

# Management Letter

## City of Loretto

Loretto, Minnesota

For the Year Ended  
December 31, 2017

Management, Honorable Mayor and City Council  
City of the Loretto, Minnesota

We have audited each major fund of the governmental and proprietary funds and the aggregate remaining fund information of the City of Loretto, Minnesota (the City) for the year ended December 31, 2017. 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 November 7, 2017. In our report, our opinion was adverse because the City prepared its financial statements on the regulatory basis, which is a special purpose framework other than accounting principles generally accepted in the United States of America. 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 the regulatory basis of accounting prescribed by the Minnesota Office of the State Auditor. 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 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 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. 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 certain deficiencies in internal control described on the following pages as findings 2017-001 and 2017-002 that we consider to be significant deficiencies.

**2017-001**

**Limited Segregation of Duties**

*Condition:* During our audit we reviewed procedures over disbursements, cash receipts, payroll and utility billing and found the City to have limited segregation of duties over those transaction cycles.

*Criteria:* There are four general categories of duties: authorization, custody, record keeping and reconciliation. In an ideal system, different employees perform each of these four major functions. In other words, no one person has control of two or more of these responsibilities.

*Cause:* As a result of the limited number of staff, in the disbursements cycle, the City Clerk has control over check stock, enters transactions into the accounting system, receives the bank statement, and also reconciles the bank account on a monthly basis. In the receipts cycle, the Utility Clerk opens mail, posts to the utility billing software and prepares the deposit. In the payroll cycle, the City Clerk has control over the checks, sets up employee records, approves timesheets and the payroll, posts to the general ledger and reconciles bank accounts. In the utility billing cycle, the City Council approves rates but the Utility Clerk, does all other duties, with oversight by the City Clerk.

*Effect:* The existence of this limited segregation of duties increases the risk of fraud.

*Recommendation:* While we recognize staff is not large enough to eliminate this deficiency, we recommend that the City evaluate the current procedures and segregate duties where possible and implement any compensating controls. Compensating controls could consist of additional monitoring and review, such as approving all adjustments with utility billing, review of payroll records, and review of bank statements prior to the City Clerk receiving them. It is important that the City Council is aware of this condition and monitor all financial information.

*Management Response:*

Management recognizes that it is not economically feasible to correct this finding, is aware of the deficiency and is relying on oversight by management and the City Council to monitor this deficiency.

*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. 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. 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 organizations of your size. However, based on auditing standards, 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 a disclosure checklist is 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 deficiency and thoroughly reviews a draft of the financial statements.

### **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 grants, 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 under *Government Auditing Standards* or statutes set forth by the State of Minnesota.

### **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. No new accounting policies were adopted and the application of existing policies were not changed during the year ended December 31, 2017. 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 include depreciation on capital assets, allocation of payroll and the liability for the defined benefit contribution plan.

- 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 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.
- Management's estimate of its portion of the City's net pension liabilities related to its proportionate share of PERA pensions (assets) are based on the City's contributions in relation to all contributions to each plan as a whole. The overall net pension liability for PERA is based on several factors including, but not limited to, anticipated retirement age for active employees, life expectancy, survivor life expectancy, and high-five salary.

We evaluated the key factors and assumptions used to develop these accounting estimates in determining that it is 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. In addition, none of the misstatements detected as a result of audit procedures and corrected by management were material, either individually or in the aggregate, to the financial statements taken as a whole.

#### **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, which 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 February 19, 2018.

#### **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 governmental unit'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) (the Schedule of Employer's Share of the Net Pension Liability and the Schedule 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 (individual fund financial 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 or the supplementary information, 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 them.

## Financial Position and Results of Operations

Our principal observations and recommendations are summarized below. These recommendations resulted from our observations made in connection with our audit of the City's financial statements for the year ended December 31, 2017.

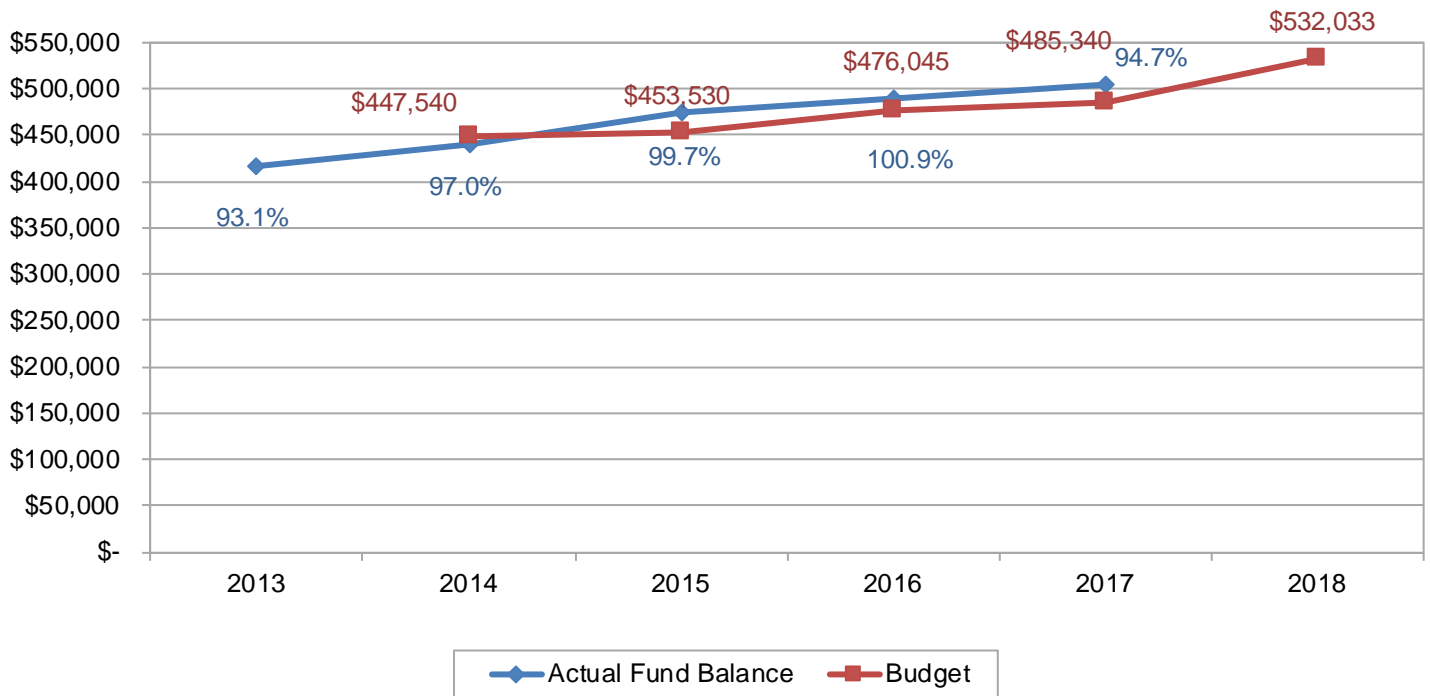
### General Fund

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 \$13,768 from 2016. The fund balance of \$503,613 is 94.7 percent of the 2018 budgeted expenditures. We recommend 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 identifies a targeted level of an amount not less than 50 percent of the next year's budgeted disbursements. The City's ending fund balance is above this target level.

