CITY OF ZIMMERMAN
ZIMMERMAN, MINNESOTA

MANAGEMENT LETTER

FOR THE YEAR ENDED
DECEMBER 31, 2013

ABDO
EICK &
MEYERS LLP
Certified Public Accountants & Consultants

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ZIMMERMAN, MINNESOTA

MANAGEMENT LETTER

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ABDO
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May 7, 2014

Management, Honorable Mayor and Council
City of Zimmerman, Minnesota

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 of Zimmerman, Minnesota (the City), for the year ended December 31, 2013. Professional standards require that we provide you with information about our responsibilities under generally accepted auditing standards, *Government Audit Standards,* as well as certain information related to the planned scope and timing of our audit. We have communicated such information in our letter dated November 6, 2013. Professional standards require that we provide you with 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 over financial reporting (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 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.

Our consideration of internal control was for the limited purpose described in the preceding paragraph 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. However, as described below, we identified a certain deficiency in internal control that we consider to be a material weakness and another we consider a significant deficiency.

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 City's financial statements will not be prevented, or detected and corrected on a timely basis. We consider the deficiency described on the following page as finding 2013-002 to be a material weakness.

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. We consider the deficiency described on the following page as finding 2013-001 to be a significant deficiency.

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Edina, MN 55436
952.835.9090 | Fax 952.835.3261

2013-001 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. 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 ensure adequate internal control over safeguarding of assets and the reliability of financial records and reporting.

Cause: From a practical standpoint, we both prepare your statements and determine the fairness of the presentation in connection with our audit. This is not unusual for us to do with organizations 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. As in prior years, we have instructed management to review a draft of the auditor prepared financials in detail for accuracy; we have answered any questions that management might have, and have encouraged research of any accounting guidance in connection with the adequacy and appropriateness of classification of disclosures in your statements. We are satisfied that the appropriate steps have been taken to provide you with the completed financial statements.

Recommendation: Under these circumstances, the most effective controls lie in management's knowledge of the City's financial operations. It is the responsibility of management and those charged with governance to make the decision whether to accept the degree of risk associated with this condition because of cost and other considerations. Regarding the specific situations listed above, we would offer the following specific recommendation: 1) Utilize a disclosure checklist to ensure all required disclosures are present and agree to work papers, and 2) Agree your accounting information from Banyon to the amounts reported in the financial statements.

Management response:

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

2013-002 Material audit adjustment

Condition:	During our audit, an adjustment was needed to record an additional retainage payable at year end related to the 2013 Street Improvement Project.
Criteria:	The year-end closing process needs to consider and include adjustment for all measurable and incurred liabilities.
Cause:	The entry for this transaction was inadvertently omitted.
Effect:	The omission of this entry resulted in an understatement of liabilities.
Recommendation:	We recommend that management review the related journal entry, obtain an understanding of why the entry was necessary and modify current procedures to ensure that future corrections are not needed.

Management response:

Management understands the finding, and concurs that complete reconciliations of all accounts, including journal entries to adjust balances to these reconciliations needs to be done prior to the start of the audit. Staff strives to make sure this is done. It should be noted that the number of necessary adjustments has been significantly reduced over the past few years as staff has taken a more active role in the audit process.

Compliance and Other Matters

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, and grant agreements, 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, and accordingly, we do not express such an opinion. 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. As a result of our testing we noted no instances of noncompliance or other matters that are required to be reported under *Government Auditing Standards* or statutes set forth by the State of Minnesota.

Summary of Prior Year Findings

2012-001 Unauthorized investments

Condition:	Auditing for legal compliance requires a review of the City's deposits and investments. Our study indicated an instance of non-compliance related to allowable investments
Criteria:	Minnesota statute 118A.04 lists the criteria of investment instruments that Cities are allowed to invest. Investments in a general obligation of a state or local government with taxing powers are required to be rated "A" or better by a national bond rating service.

Current year statues:

The City held an investment in a general obligation of municipality that was not rated by S&P or Moody's rating services until it maturated. The Investment matured during 2013; therefore, the finding has been removed.

Planned Scope and Timing of the Audit

We performed the audit according to the planned scope and timing previously communicated to you.

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. The requirements of GASB statement No. 61was adopted for the year ended December 31, 2013. The application of existing policies was not changed during the year. We noted no transactions entered into by the City during the year for which there is a lack of authoritative guidance or consensus. All significant transactions have been recognized in the financial statements in the proper period.

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, construction costs, value of donated assets, and allocation of payroll and compensated absences.

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

- Management's allocation of construction costs is based on amounts identified by the project engineer. These allocations are used to allocate other project costs, including engineering, to each fund.

- The estimated value of donated lights was determined based on market value of similar assets discounted for remaining useful life.

- Allocations of gross wages and payroll benefits are approved by 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.

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. We proposed one journal entry that we consider to be an audit entry or correction of management decisions. This related to the situation previously discussed in finding 2013-002.

We assisted in preparing a number of year-end accounting entries. These were necessary to adjust the City's records at year end to correct ending balances. The City will receive better more timely information if the preparation of year-end entries is completed internally.

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 representations letter dated May 7, 2014.

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 Matters

With respect to the supplementary information accompanying the financial statements, we made certain inquiries of management and evaluated the form, content, and methods of preparing the information to determine that the information complies with accounting principles generally accepted in the United States of America, the method of preparing it has not changed from the prior period, and the information is appropriate and complete in relation to our audit of the 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.

Other Audit Findings or Issues

We generally discuss a variety of matters, including the application of accounting principles and auditing standards, with management 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.

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, 2013.

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 $113,752 from 2012. We recommend that the fund balance be maintained at a level sufficient to fund operations until the major revenue sources are received in June. The City's fund balance policy for the General fund identifies a minimum unrestricted fund balance of 50 percent of the following year's budgeted expenditures for cash-flow timing needs. The City's ending fund balance is above this target as shown on 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 governmental fund expenditures.

- Expenditures not anticipated at the time the annual budget was adopted may need immediate 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 maintaining, improving or obtaining its bond rating. The result will be better interest rates in future bond sales.

