Management Letter

City of Northfield

Northfield, Minnesota

For the Year Ended
December 31, 2017

ABDO EICK & MEYERS LLP
Certified Public Accountants & Consultants

June 12, 2018

Management, Honorable Mayor and City Council
City of Northfield, Minnesota

We have audited the financial statements of the governmental activities, the business-type activities, the aggregate discretely presented component units, each major fund and the aggregate remaining fund information of the City of Northfield (the City) for the year ended December 31, 2017. We did not audit the financial statements of the Northfield Municipal Hospital discretely presented component unit. Those financial statements were audited by other auditors, whose report has been furnished to us, and our opinion insofar as it relates to the amounts included for the Northfield Municipal Hospital, is based solely on the report of the other auditors. Professional standards require that we provide you with the following information about our responsibilities under generally accepted auditing standards, *Governmental 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 30, 2017. Professional standards also require that we communicate to you the following information related to our audit.

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

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

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

Significant Audit Findings

In planning and performing our audit, we considered the City's internal control over financial reporting as a basis for designing our auditing procedures for the purpose of expressing our opinion on the financial statements, but not for the purpose of expressing an opinion on the effectiveness of the City's internal control over financial reporting. Accordingly, we do not express an opinion on the effectiveness of the City's internal control over financial reporting.

Our consideration of internal control over financial reporting was for the limited purpose described in the preceding paragraph and was not designed to identify all deficiencies in internal control over financial reporting that might be significant deficiencies or material weaknesses and therefore, there can be no assurance that all deficiencies, significant deficiencies, or material weaknesses have been identified. However, as described below, we identified certain deficiencies in internal control over financial reporting that we consider to be material weaknesses and other deficiencies that we consider to be significant deficiencies.

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. We considered the deficiency described below as finding 2017-001 to be a material weakness.

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2017-001 **Material Audit Adjustments**

Condition: During our audit, adjustments were needed to record a number of accounting and audit adjustments, including the following material entries:

- To adjust accrued salaries and wages payable.
- To adjust due from other governments.
- To record additional interfund transfers.
- To adjust special assessment revenue.
- To record capital assets.
- To adjust debt activity.

Criteria: The financial statements are the responsibility of the City's management.

Cause: City staff has not prepared a year-end trial balance reflecting all necessary accounting entries.

Effect: This indicates that it would be likely that a misstatement may occur and not be detected by the City's system of internal control. The audit firm cannot serve as a compensating control over this deficiency.

Recommendation: We recommend that management review each 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 has made improvements in recording year-end adjustments. Management will review and gain an understanding of the audit adjustments in order to reduce the number of entries necessary for future audits.

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 below as finding 2017-002 to be a significant deficiency.

2017-002 **Preparation of Financial Statements**

Condition: As in prior years, we were requested to draft the audited financial statements and related footnote disclosures as part of our regular audit services. Recent auditing standards require auditors to communicate this situation to the 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. However, based on recent 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 ensure adequate internal control over safeguarding of assets and the reliability of financial records and reporting.

Cause: From a practical standpoint, we prepare the statements and determine the fairness of the presentation at the same time in connection with out 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. 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 situation 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 software financial information to the amount reported in the financial statements.

Management Response:

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

Compliance 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, grant agreements, and other matters noncompliance with which could have a direct and material effect on the determination of financial statement amounts. However, providing an opinion on compliance with those provisions was not an objective of our audit. While our audit provides a reasonable basis for our opinion, it does not provide a legal determination on the City's compliance with those requirements. The results of our tests disclosed one instance of noncompliance or other matters that is required to be reported under *Government Auditing Standards,* or Minnesota statutes.

Qualitative Aspects of Accounting Practices

Management is responsible for the selection and use of appropriate accounting policies. The significant accounting policies used by the City are described in Note 1 to the financial statements. 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 City were capital asset basis, depreciation, compensated absences, other postemployment benefits and the liability for the City's pension.

- Management's estimate of capital asset basis is based on estimated historical cost of the capital assets and depreciation is based on the estimated useful lives of capital assets.

- Compensated absences are based on vacation and sick hours accrued at year end.