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

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

## Fund Balance as a Percent of Next Year's Budgeted Disbursements



We have compiled a peer group average derived from information we have requested from the Office of the State Auditor and then compiled data for Cities who report under the Regulatory basis. In 2015 and 2016, the average General fund balance as a percentage of expenditures was 114 percent and 116 percent, respectively. Based on comparison to the peer groups, the City's General fund balance is comparable with the average.

The 2017 General fund operations are summarized as follows:

	Budgeted Amounts		Actual Amounts	Variance with Final Budget
	Original	Final		
Receipts	\$ 480,340	\$ 480,340	\$ 554,368	\$ 74,028
Disbursements	485,340	485,340	508,100	(22,760)
Excess of Receipts over Disbursements	<u>(5,000)</u>	<u>(5,000)</u>	<u>46,268</u>	<u>51,268</u>
Other Financing Sources (Uses)				
Transfers in	5,000	5,000	-	(5,000)
Transfers out	-	-	(32,500)	(32,500)
Total Other Financing Sources (Uses)	<u>5,000</u>	<u>5,000</u>	<u>(32,500)</u>	<u>(37,500)</u>
Net Change in Cash Fund Balances	-	-	13,768	13,768
Cash Fund Balances, January 1	<u>489,845</u>	<u>489,845</u>	<u>489,845</u>	<u>-</u>
Cash Fund Balances, December 31	<u>\$ 489,845</u>	<u>\$ 489,845</u>	<u>\$ 503,613</u>	<u>\$ 13,768</u>

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

- Receipts from Fire State Aids were \$19,638 over budget due to the receipt of fire aid over expectation.
- Refunds and reimbursements were \$11,705 over budget due to reimbursements to cover the shared costs of tractor repairs.
- Licenses and permits were over budget by \$9,836
- The fire department within the public safety function was over budget by \$22,809. This variance relates to the remittance of unbudgeted fire state aid receipts as noted above.
- Actual transfers vary from budgeted amounts due to the following factors:
  - The City budgeted a \$5,000 transfer in from the TIF fund. \$5,000 was applied to the reduction of the related interfund loan and although cash was allocated between funds, a transfer in was not recorded.
  - The City transferred \$32,500 to the Capital Improvement fund for current and future capital purchases.

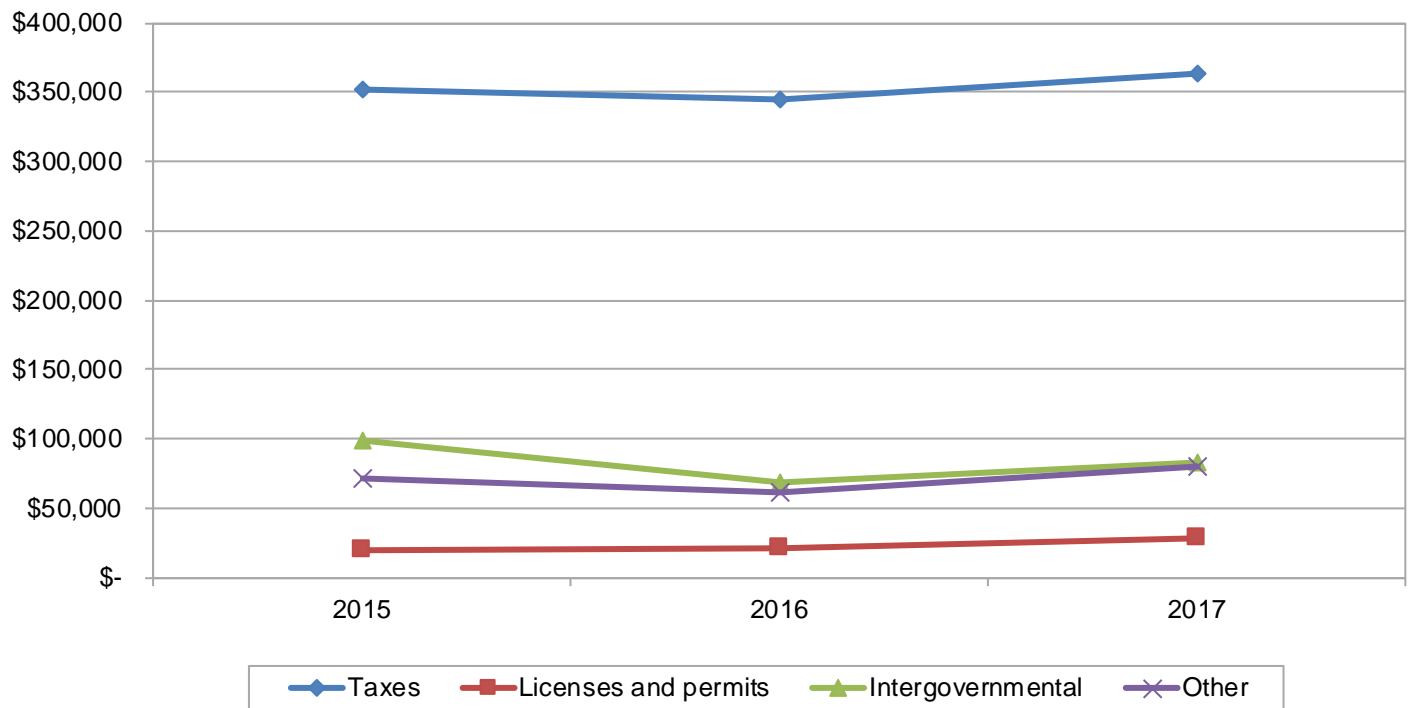


A more detailed comparison of General fund receipts and transfers is as follows:

Source	2015	2016	2017	Percent of Total	Per Capita
Taxes	\$ 351,612	\$ 344,645	\$ 363,688	65.6 %	\$ 560
Licenses and Permits	20,223	20,646	28,136	5.1	43
Intergovernmental	98,416	68,074	82,610	14.9	127
Charges for Services	2,375	4,157	2,974	0.5	5
Fines and Forfeitures	4,491	3,078	5,068	0.9	8
Interest on Investments	239	445	1,389	0.3	2
Miscellaneous	64,986	53,478	70,503	12.7	109
<b>Total Receipts and Transfers</b>	<b>\$ 542,342</b>	<b>\$ 494,523</b>	<b>\$ 554,368</b>	<b>100.0 %</b>	<b>\$ 854</b>

The receipts are graphically presented for the past three years as follows:

