 with regard to the following issues:

1. Information that is required to be presented as notes to the 10-year schedules of required supplementary information about investment-related factors that significantly affect trends in the amounts reported.

2. Accounting and financial reporting for separately financed specific liabilities of individual employers and nonemployer contributing entities for defined benefit pensions.

3. Timing of employer recognition of revenue for the support of nonemployer contributing entities not in a special funding situation.

Effective Date and Transition

The requirements of this Statement that address accounting and financial reporting by employers and governmental nonemployer contributing entities for pensions that are not within the scope of Statement 68 are effective for financial statements for fiscal years beginning after June 15, 2016, and the requirements of this Statement that address financial reporting for assets accumulated for purposes of providing those pensions are effective for fiscal years beginning after June 15, 2015. The requirements of this Statement for pension plans that are within the scope of Statement 67 or for pensions that are within the scope of Statement 68 are effective for fiscal years beginning after June 15, 2015. Earlier application is encouraged.

How the Changes in This Statement Will Improve Financial Reporting

The requirements of this Statement will improve financial reporting by establishing a single framework for the presentation of information about pensions, which will enhance the comparability of pension-related information reported by employers and nonemployer contributing entities.

GASB Statement No. 74 - *Financial Reporting for Postemployment Benefit Plans Other than Pension Plans*

Summary

The objective of this Statement is to improve the usefulness of information about postemployment benefits other than pensions (other postemployment benefits or OPEB) included in the general purpose external financial reports of state and local governmental OPEB plans for making decisions and assessing accountability. This Statement results from a comprehensive review of the effectiveness of existing standards of accounting and financial reporting for all postemployment benefits (pensions and OPEB) with regard to providing decision-useful information, supporting assessments of accountability and interperiod equity, and creating additional transparency.

This Statement replaces Statements No. 43, Financial Reporting for Postemployment Benefit Plans Other Than Pension Plans, as amended, and No. 57, OPEB Measurements by Agent Employers and Agent Multiple-Employer Plans. It also includes requirements for defined contribution OPEB plans that replace the requirements for those OPEB plans in Statement No. 25, Financial Reporting for Defined Benefit Pension Plans and Note Disclosures for Defined Contribution Plans, as amended, Statement 43, and Statement No. 50, Pension Disclosures.

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.

The scope of this Statement includes OPEB plans-defined benefit and defined contribution-administered through trusts that meet the following criteria:

- Contributions from employers and nonemployer contributing entities to the OPEB plan and earnings on those contributions are irrevocable.
- OPEB plan assets are dedicated to providing OPEB to plan members in accordance with the benefit terms.
- OPEB plan assets are legally protected from the creditors of employers, nonemployer contributing entities, and the OPEB plan administrator. If the plan is a defined benefit OPEB plan, plan assets also are legally protected from creditors of the plan members.

This Statement also includes requirements to address financial reporting for assets accumulated for purposes of providing defined benefit OPEB through OPEB plans that are not administered through trusts that meet the specified criteria.

Effective Date and Transition

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

How the Changes in This Statement Will Improve Financial Reporting

The requirements of this Statement will improve financial reporting primarily through enhanced note disclosures and schedules of required supplementary information that will be presented by OPEB plans that are administered through trusts that meet 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.

GASB Statement No. 75 - *Accounting and Financial Reporting for Postemployment Benefit Plans Other than Pension*

Summary

The primary objective of this Statement is to improve accounting and financial reporting by state and local governments for postemployment benefits other than pensions (other postemployment benefits or OPEB). It also improves information provided by state and local governmental employers about financial support for OPEB that is provided by other entities. This Statement results from a comprehensive review of the effectiveness of existing standards of accounting and financial reporting for all postemployment benefits (pensions and OPEB) with regard to providing decision-useful information, supporting assessments of accountability and interperiod equity, and creating additional transparency.

This Statement replaces the requirements of Statements No. 45, Accounting and Financial Reporting by Employers for Postemployment Benefits Other than Pensions, as amended, and No. 57, OPEB Measurements by Agent Employers and Agent Multiple-Employer Plans, for OPEB. Statement No. 74, Financial Reporting for Postemployment Benefit Plans Other than Pension Plans, establishes new accounting and financial reporting requirements for OPEB plans.