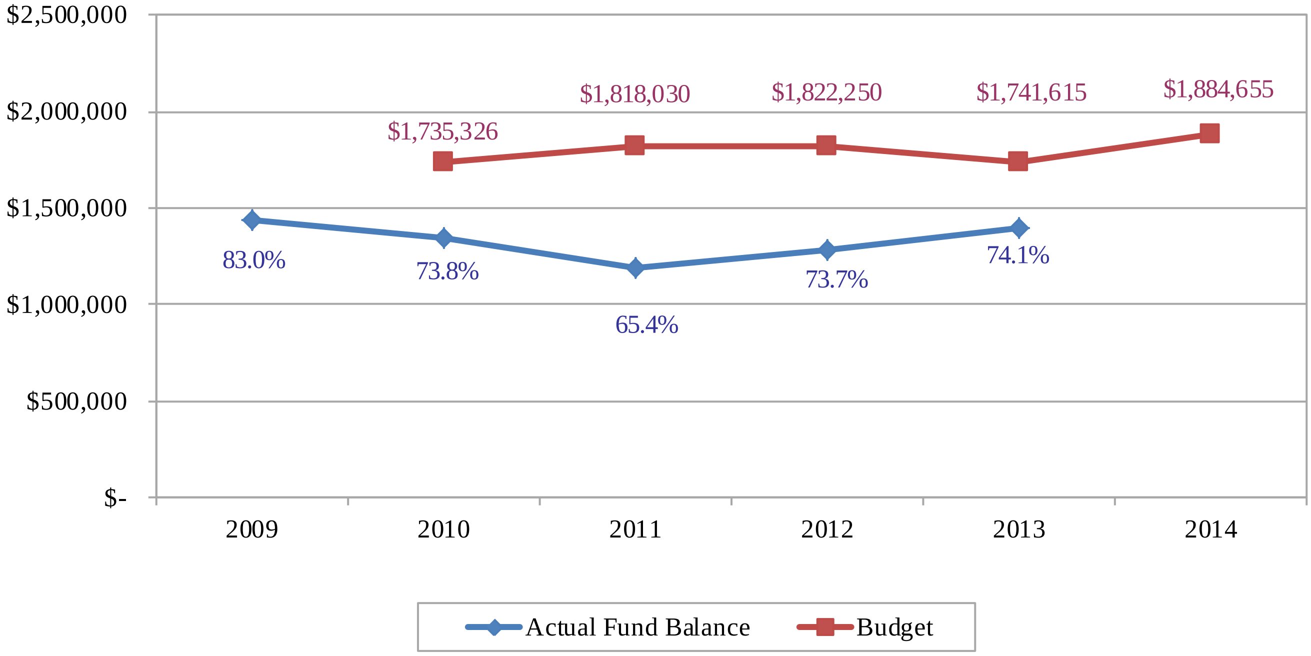
In accordance with the fund balance policy, management has committed and assigned portions of the General fund balance for specific purposes:

Purpose	Amount
Committed to	
Compensated Absences	$ 100,000
Assigned for	
Skate Park	14,500
Community Recreation	4,000
Downtown Planning	10,000
Codification	38,694
Comprehensive Land Use Plan Update	15,000
Capital Improvements	108,273
Trucks	30,266
Small Tools and Minor Equipment	230
Culverts	2,000
Total General fund assigned and committed fund balance	$ 322,963

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

Year	Fund Balance December 31	Budget Year	General Fund Budget	Percent of Fund Balance to Budget
2009	$ 1,440,252	2010	$ 1,735,326	83.0 %
2010	1,341,597	2011	1,818,030	73.8
2011	1,191,458	2012	1,822,250	65.4
2012	1,282,986	2013	1,741,615	73.7
2013	1,396,738	2014	1,884,655	74.1

Fund Balance as a Percent of Next Year's Budget



People + Process. Going Beyond the Numbers

The General fund 2013 operations are summarized as follows:

	Final Budgeted Amounts	Actual Amounts	Variance with Final Budget
Revenues	$ 1,699,115	$ 1,726,664	$ 27,549
Expenditures	1,741,615	1,664,503	77,112
Excess (deficiency) of revenues over (under) expenditures	(42,500)	62,161	104,661
Other financing sources			
Transfers in	70,000	50,000	(20,000)
Sale of capital assets	-	1,591	1,591
Total other financing sources	70,000	51,591	(18,409)
Net change in fund balances	27,500	113,752	86,252
Fund balances, January 1	1,282,986	1,282,986	-
Fund balances, December 31	$ 1,310,486	$ 1,396,738	$ 86,252

The City did not amend the General fund budget during the year. The original and final budget called for a positive $27,500 net increase in fund balance. Actual change in fund balance was an increase of $113,752.

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

- Intergovernmental revenue was $21,322 over budget expectations. The variance primarily relates to fire aid in excess of budget by $16,181, which is offset by contributions to the Fire Relief Association.

- Significant expenditure variances included the following:

  - The public works function was under budget within current expenditures by $56,148 due to not needing repairs on the civil defense siren and not completing budgeted crack filling in 2013.

  - Other functions with expenditures under budget include general government ($16,653) and culture and recreation ($10,749).