### Receipts



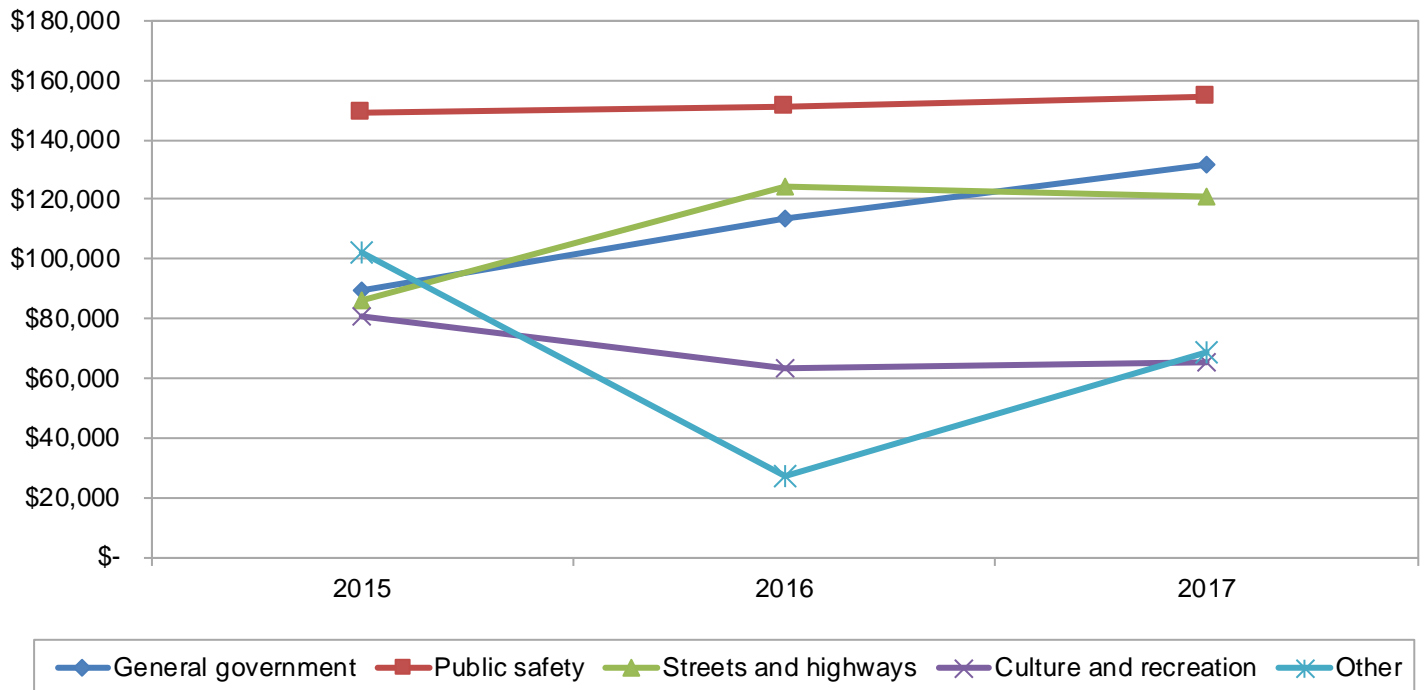
A more detailed comparison of disbursements and transfers is as follows:

Program	2015	2016	2017	Percent of Total	Per Capita	Peer Group Per Capita
General Government	\$ 89,188	\$ 113,832	\$ 131,419	24.2 %	\$ 202	\$ 223
Public Safety	149,134	151,146	154,372	28.6	238	221
Streets and Highways	86,350	124,200	120,672	22.3	186	168
Culture Aand Recreation	80,460	63,152	65,273	12.1	101	52
Miscellaneous	360	706	(239)	-	-	32
Capital Outlay	71,994	8,869	36,603	6.8	56	79
Transfers Out	29,522	17,500	32,500	6.0	50	-
<b>Total Disbursements and Transfers</b>	<b>\$ 507,008</b>	<b>\$ 479,405</b>	<b>\$ 540,600</b>	<b>100.0 %</b>	<b>\$ 833</b>	<b>\$ 775</b>

The above chart compares the amount your City spends per capita, in comparison to a peer group. The peer group average is compiled from information we have requested from the Office of the State Auditor for Cities who report under the regulatory basis.

The disbursements are presented graphically for the past three years as follows:

### Disbursements



## Special Revenue Fund

The City maintains the following special revenue fund:

Fund	Fund Balance December 31,		Increase (Decrease)
	2017	2016	
TIF District 1	\$ (3,338)	\$ (6,418)	\$ 3,080

This fund accounts for the TIF activity. Currently the General fund is financing the deficit. During 2017 TIF District 1 paid \$5,000 of interest on the interfund loan. The loan has a remaining balance of \$32,313. There is a ending cash balance of \$28,975. The City plans on paying \$5,000 on the loan annually.

## Capital Projects Funds

The City maintains the following capital project funds:

Fund	Fund Balance December 31,		Increase (Decrease)
	2017	2016	
Major Capital Improvements	\$ 125,190	\$ 117,767	\$ 7,423
Nonmajor Lions Park	\$ 9,652	\$ -	\$ 9,652

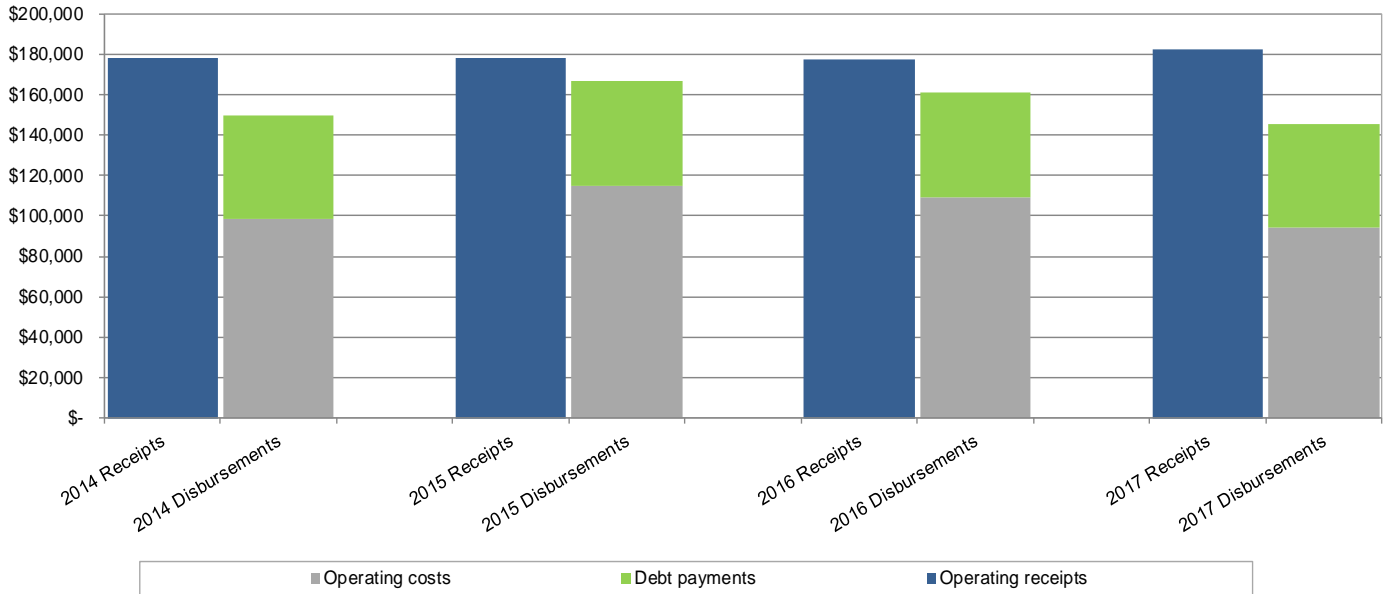
The capital improvements funds account for the resources accumulated and payments made for various capital purchases and improvement projects.