The scope of this Statement addresses accounting and financial reporting for OPEB that is provided to the employees of state and local governmental employers. This Statement establishes standards for recognizing and measuring liabilities, deferred outflows of resources, deferred inflows of resources, and expense/expenditures. For defined benefit OPEB, this Statement identifies the methods and assumptions that are required to be used to project benefit payments, discount projected benefit payments to their actuarial present value, and attribute that present value to periods of employee service. Note disclosure and required supplementary information requirements about defined benefit OPEB also are addressed.

In addition, this Statement details the recognition and disclosure requirements for employers with payables to defined benefit OPEB plans that are administered through trusts that meet the specified criteria and for employers whose employees are provided with defined contribution OPEB. This Statement also addresses certain circumstances in which a nonemployer entity provides financial support for OPEB of employees of another entity.

In this Statement, distinctions are made regarding the particular requirements depending upon whether the OPEB plans through which the benefits are provided are administered through trusts that meet the following criteria:

- Contributions from employers and nonemployer contributing entities to the OPEB plan and earnings on those contributions are irrevocable.

- OPEB plan assets are dedicated to providing OPEB to plan members in accordance with the benefit terms.

- OPEB plan assets are legally protected from the creditors of employers, nonemployer contributing entities, the OPEB plan administrator, and the plan members.

Effective Date

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

How the Changes in This Statement Will Improve Financial Reporting

The requirements of this Statement will improve the decision-usefulness of information in employer and governmental nonemployer contributing entity financial reports and will enhance its value for assessing accountability and interperiod equity by requiring recognition of the entire OPEB liability and a more comprehensive measure of OPEB expense. Decision-usefulness and accountability also will be enhanced through new note disclosures and required supplementary information, as follows:

- More robust disclosures of assumptions will allow for better informed assessments of the reasonableness of OPEB measurements.
- Explanations of how and why the OPEB liability changed from year to year will improve transparency.
- The summary OPEB liability information, including ratios, will offer an indication of the extent to which the total OPEB liability is covered by resources held by the OPEB plan, if any.
- For employers that provide benefits through OPEB plans that are administered through trusts that meet the specified criteria, the contribution schedules will provide measures to evaluate decisions related to contributions.

The consistency, comparability, and transparency of the information reported by employers and governmental nonemployer contributing entities about OPEB transactions will be improved by requiring:

- The use of a discount rate that considers the availability of the OPEB plan's fiduciary net position associated with the OPEB of current active and inactive employees and the investment horizon of those resources, rather than utilizing only the long-term expected rate of return regardless of whether the OPEB plan's fiduciary net position is projected to be sufficient to make projected benefit payments and is expected to be invested using a strategy to achieve that return.
- A single method of attributing the actuarial present value of projected benefit payments to periods of employee service, rather than allowing a choice among six methods with additional variations.
- Immediate recognition in OPEB expense, rather than a choice of recognition periods, of the effects of changes of benefit terms.
- Recognition of OPEB expense that incorporates deferred outflows of resources and deferred inflows of resources related to OPEB over a defined, closed period, rather than a choice between an open or closed period.

GASB Statement No. 76 - *The Hierarchy of Generally Accepted Accounting Principles for State and Local Governments*

Summary

The objective of this Statement is to identify-in the context of the current governmental financial reporting environment-the hierarchy of generally accepted accounting principles (GAAP). The "GAAP hierarchy" consists of the sources of accounting principles used to prepare financial statements of state and local governmental entities in conformity with GAAP and the framework for selecting those principles. This Statement reduces the GAAP hierarchy to two categories of authoritative GAAP and addresses the use of authoritative and nonauthoritative literature in the event that the accounting treatment for a transaction or other event is not specified within a source of authoritative GAAP.

This Statement supersedes Statement No. 55, The Hierarchy of Generally Accepted Accounting Principles for State and Local Governments.

Effective Date

The requirements of this Statement are effective for financial statements for periods beginning after June 15, 2015, and should be applied retroactively. Earlier application is permitted.