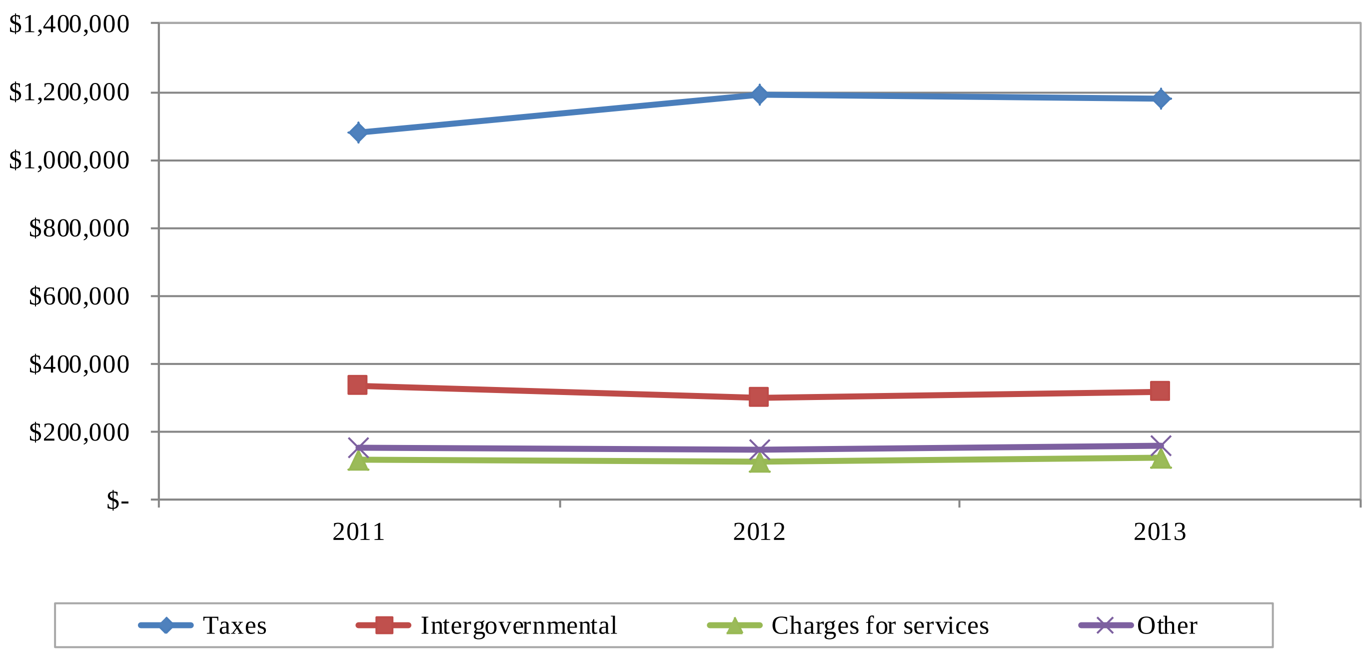
- A budgeted transfer relating to reimbursement from the EDA for $20,000 was determined unnecessary.

People + Process® Going Beyond the Numbers

A comparison between 2011, 2012, and 2013 General fund revenues and other financing sources is presented below:

Source	2011	2012	2013	Percent of Total	Per Capita
Taxes					
Property taxes collected	$ 1,050,731	$ 1,168,686	$ 1,148,010	64.5 %	$ 219
Cable franchise fees	29,869	25,201	30,831	1.7	6
Licenses and permits	48,772	40,888	59,390	3.3	11
Intergovernmental	333,170	298,224	316,064	17.8	60
Charges for services	116,258	114,236	125,625	7.1	24
Fines and forfeitures	21,628	17,928	19,080	1.1	4
Investment earnings	20,135	16,650	13,600	0.8	3
Miscellaneous	12,399	20,592	14,064	0.8	3
Transfers in	50,000	50,000	50,000	2.8	10
Sale of capital assets	-	500	1,591	0.1	-
Total revenues and other financing sources	$ 1,682,962	$ 1,752,905	$ 1,778,255	100.0 %	$ 340

A graphical presentation of 2011, 2012, and 2013 revenues and other financing sources follows:



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

- Within revenues from taxes, the increase from 2011 to 2012 was largely a combination of 1) an increase in the tax levy from $1,105,547 to $1,168,652 and 2) nearly $93,000 set aside as reimbursement from the state through property tax credits that was unalloted.

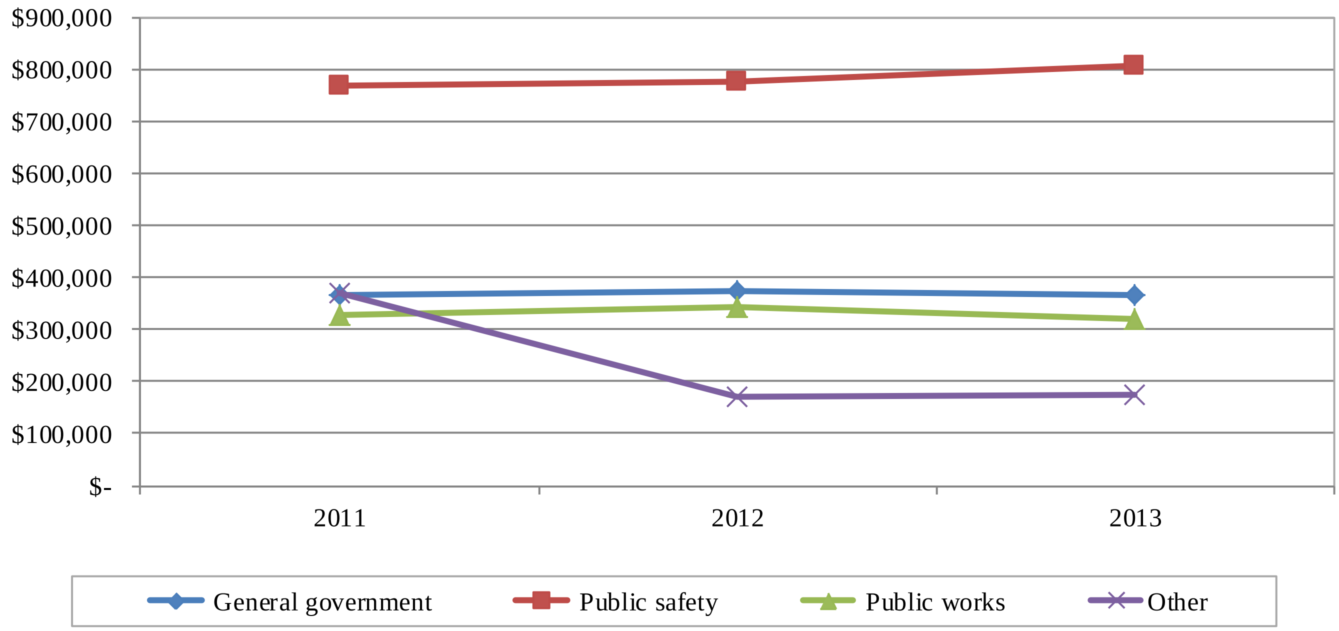
- The slight decrease in property taxes collected from 2012 to 2013 relates to the decreased levy of $1,140,573. Although the delinquent collections on previous year unpaid balances were comparable to the portion unpaid of the 2013 levy, it is important to note that the receivable at year-end decreased significantly as a result of County identified adjustments of $29,694. A significant portion of this ($19,795) relates to properties in forfeiture.