- Other postemployment benefits are based on an actuarial calculation. 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.

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

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 four material journal entries that we consider to be audit entries or corrections of management decisions. They related to the following situations:

- To adjust accrued salaries and wages payable.
- To adjust due from other governments.
- To record additional interfund transfers.
- To adjust special assessment revenue.

We also 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 should establish more detailed processes and procedures to reduce the total number of entries needed. 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 representation letter dated June 12, 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 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

We applied certain limited procedures to the required supplementary information (RSI) (Management’s Discussion and Analysis, the Schedules of Employer’s Share of the Net Pension Liability, the Schedules of Employer’s Contributions and the Schedule of Funding Progress for Other Post-Employment Benefits Plan), which is information that supplements the basic financial statements. Our procedures consisted of inquiries of management regarding the methods of preparing the information and comparing the information for consistency with management’s responses to our inquiries, the basic financial statements, and other knowledge we obtained during our audit of the basic financial statements. We did not audit the RSI and do not express an opinion or provide any assurance on the RSI.

We were engaged to report on the supplementary information (combining and individual fund financial statements), 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 or statistical sections, which accompany the financial statements but are not RSI. We did not audit or perform other procedures on this other information and we do not express an opinion or provide any assurance on them.

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 governmental unit’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 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

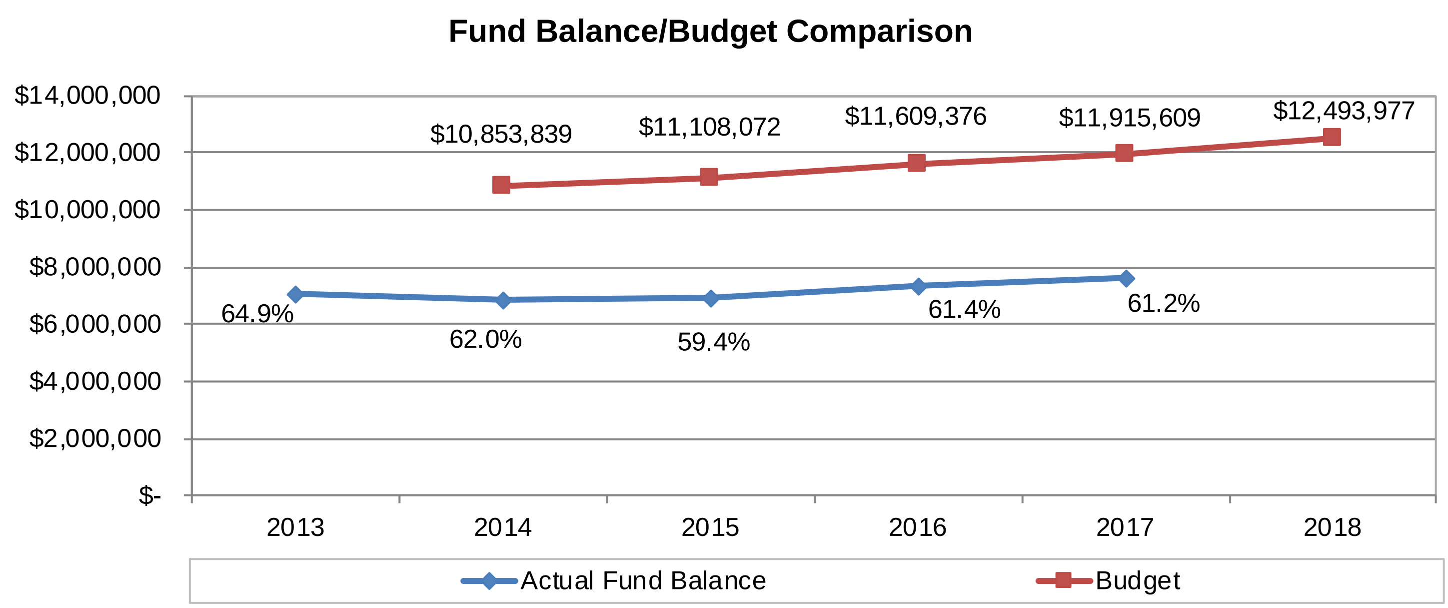
All general governmental functions of the City which are not accounted for in separate funds are included in the General fund.