How the Changes in This Statement Will Improve Financial Reporting

The requirements in this Statement improve financial reporting by (1) raising the category of GASB Implementation Guides in the GAAP hierarchy, thus providing the opportunity for broader public input on implementation guidance; (2) emphasizing the importance of analogies to authoritative literature when the accounting treatment for an event is not specified in authoritative GAAP; and (3) requiring the consideration of consistency with the GASB Concepts Statements when evaluating accounting treatments specified in nonauthoritative literature. As a result, governments will apply financial reporting guidance with less variation, which will improve the usefulness of financial statement information for making decisions and assessing accountability and enhance the comparability of financial statement information among governments.

GASB Statement No. 77 - *Tax Abatement Disclosures*

Summary

Financial statements prepared by state and local governments in conformity with generally accepted accounting principles provide citizens and taxpayers, legislative and oversight bodies, municipal bond analysts, and others with information they need to evaluate the financial health of governments, make decisions, and assess accountability. This information is intended, among other things, to assist these users of financial statements in assessing (1) whether a government's current-year revenues were sufficient to pay for current-year services (known as interperiod equity), (2) whether a government complied with finance-related legal and contractual obligations, (3) where a government's financial resources come from and how it uses them, and (4) a government's financial position and economic condition and how they have changed over time.

Financial statement users need information about certain limitations on a government's ability to raise resources. This includes limitations on revenue-raising capacity resulting from government programs that use tax abatements to induce behavior by individuals and entities that is beneficial to the government or its citizens. Tax abatements are widely used by state and local governments, particularly to encourage economic development. For financial reporting purposes, this Statement defines a tax abatement as resulting from an agreement between a government and an individual or entity in which the government promises to forgo tax revenues and the individual or entity promises to subsequently take a specific action that contributes to economic development or otherwise benefits the government or its citizens.

Although many governments offer tax abatements and provide information to the public about them, they do not always provide the information necessary to assess how tax abatements affect their financial position and results of operations, including their ability to raise resources in the future. This Statement requires disclosure of tax abatement information about (1) a reporting government's own tax abatement agreements and (2) those that are entered into by other governments and that reduce the reporting government's tax revenues.

This Statement requires governments that enter into tax abatement agreements to disclose the following information about the agreements:

- Brief descriptive information, such as the tax being abated, the authority under which tax abatements are provided, eligibility criteria, the mechanism by which taxes are abated, provisions for recapturing abated taxes, and the types of commitments made by tax abatement recipients.

- The gross dollar amount of taxes abated during the period.

- Commitments made by a government, other than to abate taxes, as part of a tax abatement agreement.

Governments should organize those disclosures by major tax abatement program and may disclose information for individual tax abatement agreements within those programs.

Tax abatement agreements of other governments should be organized by the government that entered into the tax abatement agreement and the specific tax being abated. Governments may disclose information for individual tax abatement agreements of other governments within the specific tax being abated. For those tax abatement agreements, a reporting government should disclose:

- The names of the governments that entered into the agreements.
- The specific taxes being abated.
- The gross dollar amount of taxes abated during the period.

Effective Date and Transition

The requirements of this Statement are effective for financial statements for periods beginning after December 15, 2015. Earlier application is encouraged.

How the Changes in This Statement Will Improve Financial Reporting

The requirements of this Statement improve financial reporting by giving users of financial statements essential information that is not consistently or comprehensively reported to the public at present. Disclosure of information about the nature and magnitude of tax abatements will make these transactions more transparent to financial statement users. As a result, users will be better equipped to understand (1) how tax abatements affect a government's future ability to raise resources and meet its financial obligations and (2) the impact those abatements have on a government's financial position and economic condition.

GASB Statement No. 78 - *Pension Provided Through Certain Multiple-Employer Defined Benefit Pension Plans*

Summary

The objective of this Statement is to address a practice issue regarding the scope and applicability of Statement No. 68, Accounting and Financial Reporting for Pensions. This issue is associated with pensions provided through certain multiple-employer defined benefit pension plans and to state or local governmental employers whose employees are provided with such pensions.

Prior to the issuance of this Statement, the requirements of Statement 68 applied to the financial statements of all state and local governmental employers whose employees are provided with pensions through pension plans that are administered through trusts that meet the criteria in paragraph 4 of that Statement.