A comparison between 2011, 2012, and 2013 General fund expenditures and transfers is presented below:

Program	2011	2012	2013	Percent of Total	Per Capita	Peer Group Per Capita
General government	$ 364,988	$ 374,352	$ 365,632	22.0 %	$ 70	$ 125
Public safety	768,979	774,831	806,165	48.4	154	218
Public works	327,732	341,958	318,927	19.2	61	106
Culture and recreation	152,688	160,043	165,426	9.9	32	54
Miscellaneous	2,202	3,052	2,378	0.1	-	12
Capital outlay	216,512	7,141	5,975	0.4	1	34
Total expenditures and transfers	$ 1,833,101	$ 1,661,377	$ 1,664,503	100.0 %	$ 318	$ 549

The above chart compares the amount the City spends per capita, in comparison to a peer group. The peer group average is compiled from 2012 information from the 4th Class Cities (populations 2,500 to 10,000) that we have requested from the Office of the State Auditor.

A graphical presentation of 2011, 2012, and 2012 expenditures and transfers follows:



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

- Public safety expenses have increased approximately $37,000 from 2011 to 2013, largely a combination of the following:
    - $17,683 more contributed to the Fire Relief Association (funded from the State and passed through the City to the Fire Relief Association).
    - $38,480 related to increases in the police contract.
    - $17,050 related to decreases in the fire contract.

- Capital outlay has decreased significantly from the balance of $216,512 in 2011. The expenditures in 2011 related to County Highway 45 reconstruction as well as the purchase of a lawn mower.

Special Revenue Funds

Special revenue funds include funds used to account for revenue derived from specific sources that are restricted or committed to expenditures for specific purposes. A summary of the fund balances is shown below:

Fund	Fund Balances, December 31, 2012	Fund Balances, December 31, 2013	Increase (Decrease)
Nonmajor			
NSP Grant	$ -	$ -	$ -
Economic Development Authority (EDA)	66,220	114,737	48,517
Total	$ 66,220	$ 114,737	$ 48,517

The increase in the EDA was a combination of the following: $38,181 received from the TIF districts for administrative fees and $26,791 as a result of the reduced interfund loan payable to the Water fund.

Capital Projects Funds

The fund balances of the capital projects funds were as follows:

Fund	Fund Balances, December 31, 2012	Fund Balances, December 31, 2013	Increase (Decrease)
Major			
2013 Street Improvement	$ -	$ (225,346)	$ (225,346)
Nonmajor			
Park	159,955	69,206	(90,749)
TIF District 1	22,318	-	(22,318)
TIF District 2	177,426	241,013	63,587
TIF District 7	121,571	112,933	(8,638)
TIF District 8	(174,563)	(167,024)	7,539
TIF District 9	153,588	150,311	(3,277)
Municipal Building	16,317	8,612	(7,705)
County Road 4 Improvement Project	(44,201)	(42,232)	1,969
2nd Avenue N. Improvement Project	(52,767)	-	52,767
Permanent Improvement	313,968	263,959	(50,009)
2001 Improvement Project	247,405	286,918	39,513
2nd Street East	(179,618)	(153,235)	26,383
Total	$ 761,399	$ 545,115	$ (216,284)

The City should annually review financing plans to ensure that future revenue sources will be sufficient to eliminate each deficit:

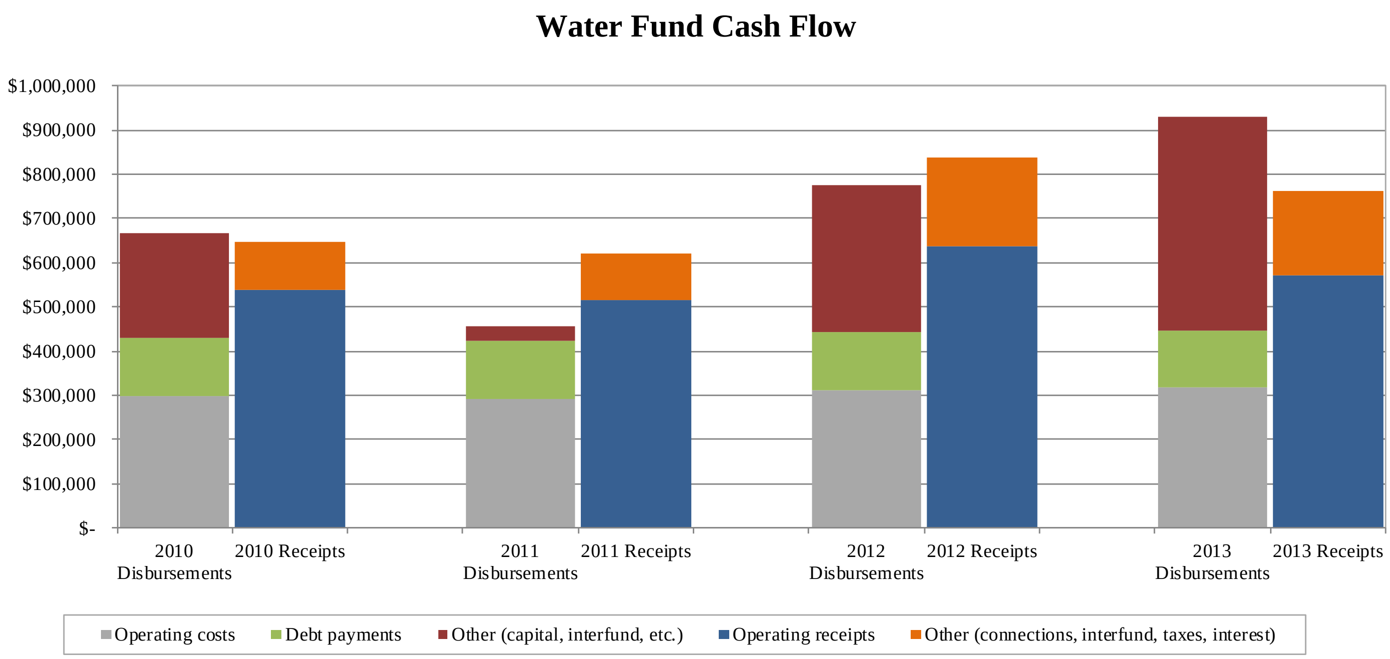
- The 2013 Street Improvement fund deficit is planned to be eliminated through future state aid ($176,697 unearned at 12/31/2013) and future collections of special assessments ($211,402 outstanding receivable at 12/31/2013).
- Within TIF District 8, TIF funds should not have a cash deficit by Minnesota statute. The City has established an interfund loan to the extent of the cash deficit in the TIF District 8 fund.
- The County Road 4 Improvement was a joint project with the County and is nearing completion at the end of 2013. A future transfer may be necessary to eliminate the deficit when the project is completed.
- Currently the deficit in the 2nd Street East Fund is planned to be eliminated over time with tax levies ($32,106 received in 2013).