## Enterprise Funds

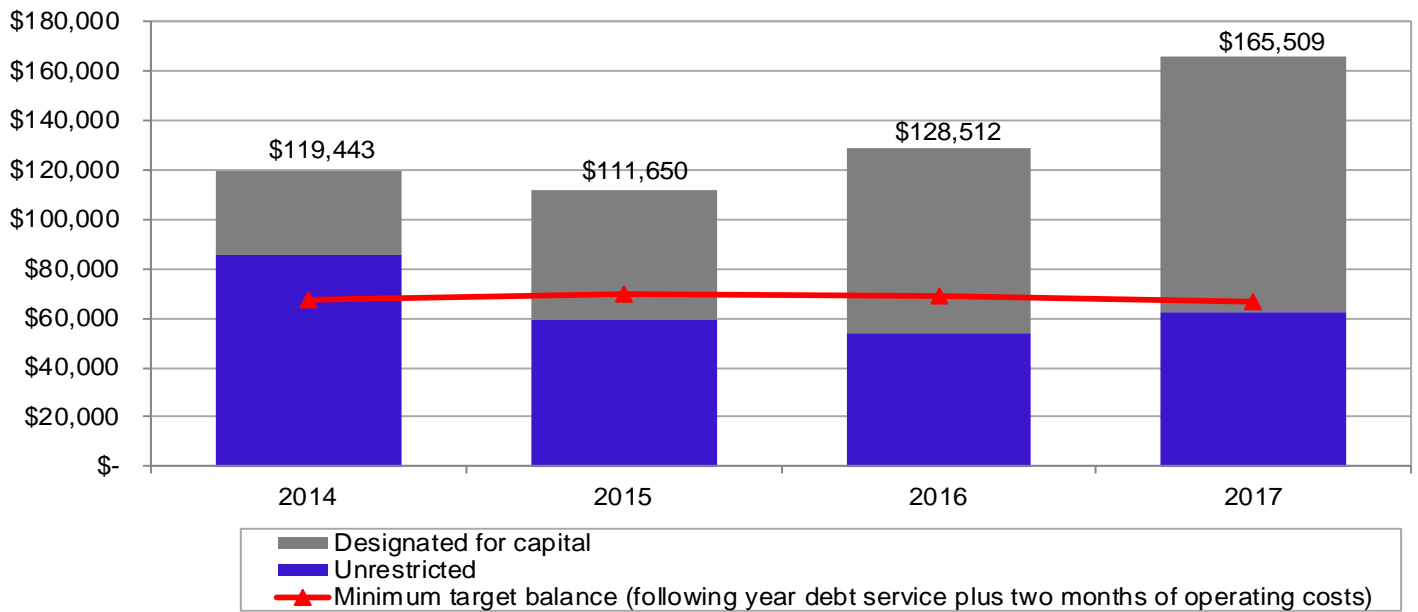
### Water Fund

The results of the operations in terms of cash flows and the breakdown of the cash balances for the past four years are as follows:

#### Water Fund Cash Flows



#### Water Fund Cash Balances



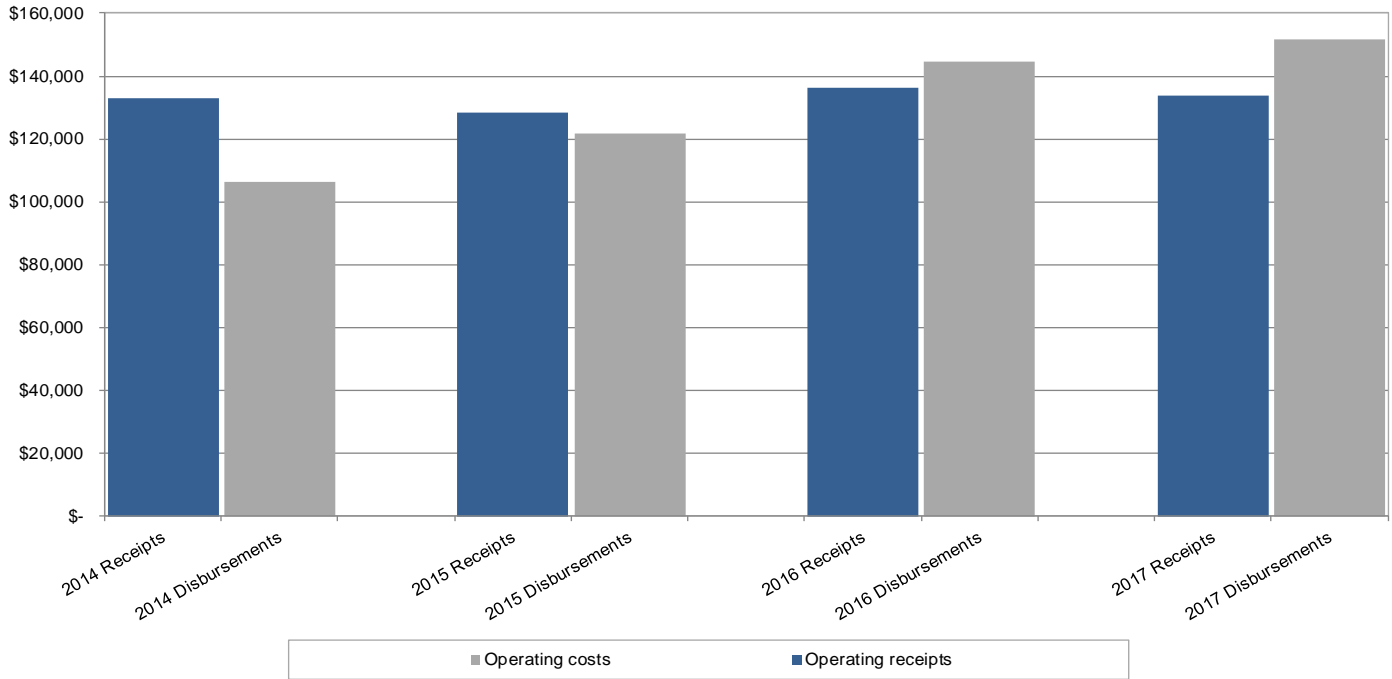
	2014	2015	2016	2017
Bonds Payable	<u>\$ 493,000</u>	<u>\$ 453,000</u>	<u>\$ 412,000</u>	<u>\$ 370,000</u>

Operating margins are sufficient to keep pace with operating expenses. The increase in cash for 2017 is a result of an excess of operating receipts over operating costs and debt payments. Of the 2017 cash balance, approximately \$102,730 has been internally designated for capital.