Minnesota municipalities must maintain substantial amounts of fund balance in order to meet their liquidity and working capital needs as an operating entity. That is because a substantial portion of your revenue sources (taxes and intergovernmental revenues) are received in the last two months of each six-month cycle.

As you can see from the following information, it is necessary to maintain fund balance in order to keep pace with the increasing operating budget. *This information is also presented in graphic form below*.

Year	Total General Fund Balance December 31	Budget Year	General Fund Budget	Percent of Fund Balance to Budget
2013	$ 7,040,453	2014	$ 10,853,839	64.9 %
2014	6,890,491	2015	11,108,072	62.0
2015	6,900,596	2016	11,609,376	59.4
2016	7,315,431	2017	11,915,609	61.4
2017	7,648,180	2018	12,493,977	61.2

The following is an analysis of the General fund's fund balance for the past five years compared to the following year's budget:



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 of the 2nd class which have populations of 20,000-100,000. In 2015 and 2016, the average General fund balance as a percentage of expenditures was 57 percent and 55 percent, respectively. The City's total General fund balance is 66.1 percent of expenditures. Based on comparison to the peer groups, the City's General fund balance is above average.

People + Process. Going Beyond the Numbers

The General fund balance increased by $332,749 in 2017. The total unassigned fund balance is $7,466,114 or 59.8 percent of the 2018 budget. Many other organizations, including the Office of the State Auditor (the OSA) and League of Minnesota Cities (LMC) recommend that a fund balance reserve be anywhere from 35 to 50 percent of planned expenditures. We concur with those recommendations.

Although there is no legislation regulating fund balance, it is a good policy to designate intended use of fund balance. This helps address citizen concerns as to the use of fund balance and tax levels. The City's current fund balance policy strives to maintain 40 percent of the ensuing year's General fund expenditures. We recommend a minimum fund balance for working capital be approximately 40 percent to 50 percent of planned disbursements. So at the current level, the fund balance is considered higher than what is recommended.

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.
- The City is vulnerable to legislative actions at the State and Federal level. The State continually adjusts the local government aid. An adequate fund balance will provide a temporary buffer against those aid adjustments or levy limits.
- 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.

The 2017 General fund operations are summarized as follows:

	Final Budgeted Amounts	Actual Amounts	Variance with Final Budget
Revenues	$ 11,696,909	$ 11,764,118	$ 67,209
Expenditures	11,852,909	11,296,641	556,268
Revenues in Excess (Deficiency) of Expenditures	(156,000)	467,477	623,477
Other Financing Sources (Uses)			
Sale of capital assets	-	17,464	17,464
Transfers in	156,000	150,000	(6,000)
Transfers out	(267,017)	(302,192)	(35,175)
Total Other Financing Sources (Uses)	(111,017)	(134,728)	(23,711)
Net Change in Fund Balances	$ (267,017)	332,749	$ 599,766
Fund Balances, January 1		7,315,431	
Fund Balances, December 31		$ 7,648,180	