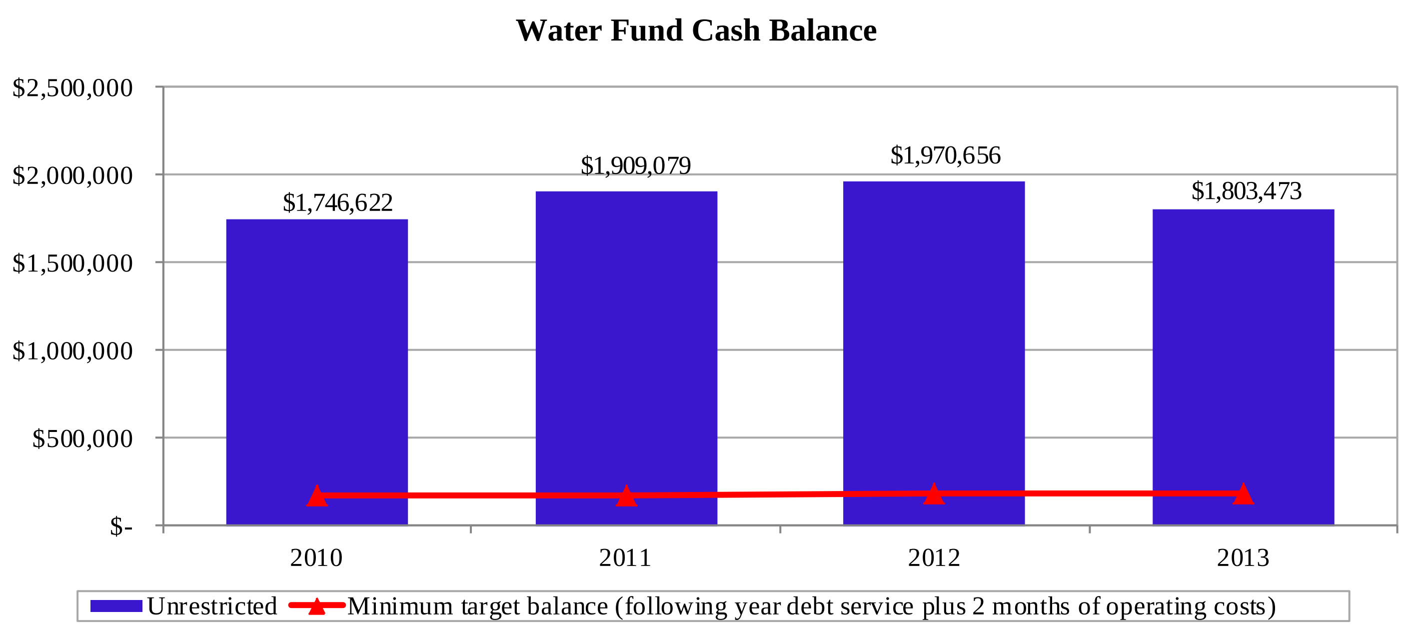
The decrease in the Park fund relates primarily to costs incurred to install the donated lights for the ballfield lighting project.

The Permanent Improvement fund transferred $52,767 to the 2nd Avenue N. Improvement Project to eliminate the deficit.

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:



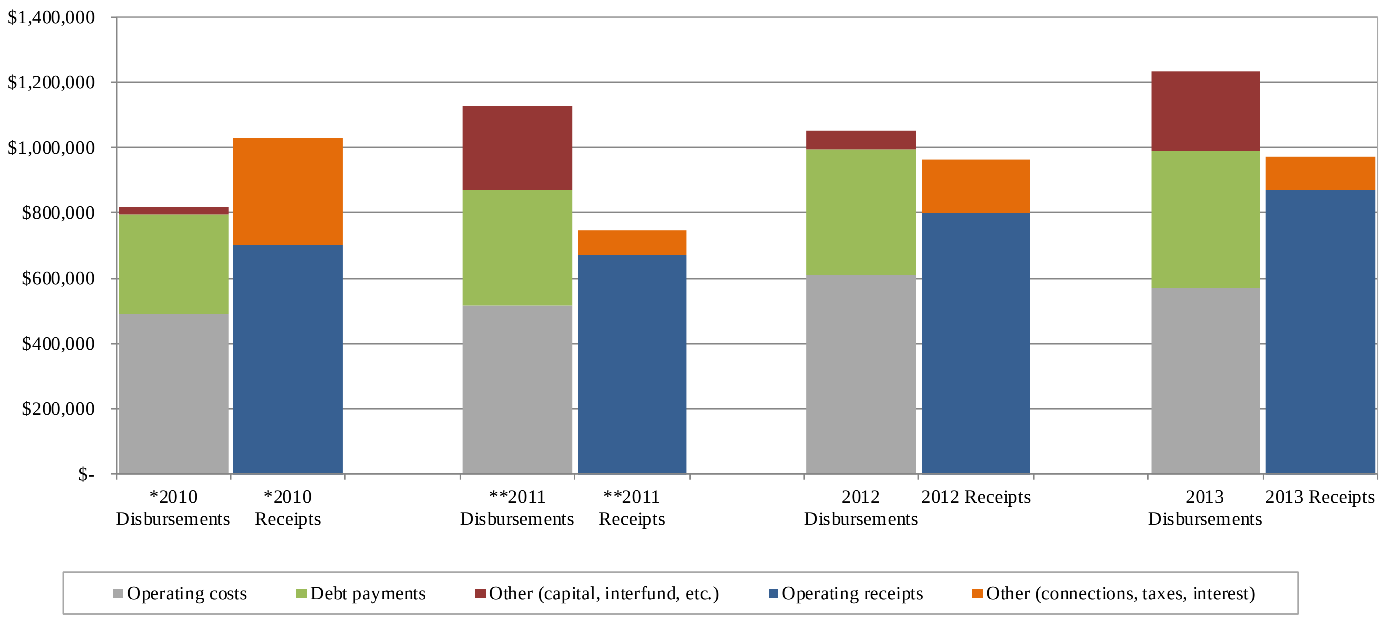


Some of the items with significant changes are highlighted below:

- Operating receipts (blue) were sufficient to cover operating costs (grey) and debt payments (green) in each of the four years presented. Although rates did increase in 2013, usage significantly decreased resulting in less collected from users.
- Other disbursements for 2012 include over $305,000 paid toward the County Road 4 Improvement Project. For 2013, other disbursements include approximately $400,000 of capital costs associated with the 2013 Street Improvement Project and the Highway 169 Water Main Crossing Project.
- Connection fees of $92,925 and $42,000 were received in 2012 and 2013, respectively.
- The total bonds payable outstanding at the end of 2013 is $1,430,000.

We continue to recommend that rates be reviewed annually to ensure that they are sufficient to cover operating costs, annual scheduled debt payments, and planned project costs.

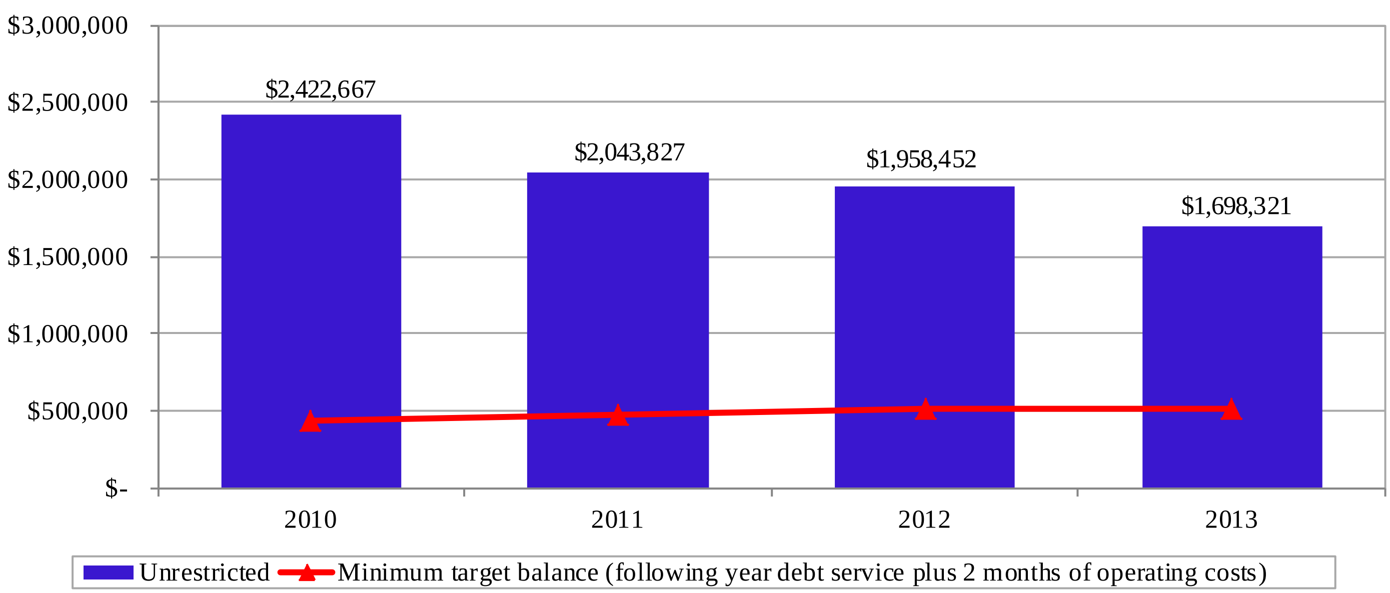
Sewer Fund Cash Flow - Excluding 2010 and 2011 Bond Proceeds and Related Capital



* Excluded $1,390,816 of project costs relating to the treatment facility improvement project and related bond proceeds of $1,391, 736.

** Excluded $50,518 of bond proceeds and related project costs.

Sewer Fund Cash Balance



Some of the items with significant changes are highlighted below:

- Although rates have increased in both 2012 and 2013, operating receipts (blue) have not been sufficient to cover operating costs (grey) and debt payments (green) in any of the four years presented. As a result of this as well as capital and other disbursements, the related decrease in cash can be seen in the cash balance chart above.
- Other disbursements for 2013 include roughly $117,000 paid toward capital costs associated with the 2013 Street Improvement Project and $102,000 paid for the SBR Digester Cover Project (installed/capitalized in 2012).
- Connection fees of $92,925 and $42,000 were received in 2012 and 2013, respectively.
- The total bonds payable outstanding at the end of 2013 is $3,726,000.