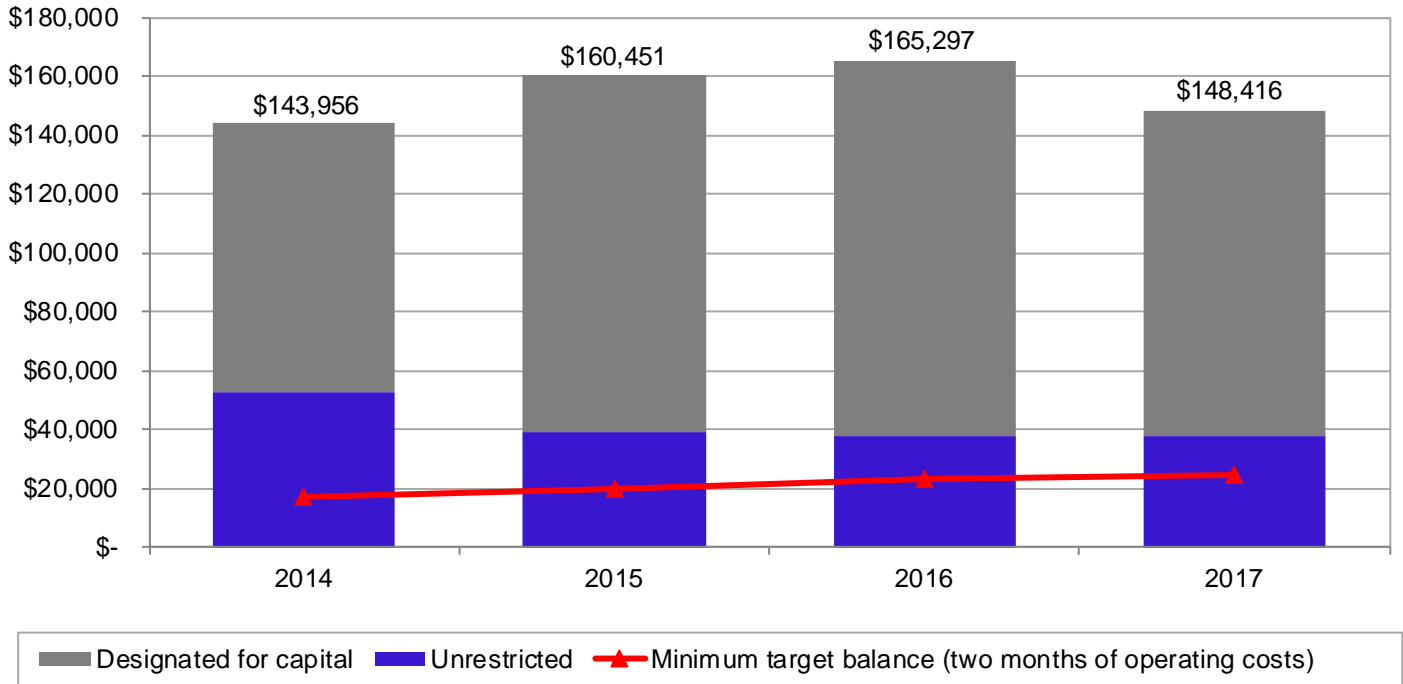
Wastewater Fund

The results of the operations in terms of cash flows and the breakdown of the cash balances for the past four years are as follows:

**Wastewater Fund Cash Flows**



**Wastewater Fund Cash Balances**

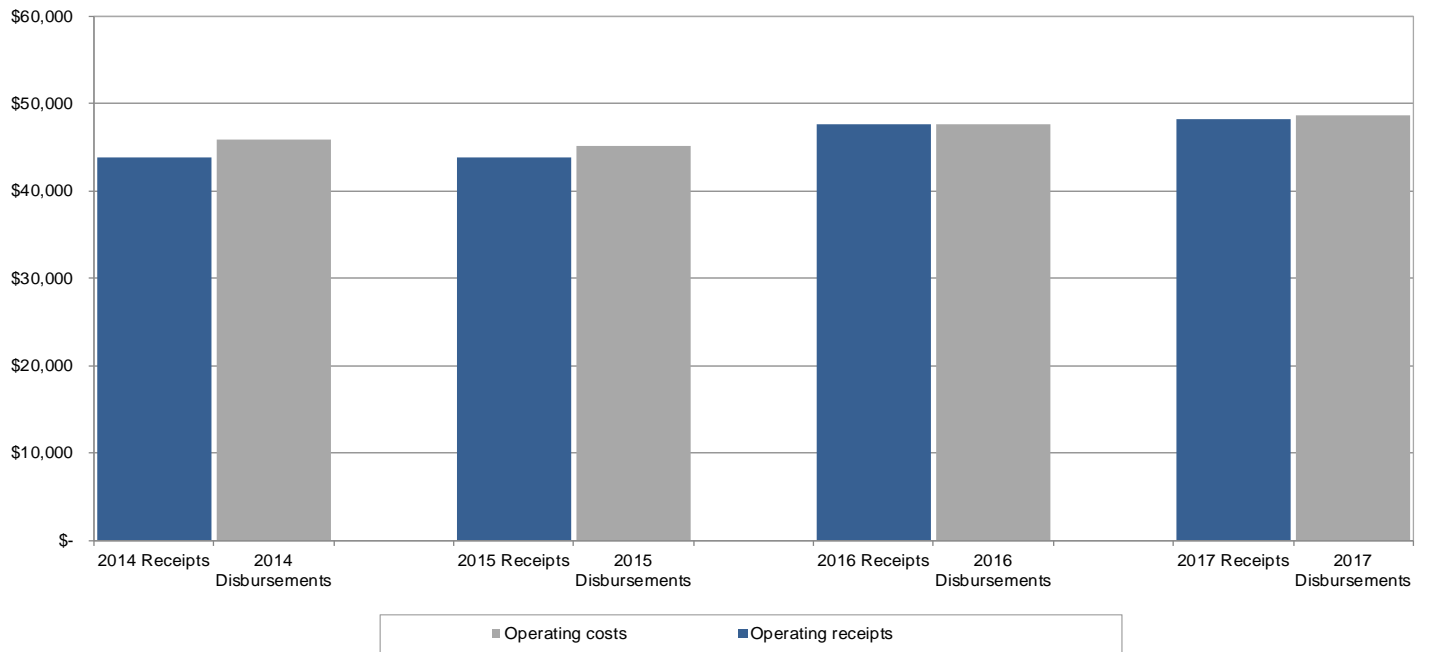


Of the 2017 cash balance, approximately \$110,000 has been internally designated for capital. As planning commences for the wastewater improvement project, the City should evaluate current cash balances and possible other funding sources.