This Statement amends the scope and applicability of Statement 68 to exclude pensions provided to employees of state or local governmental employers through a cost-sharing multiple-employer defined benefit pension plan that (1) is not a state or local governmental pension plan, (2) is used to provide defined benefit pensions both to employees of state or local governmental employers and to employees of employers that are not state or local governmental employers, and (3) has no predominant state or local governmental employer (either individually or collectively with other state or local governmental employers that provide pensions through the pension plan). This Statement establishes requirements for recognition and measurement of pension expense, expenditures, and liabilities; note disclosures; and required supplementary information for pensions that have the characteristics described above.

Effective Date

The requirements of this Statement are effective for reporting periods beginning after December 15, 2015. Earlier application is encouraged.

Future Accounting Standard Changes - Continued

GASB Statement No. 79 - *Certain External Investment Pools and Pool Participants*

Summary

This Statement addresses accounting and financial reporting for certain external investment pools and pool participants. Specifically, it establishes criteria for an external investment pool to qualify for making the election to measure all of its investments at amortized cost for financial reporting purposes. An external investment pool qualifies for that reporting if it meets all of the applicable criteria established in this Statement. The specific criteria address (1) how the external investment pool transacts with participants; (2) requirements for portfolio maturity, quality, diversification, and liquidity; and (3) calculation and requirements of a shadow price. Significant noncompliance prevents the external investment pool from measuring all of its investments at amortized cost for financial reporting purposes. Professional judgment is required to determine if instances of noncompliance with the criteria established by this Statement during the reporting period, individually or in the aggregate, were significant.

If an external investment pool does not meet the criteria established by this Statement, that pool should apply the provisions in paragraph 16 of Statement No. 31, Accounting and Financial Reporting for Certain Investments and for External Investment Pools, as amended. If an external investment pool meets the criteria in this Statement and measures all of its investments at amortized cost, the pool's participants also should measure their investments in that external investment pool at amortized cost for financial reporting purposes. If an external investment pool does not meet the criteria in this Statement, the pool's participants should measure their investments in that pool at fair value, as provided in paragraph 11 of Statement 31, as amended.

This Statement establishes additional note disclosure requirements for qualifying external investment pools that measure all of their investments at amortized cost for financial reporting purposes and for governments that participate in those pools. Those disclosures for both the qualifying external investment pools and their participants include information about any limitations or restrictions on participant withdrawals.

Effective Date

The requirements of this Statement are effective for reporting periods beginning after June 15, 2015, except for the provisions in paragraphs 18, 19, 23-26, and 40, which are effective for reporting periods beginning after December 15, 2015.

How the Changes in This Statement Will Improve Financial Reporting

This Statement will enhance comparability of financial statements among governments by establishing specific criteria used to determine whether a qualifying external investment pool may elect to use an amortized cost exception to fair value measurement. Those criteria will provide qualifying external investment pools and participants in those pools with consistent application of an amortized cost-based measurement for financial reporting purposes. That measurement approximates fair value and mirrors the operations of external investment pools that transact with participants at a stable net asset value per share.

GASB Statement No. 80 - *Blending Requirements for Certain Component Units - an Amendment of GASB Statement No. 14*

Summary

The objective of the Statement is to improve financial reporting by clarifying the financial statement presentation requirements for certain component units. This Statement amends the blending requirements established in paragraph 53 of Statement No. 14, *The Financial Reporting Entity, as amended*.

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 Statement No. 39, *Determining Whether Certain Organizations Are Component Units*.

Future Accounting Standard Changes - Continued

Effective Date

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

How the Changes in This Statement Will Improve Financial Reporting

The requirements of this Statement enhance the comparability of financial statements among governments. Greater comparability improves the decision-usefulness of information reported in financial statements and enhances its value for assessing government accountability.

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Restriction on Use

This communication is intended solely for the information and use of management, the City Council, others within the City, and the Minnesota Office of the State Auditor and is not intended to be, and should not be, used by anyone other than these specified parties.

The comments and recommendation in this report are purely constructive in nature, and should be read in this context. Our audit would not necessarily disclose all weaknesses in the system because it was based on selected tests of the accounting records and related data.

If you have any questions or wish to discuss any of the items contained in this letter, please feel free to contact us at your convenience. We wish to thank you for the continued opportunity to be of service, and for the courtesy and cooperation extended to us by your staff.

Abdo Eick & Meyers, LLP

ABDO, EICK & MEYERS, LLP
Minneapolis, Minnesota
April 20, 2016

People + Process. Going Beyond the Numbers