Like the Water fund, we continue to recommend that rates be reviewed annually to ensure that they are sufficient to cover operating costs, annual scheduled debt payments, and planned project costs.

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	2010	2011	2012	2013
Debt to assets	Total liabilities/total assets	Government-wide	22.4%	21.6%	20.7%	19.3%
			34.3%	*32.9%*	*32.8%*	*N/A*
Debt service coverage	Net cash provided by operations/ enterprise fund debt payments	Enterprise funds	101.8%	77.9%	100.8%	100.6%
			90.3%	*105.7%*	*106.3%*	*N/A*
Debt per capita	Bonded debt/population	Government-wide	$ 1,249	$ 1,139	$ 1,065	$ 984
			$ 2,774	*$ 2,826*	*$ 2,626*	*N/A*
Taxes per capita	Tax revenues/population	Government-wide	$ 278	$ 268	$ 297	$ 280
			$ 459	*$ 500*	*$ 479*	*N/A*
Current expenditures per capita	Governmental fund current expenditures/population	Governmental funds	$ 465	$ 312	$ 317	$ 321
			$ 624	*$ 640*	*$ 649*	*N/A*
Capital expenditures per capita	Governmental fund capital outlay/population	Governmental funds	$ 10	$ 87	$ 265	$ 208
			$ 265	*$ 229*	*$ 298*	*N/A*
Capital assets % left to depreciate - Governmental	Net capital assets/ gross capital assets	Government-wide	64.6%	62.0%	60.5%	61.8%
			67.9%	*64.3%*	*65.4%*	*N/A*
Capital assets % left to depreciate - Business-type	Net capital assets/ gross capital assets	Government-wide	72.6%	70.5%	68.7%	67.0%
			67.8%	*64.5%*	*63.1%*	*N/A*

Represents the City of Zimmerman
Represents Peer Group Average

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 expenditures 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 expenditures 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 City financial statements: **(1)**

GASB Statement No. 67 - *The Financial Reporting for Pension Plans- an Amendment to GASB Statement No. 25*

Summary

The objective of this Statement is to improve financial reporting by state and local governmental pension plans. This Statement results from a comprehensive review of the effectiveness of existing standards of accounting and financial reporting for pensions 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. 25, *Financial Reporting for Defined Benefit Pension Plans and Note Disclosures for Defined Contribution Plans*, and No. 50, *Pension Disclosures*, as they relate to pension plans that are administered through trusts or equivalent arrangements (hereafter jointly referred to as trusts) that meet certain criteria.

The requirements of Statements No. 25 and No. 50 remain applicable to pension plans that are not administered through trusts covered by the scope of this Statement and to defined contribution plans that provide postemployment benefits other than pensions.

This Statement is effective for financial statements for fiscal years beginning after June 15, 2013. 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 the pension plans that are within its scope. The new information will enhance the decision-usefulness of the financial reports of these pension plans, their value for assessing accountability, and their transparency by providing information about measures of net pension liabilities and explanations of how and why those liabilities changed from year to year. The net pension liability information, including ratios, will offer an up-to-date indication of the extent to which the total pension liability is covered by the fiduciary net position of the pension plan. The comparability of the reported information for similar types of pension plans will be improved by the changes related to the attribution method used to determine the total pension liability. The contribution schedule will provide measures to evaluate decisions related to the assessment of contribution rates in comparison to actuarially determined rates, when such rates are determined. In that circumstance, it also will provide information about whether employers and nonemployer contributing entities, if applicable, are keeping pace with actuarially determined contribution measures. In addition, new information about rates of return on pension plan investments will inform financial report users about the effects of market conditions on the pension plan's assets over time and provide information for users to assess the relative success of the pension plan's investment strategy and the relative contribution that investment earnings provide to the pension plan's ability to pay benefits to plan members when they come due.

Future Accounting Standard Changes - continued

GASB Statement No. 68 - *The Accounting and Financial Reporting of Pensions- an Amendment of GASB Statement No. 27*

The primary objective of this Statement is to improve accounting and financial reporting by state and local governments for pensions. It also improves information provided by state and local governmental employers about financial support for pensions 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 pensions with regard to providing decision-useful information, supporting assessments of accountability and interperiod equity, and creating additional transparency.

This Statement replaces the requirements of Statement No. 27, Accounting for Pensions by State and Local Governmental Employers, as well as the requirements of Statement No. 50, Pension Disclosures, as they relate to pensions that are provided through pension plans administered as trusts or equivalent arrangements (hereafter jointly referred to as trusts) that meet certain criteria. The requirements of Statements 27 and 50 remain applicable for pensions that are not covered by the scope of this Statement.

This Statement is effective for fiscal years beginning after June 15, 2014. 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 net pension liability and a more comprehensive measure of pension expense. Decision-usefulness and accountability also will be enhanced through new note disclosures and required supplementary information.

GASB Statement No. 69 - *Government Combinations and Disposals of Government Operations*

Summary

This Statement establishes accounting and financial reporting standards related to government combinations and disposals of government operations. As used in this Statement, the term government combinations include a variety of transactions referred to as mergers, acquisitions, and transfers of operations.

The distinction between a government merger and a government acquisition is based upon whether an exchange of significant consideration is present within the combination transaction. Government mergers include combinations of legally separate entities without the exchange of significant consideration. This Statement requires the use of carrying values to measure the assets and liabilities in a government merger. Conversely, government acquisitions are transactions in which a government acquires another entity, or its operations, in exchange for significant consideration. This Statement requires measurements of assets acquired and liabilities assumed generally to be based upon their acquisition values. This Statement also provides guidance for transfers of operations that do not constitute entire legally separate entities and in which no significant consideration is exchanged. This Statement defines the term operations for purposes of determining the applicability of this Statement and requires the use of carrying values to measure the assets and liabilities in a transfer of operations.

A disposal of a government's operations results in the removal of specific activities of a government. This Statement provides accounting and financial reporting guidance for disposals of government operations that have been transferred or sold.