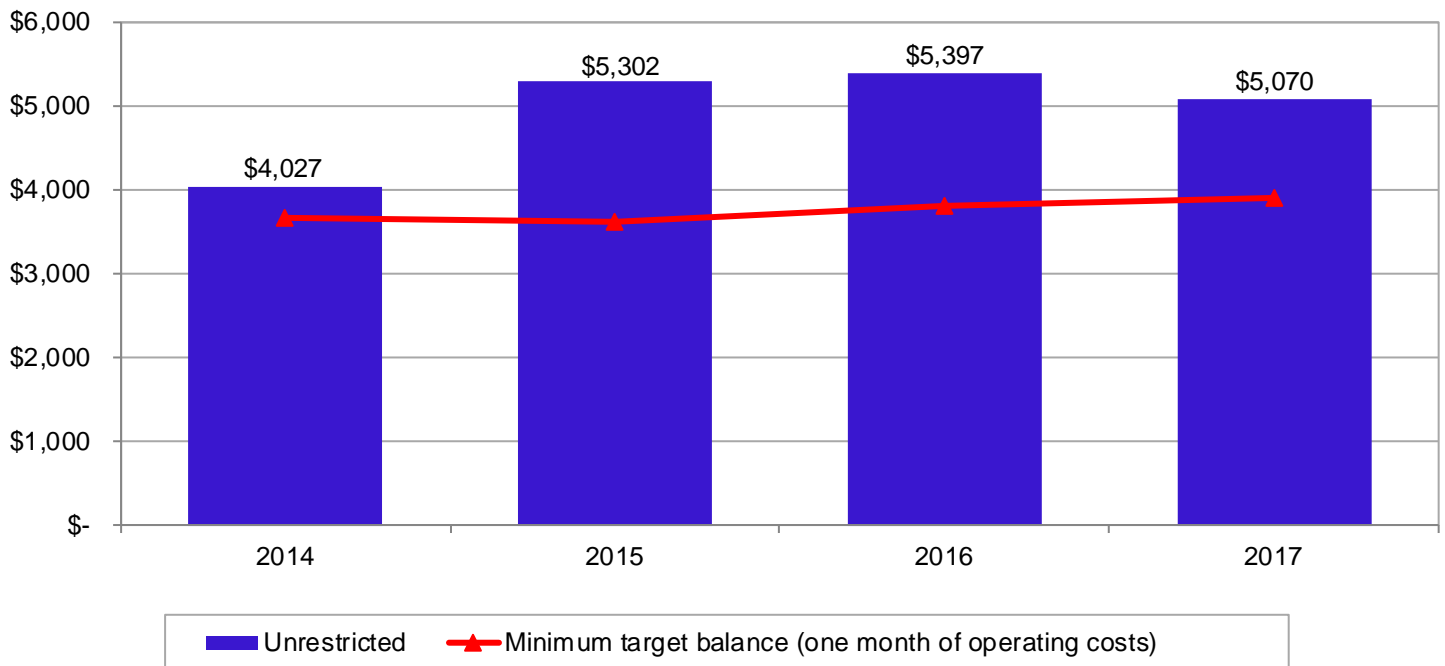
*Garbage Fund*

The results of the operations in terms of cash flows and the breakdown of the cash balances for the past four years are as follows:

**Garbage Fund Cash Flows**



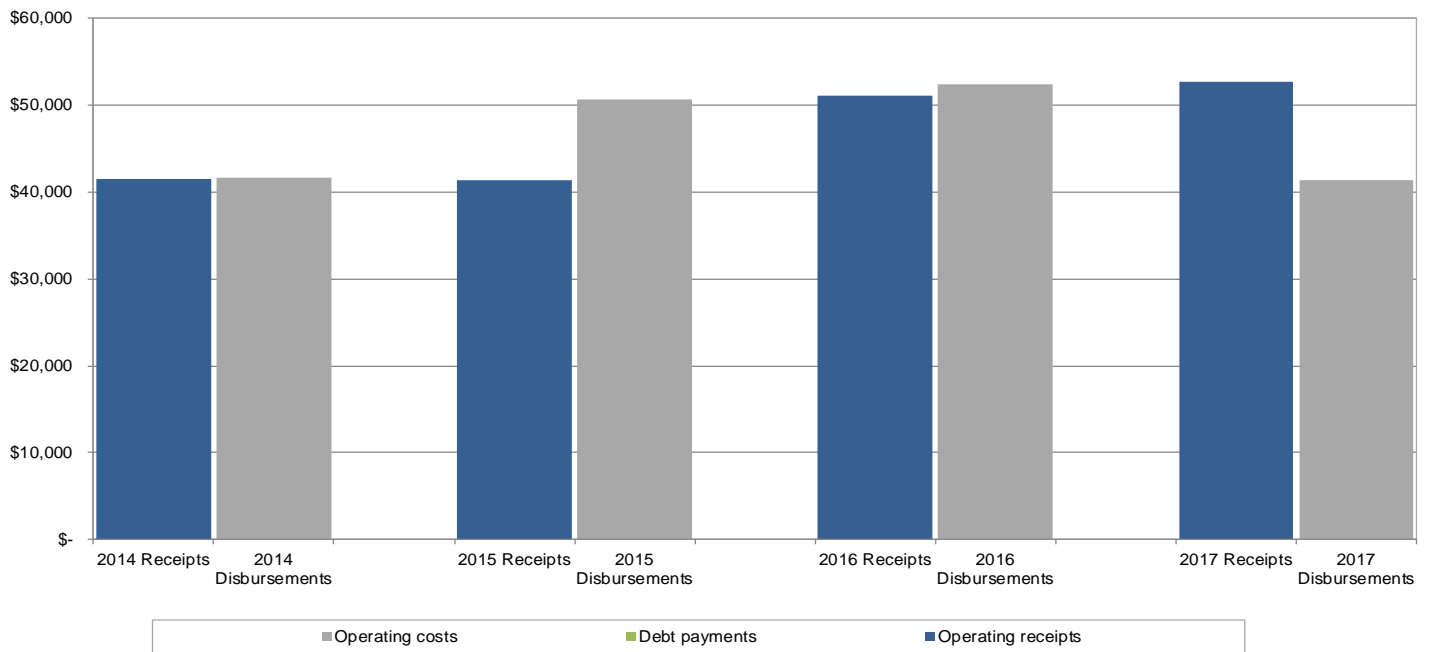
**Garbage Fund Cash Balances**



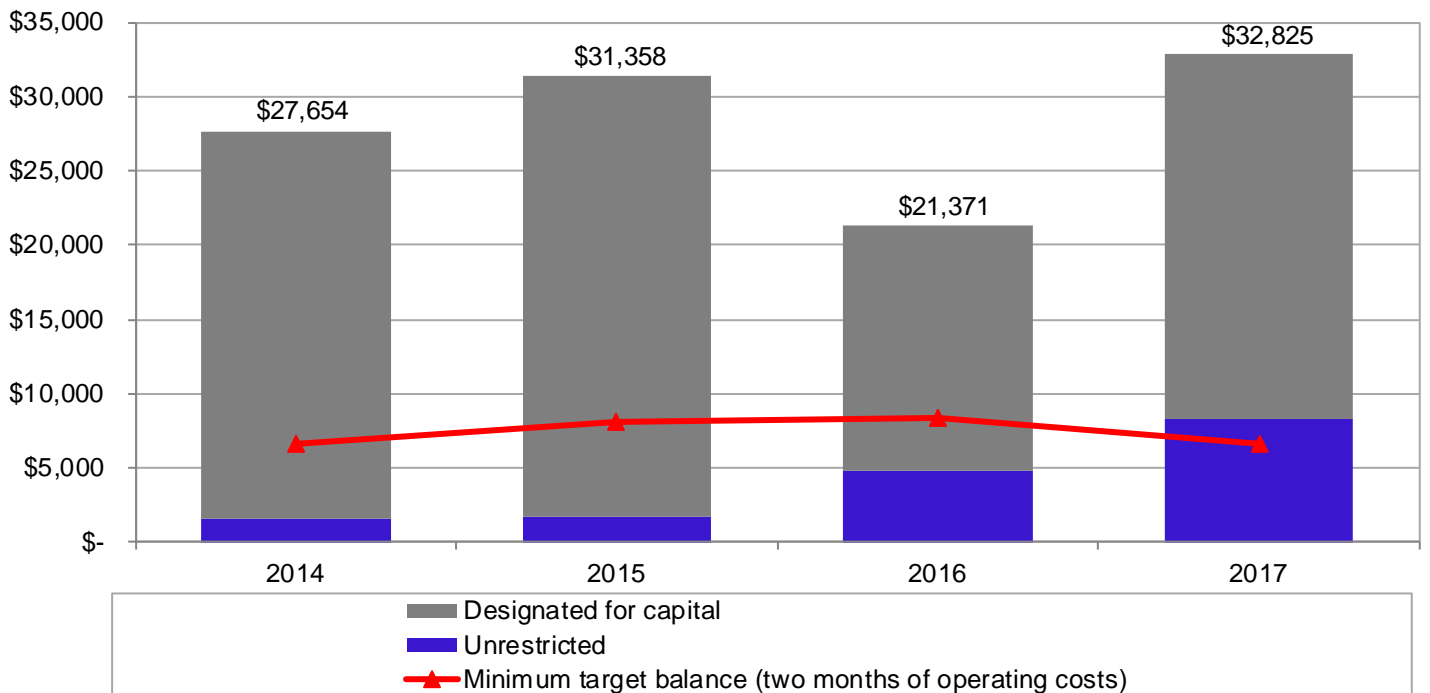
Storm Water Fund

The results of the operations in terms of cash flows and the breakdown of the cash balances for the past four years are as follows:

**Storm Water Fund Cash Flows**



**Storm Water Fund Cash Balances**



In 2017, the undesignated cash balance of the Storm Water fund is above the targeted balance (approximately \$6,000), which includes approximately 2 months of operating costs. Of the 2017 cash balance, approximately \$24,000 has been internally designated for capital.

## 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 available on the website of the Office of the State Auditor. A combination of 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) ratios are shown below.

Ratio	Calculation	Source	2014	2015	2016	2017
Debt Service Coverage	Net cash provided by operations/ enterprise fund debt payments	Enterprise funds	156%	122%	132%	171%
			110%	110%	141%	N/A
Debt Per Capita	Bonded debt/population	Government-wide	\$ 766	\$ 703	\$ 639	\$ 570
			\$ 2,702	\$ 2,080	\$ 2,387	N/A
Taxes Per Capita	Tax revenues/population	Government-wide	\$ 530	\$ 546	\$ 534	\$ 560
			\$ 457	\$ 482	\$ 552	N/A
Current Expenditures Per Capita	Governmental fund current expenditures / population	Governmental funds	\$ 656	\$ 656	\$ 715	\$ 743
			\$ 859	\$ 855	\$ 830	N/A
Capital Expenditures Per Capita	Governmental fund capital outlay / population	Governmental funds	\$ 124	\$ 166	\$ 36	\$ 96
			\$ 258	\$ 256	\$ 274	N/A
Capital Assets % Left to Depreciate - Business-type	Net capital assets/ gross capital assets	Government-wide	79%	76%	74%	70%
			63%	64%	64%	N/A

Represents the City of Loretto

Peer Group Average



### **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 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. For Loretto, all assets purchased or constructed prior to 2005 are considered fully depreciated and are not included in the financial statements or this ratio calculation.

## 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: <sup>(1)</sup>

### **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.

## Future Accounting Standard Changes (Continued)

- 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.

## Future Accounting Standard Changes (Continued)

### GASB Statement No. 83 - *Certain Asset Retirement Obligations*

#### Summary

This Statement addresses accounting and financial reporting for certain asset retirement obligations (AROs). An ARO is a legally enforceable liability associated with the retirement of a tangible capital asset. A government that has legal obligations to perform future asset retirement activities related to its tangible capital assets should recognize a liability based on the guidance in this Statement.

This Statement establishes criteria for determining the timing and pattern of recognition of a liability and a corresponding deferred outflow of resources for AROs. This Statement requires that recognition occur when the liability is both incurred and reasonably estimable. The determination of when the liability is incurred should be based on the occurrence of external laws, regulations, contracts, or court judgments, together with the occurrence of an internal event that obligates a government to perform asset retirement activities. Laws and regulations may require governments to take specific actions to retire certain tangible capital assets at the end of the useful lives of those capital assets, such as decommissioning nuclear reactors and dismantling and removing sewage treatment plants. Other obligations to retire tangible capital assets may arise from contracts or court judgments. Internal obligating events include the occurrence of contamination, placing into operation a tangible capital asset that is required to be retired, abandoning a tangible capital asset before it is placed into operation, or acquiring a tangible capital asset that has an existing ARO.

This Statement requires the measurement of an ARO to be based on the best estimate of the current value of outlays expected to be incurred. The best estimate should include probability weighting of all potential outcomes, when such information is available or can be obtained at reasonable cost. If probability weighting is not feasible at reasonable cost, the most likely amount should be used. This Statement requires that a deferred outflow of resources associated with an ARO be measured at the amount of the corresponding liability upon initial measurement.

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

A government may have a minority share (less than 50 percent) of ownership interest in a jointly owned tangible capital asset in which a nongovernmental entity is the majority owner and reports its ARO in accordance with the guidance of another recognized accounting standards setter. Additionally, a government may have a minority share of ownership interest in a jointly owned tangible capital asset in which no joint owner has a majority ownership, and a nongovernmental joint owner that has operational responsibility for the jointly owned tangible capital asset reports the associated ARO in accordance with the guidance of another recognized accounting standards setter. In both situations, the government's minority share of an ARO should be reported using the measurement produced by the nongovernmental majority owner or the nongovernmental minority owner that has operational responsibility, without adjustment to conform to the liability measurement and recognition requirements of this Statement.

In some cases, governments are legally required to provide funding or other financial assurance for their performance of asset retirement activities. This Statement requires disclosure of how those funding and assurance requirements are being met by a government, as well as the amount of any assets restricted for payment of the government's AROs, if not separately displayed in the financial statements.