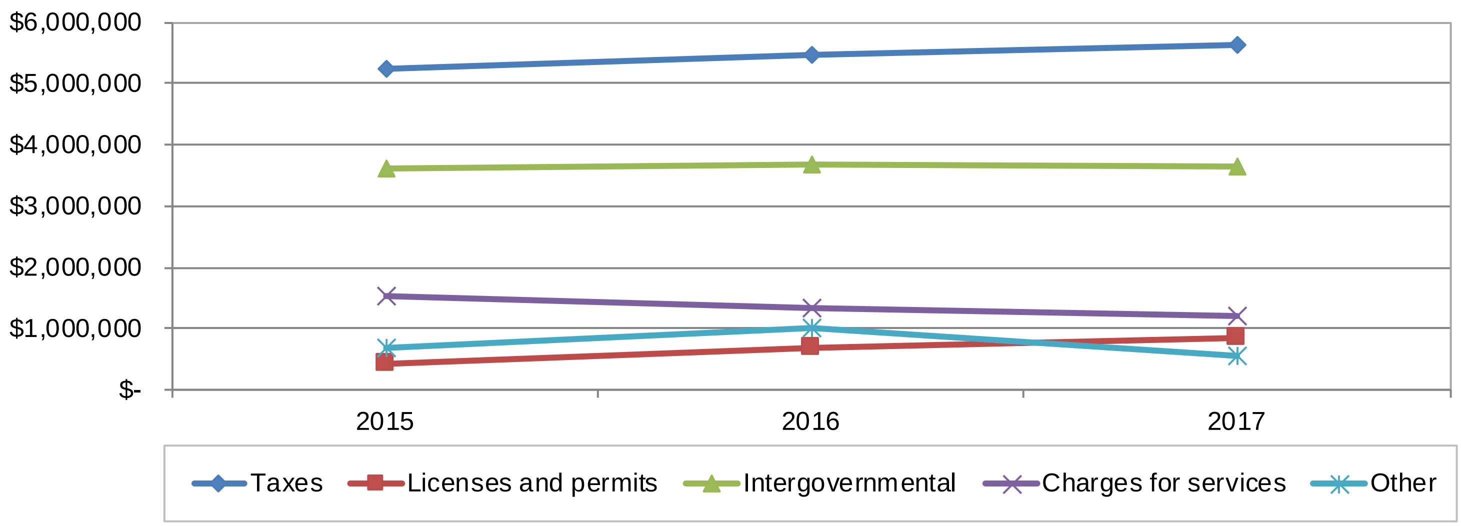
The major variances in the budget for the General fund were:

- Licenses and permits were over budget by $446,619 due to large permits for college building projects.
- Charges for services revenues were under budget by $352,013 due to less engineering charges for 2017.
- Total general government expenditures were under budget by $181,816.
- Total public safety expenditures were under budget by $133,742.
- Total culture and recreation expenditures were under budget by $90,957.

A comparison of General fund revenues and transfers for the last three years is presented below:

Source	2015	2016	2017	Percent of Total	Per Capita
Taxes	$ 5,235,618	$ 5,454,266	$ 5,624,778	47.1 %	$ 276
Licenses and Permits	428,765	679,474	859,249	7.2	42
Intergovernmental	3,608,311	3,674,908	3,659,007	30.7	180
Charges For Services	1,518,359	1,335,304	1,219,595	10.2	60
Fines and Forfeits	113,521	82,032	98,171	0.8	5
Investment Earnings (Loss)	30,372	45,623	16,127	0.1	1
Miscellaneous	315,096	308,421	304,655	2.6	15
Transfers In	223,223	568,742	150,000	1.3	7
Total Revenues and Transfers	$ 11,473,265	$ 12,148,770	$ 11,931,582	100.0 %	$ 586