This Statement requires disclosures to be made about government combinations and disposals of government operations to enable financial statement users to evaluate the nature and financial effects of those transactions.

The requirements of this Statement are effective for government combinations and disposals of government operations occurring in financial reporting periods beginning after December 15, 2013, and should be applied on a prospective basis. Earlier application is encouraged.

How the Changes in This Statement Will Improve Financial Reporting

Until now, governments have accounted for mergers, acquisitions, and transfers of operations by analogizing to accounting and financial reporting guidance intended for the business environment, generally APB Opinion No. 16, Business Combinations. This Statement provides specific accounting and financial reporting guidance for combinations in the governmental environment. This Statement also improves the decision usefulness of financial reporting by requiring that disclosures be made by governments about combination arrangements in which they engage and for disposals of government operations.

Future Accounting Standard Changes - continued

GASB Statement No. 70 - *Accounting and Financial Reporting for Nonexchange Financial Guarantees*

Summary

Some governments extend financial guarantees for the obligations of another government, a not-for-profit organization, a private entity, or individual without directly receiving equal or approximately equal value in exchange (a nonexchange transaction). As a part of this nonexchange financial guarantee, a government commits to indemnify the holder of the obligation if the entity or individual that issued the obligation does not fulfill its payment requirements. Also, some governments issue obligations that are guaranteed by other entities in a nonexchange transaction. The objective of this Statement is to improve accounting and financial reporting by state and local governments that extend and receive nonexchange financial guarantees.

This Statement requires a government that extends a nonexchange financial guarantee to recognize a liability when qualitative factors and historical data, if any, indicate that it is more likely than not that the government will be required to make a payment on the guarantee. The amount of the liability to be recognized should be the discounted present value of the best estimate of the future outflows expected to be incurred as a result of the guarantee. When there is no best estimate but a range of the estimated future outflows can be established, the amount of the liability to be recognized should be the discounted present value of the minimum amount within the range.

This Statement requires a government that has issued an obligation guaranteed in a nonexchange transaction to report the obligation until legally released as an obligor. This Statement also requires a government that is required to repay a guarantor for making a payment on a guaranteed obligation or legally assuming the guaranteed obligation to continue to recognize a liability until legally released as an obligor. When a government is released as an obligor, the government should recognize revenue as a result of being relieved of the obligation. This Statement also provides additional guidance for intra-entity nonexchange financial guarantees involving blended component units.

This Statement specifies the information required to be disclosed by governments that extend nonexchange financial guarantees. In addition, this Statement requires new information to be disclosed by governments that receive nonexchange financial guarantees.

The provisions of this Statement are effective for reporting periods beginning after June 15, 2013. Earlier application is encouraged. Except for disclosures related to cumulative amounts paid or received in relation to a nonexchange financial guarantee, the provisions of this Statement are required to be applied retroactively. Disclosures related to cumulative amounts paid or received in relation to a nonexchange financial guarantee may be applied prospectively.

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 consistent reporting by those governments that extend nonexchange financial guarantees and by those governments that receive nonexchange financial guarantees. This Statement also will enhance the information disclosed about a government's obligations and risk exposure from extending nonexchange financial guarantees. This Statement also will augment the ability of financial statement users to assess the probability that governments will repay obligation holders by requiring disclosures about obligations that are issued with this type of financial guarantee.

GASB Statement No. 71 - *Pension Transition for Contributions Made Subsequent to the Measure Date - an Amendment of GASB Statement No. 68*

Summary

The objective of this Statement is to address an issue regarding application of the transition provisions of Statement No. 68, Accounting and Financial Reporting for Pensions. The issue relates to amounts associated with contributions, if any, made by a state or local government employer or nonemployer contributing entity to a defined benefit pension plan after the measurement date of the government's beginning net pension liability.

Future Accounting Standard Changes - continued

Statement No. 68 requires a state or local government employer (or nonemployer contributing entity in a special funding situation) to recognize a net pension liability measured as of a date (the measurement date) no earlier than the end of its prior fiscal year. If a state or local government employer or nonemployer contributing entity makes a contribution to a defined benefit pension plan between the measurement date of the reported net pension liability and the end of the government's reporting period, Statement No. 68 requires that the government recognize its contribution as a deferred outflow of resources. In addition, Statement No. 68 requires recognition of deferred outflows of resources and deferred inflows of resources for changes in the net pension liability of a state or local government employer or nonemployer contributing entity that arise from other types of events. At transition to Statement No. 68, if it is not practical for an employer or nonemployer contributing entity to determine the amounts of all deferred outflows of resources and deferred inflows of resources related to pensions, paragraph 137 of Statement No. 68 required that beginning balances for deferred outflows of resources and deferred inflows of resources not be reported.

Consequently, if it is not practical to determine the amounts of all deferred outflows of resources and deferred inflows of resources related to pensions, contributions made after the measurement date of the beginning net pension liability could not have been reported as deferred outflows of resources at transition. This could have resulted in a significant understatement of an employer or nonemployer contributing entity's beginning net position and expense in the initial period of implementation.

This Statement amends paragraph 137 of Statement No. 68 to require that, at transition, a government recognize a beginning deferred outflow of resources for its pension contributions, if any, made subsequent to the measurement date of the beginning net pension liability. Statement No. 68, as amended, continues to require that beginning balances for other deferred outflows of resources and deferred inflows of resources related to pensions be reported at transition only if it is practical to determine all such amounts.

The provisions of this Statement are required to be applied simultaneously with the provisions of Statement No. 68.

How the Changes in This Statement Will Improve Financial Reporting

The requirements of this Statement will eliminate the source of a potential significant understatement of restated beginning net position and expense in the first year of implementation of Statement No. 68 in the accrual-basis financial statements of employers and nonemployer contributing entities. This benefit will be achieved without the imposition of significant additional costs.

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

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. The comments and recommendation in this report are purely constructive in nature, and should be read in this context.

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
May 7, 2014

People + Process. Going Beyond the Numbers