This Statement also requires disclosure of information about the nature of a government's AROs, the methods and assumptions used for the estimates of the liabilities, and the estimated remaining useful life of the associated tangible capital assets. If an ARO (or portions thereof) has been incurred by a government but is not yet recognized because it is not reasonably estimable, the government is required to disclose that fact and the reasons therefor. This Statement requires similar disclosures for a government's minority shares of AROs.

#### Effective Date

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

## **Future Accounting Standard Changes (Continued)**

### **How the Changes in This Statement Will Improve Financial Reporting**

This Statement will enhance comparability of financial statements among governments by establishing uniform criteria for governments to recognize and measure certain AROs, including obligations that may not have been previously reported. This Statement also will enhance the decision-usefulness of the information provided to financial statement users by requiring disclosures related to those AROs.

#### **GASB Statement No. 84 - *Fiduciary Activities***

##### **Summary**

The objective of this Statement is to improve guidance regarding the identification of fiduciary activities for accounting and financial reporting purposes and how those activities should be reported.

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

An activity meeting the criteria should be reported in a fiduciary fund in the basic financial statements. Governments with activities meeting the criteria should present a statement of fiduciary net position and a statement of changes in fiduciary net position. An exception to that requirement is provided for a business-type activity that normally expects to hold custodial assets for three months or less.

This Statement describes four fiduciary funds that should be reported, if applicable: (1) pension (and other employee benefit) trust funds, (2) investment trust funds, (3) private-purpose trust funds, and (4) custodial funds. Custodial funds generally should report fiduciary activities that are not held in a trust or equivalent arrangement that meets specific criteria.

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

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

##### **Effective Date**

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

### **How the Changes in This Statement Will Improve Financial Reporting**

The requirements of this Statement will enhance consistency and comparability by (1) establishing specific criteria for identifying activities that should be reported as fiduciary activities and (2) clarifying whether and how business-type activities should report their fiduciary activities. Greater consistency and comparability enhances the value provided by the information reported in financial statements for assessing government accountability and stewardship.

## **Future Accounting Standard Changes (Continued)**

### **GASB Statement No. 85 - Omnibus 2017**

#### **Summary**

The objective of this Statement is to address practice issues that have been identified during implementation and application of certain GASB Statements. This Statement addresses a variety of topics including issues related to blending component units, goodwill, fair value measurement and application, and postemployment benefits (pensions and other postemployment benefits [OPEB]). Specifically, this Statement addresses the following topics:

- Blending a component unit in circumstances in which the primary government is a business-type activity that reports in a single column for financial statement presentation
- Reporting amounts previously reported as goodwill and “negative” goodwill
- Classifying real estate held by insurance entities
- Measuring certain money market investments and participating interest-earning investment contracts at amortized cost
- Timing of the measurement of pension or OPEB liabilities and expenditures recognized in financial statements prepared using the current financial resources measurement focus
- Recognizing on-behalf payments for pensions or OPEB in employer financial statements
- Presenting payroll-related measures in required supplementary information for purposes of reporting by OPEB plans and employers that provide OPEB
- Classifying employer-paid member contributions for OPEB
- Simplifying certain aspects of the alternative measurement method for OPEB
- Accounting and financial reporting for OPEB provided through certain multiple-employer defined benefit OPEB plans.

#### **Effective Date**

The requirements of this Statement are effective for reporting periods 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 enhance consistency in the application of accounting and financial reporting requirements. Consistent reporting will improve the usefulness of information for users of state and local government financial statements.

### **GASB Statement No. 86 - Certain Debt Extinguishment Issues**

#### **Summary**

The primary objective of this Statement is to improve consistency in accounting and financial reporting for in-substance defeasance of debt by providing guidance for transactions in which cash and other monetary assets acquired with only existing resources - resources other than the proceeds of refunding debt - are placed in an irrevocable trust for the sole purpose of extinguishing debt. This Statement also improves accounting and financial reporting for prepaid insurance on debt that is extinguished and notes to financial statements for debt that is defeased in substance.

## Future Accounting Standard Changes (Continued)

### Effective Date

The requirements of this Statement are effective for reporting periods beginning after June 15, 2017. Earlier application is encouraged.

### How the Changes in This Statement Will Improve Accounting and Financial Reporting

The requirements of this Statement will increase consistency in accounting and financial reporting for debt extinguishments by establishing uniform guidance for derecognizing debt that is defeased in substance, regardless of how cash and other monetary assets placed in an irrevocable trust for the purpose of extinguishing that debt were acquired. The requirements of this Statement also will enhance consistency in financial reporting of prepaid insurance related to debt that has been extinguished. In addition, this Statement will enhance the decision-usefulness of information in notes to financial statements regarding debt that has been defeased in substance.

## GASB Statement No. 87 - Leases

### Summary

The objective of this Statement is to better meet the information needs of financial statement users by improving accounting and financial reporting for leases by governments. This Statement increases the usefulness of governments' financial statements by requiring recognition of certain lease assets and liabilities for leases that previously were classified as operating leases and recognized as inflows of resources or outflows of resources based on the payment provisions of the contract. It establishes a single model for lease accounting based on the foundational principle that leases are financings of the right to use an underlying asset. Under this Statement, a lessee is required to recognize a lease liability and an intangible right-to-use lease asset, and a lessor is required to recognize a lease receivable and a deferred inflow of resources, thereby enhancing the relevance and consistency of information about governments' leasing activities.

### Effective Date and Transition

The requirements of this Statement are effective for reporting periods beginning after December 15, 2019. Earlier application is encouraged.

Leases should be recognized and measured using the facts and circumstances that exist at the beginning of the period of implementation (or, if applied to earlier periods, the beginning of the earliest period restated). However, lessors should not restate the assets underlying their existing sales-type or direct financing leases. Any residual assets for those leases become the carrying values of the underlying assets.

### How the Changes in This Statement Will Improve Accounting and Financial Reporting

This Statement will increase the usefulness of governments' financial statements by requiring reporting of certain lease liabilities that currently are not reported. It will enhance comparability of financial statements among governments by requiring lessees and lessors to report leases under a single model. This Statement also will enhance the decision-usefulness of the information provided to financial statement users by requiring notes to financial statements related to the timing, significance, and purpose of a government's leasing arrangements.

<sup>(1)</sup> *Note.* From GASB Pronouncements Summaries. Copyright 2017 by the Financial Accounting Foundation, 401 Merritt 7, Norwalk, CT 06856, USA, and is reproduced with permission.

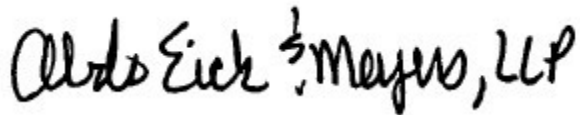
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## Restriction on Use

This communication is intended solely for the information and use of management, City Council, the Minnesota Office of the State Auditor and others within the City and is not intended to be and should not be used by anyone other than these 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 recommendations in the 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 opportunity to be of service and for the courtesy and cooperation extended to us by your staff.

A handwritten signature in black ink that reads "Aldo Eick & Meyers, LLP". The signature is written in a cursive, flowing style.

ABDO, EICK & MEYERS, LLP  
Minneapolis, Minnesota  
February 19, 2018