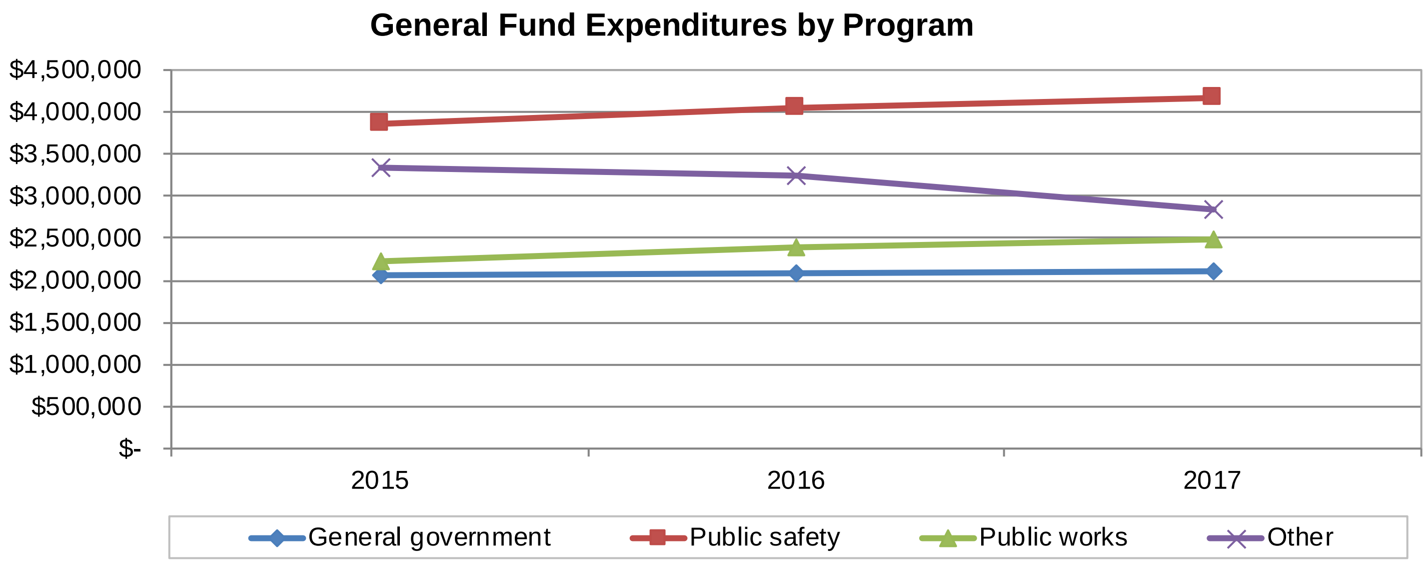
General Fund Revenues by Source



People + Process. Going Beyond the Numbers

A comparison of General fund expenditures and transfers for the last three years is presented below:

Program	2015	2016	2017	Percent of Total	Per Capita	Peer Group Per Capita 2nd Class	Peer Group Per Capita 3rd Class
Current							
General government	$ 2,053,218	$ 2,095,141	$ 2,106,224	18.2 %	$ 103	$ 94	$ 109
Public safety	3,849,981	4,045,397	4,159,937	35.8	204	258	229
Public works	2,231,624	2,381,026	2,489,659	21.5	122	87	109
Culture and recreation	1,959,915	2,084,284	2,180,036	18.8	107	60	63
Miscellaneous	150,623	109,809	130,676	1.1	6	3	15
Total Current	10,245,361	10,715,657	11,066,532	95.4	542	502	525
Capital Outlay	76,102	43,555	24,650	0.2	1	4	19
Debt Service	205,461	205,460	205,459	1.8	10	-	-
Transfers Out	936,236	794,600	302,192	2.6	15	-	-
Total Expenditures and Transfers	$ 11,463,160	$ 11,759,272	$ 11,598,833	100.0 %	$ 568	$ 506	$ 544



Special Revenue Funds

Special revenue funds have revenue from specific sources to be used for specific purpose. Listed below are the special revenue funds of the City along with the fund balances (deficits) for 2017 and 2016 and the net change:

Fund	Fund Balances December 31, 2017	Fund Balances December 31, 2016	Increase (Decrease)
Community Resource Center	$ 392,309	$ 216,627	$ 175,682
Motor Vehicle	171,959	160,023	11,936
Communication	603,648	514,655	88,993
Library Gift	72,966	77,883	(4,917)
G.W. Bunday	24,175	24,917	(742)
Scriver Memorial	140,330	139,866	464
L.J. Gustafson	32,587	33,567	(980)
Myrtle Houston Trust	42,083	42,039	44
C.C. Cloherty Endowed Book	12,533	12,364	169
Arts and Culture	9,250	14,200	(4,950)
Community Development Block Grant	354	(2,655)	3,009
Transit Grants	-	(19,197)	19,197
TZD Enforcement	21,867	13,524	8,343
Jefferson Square TIF	11,121	11,876	(755)
Master Development TIF	492,605	569,105	(76,500)
Whittier Trust	341,886	344,401	(2,515)
Rescue Squad Trust	21	10,506	(10,485)
Spring Creek TIF	8,074	4,975	3,099
Total	$ 2,377,768	$ 2,168,676	$ 209,092

Debt Service Funds

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

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

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

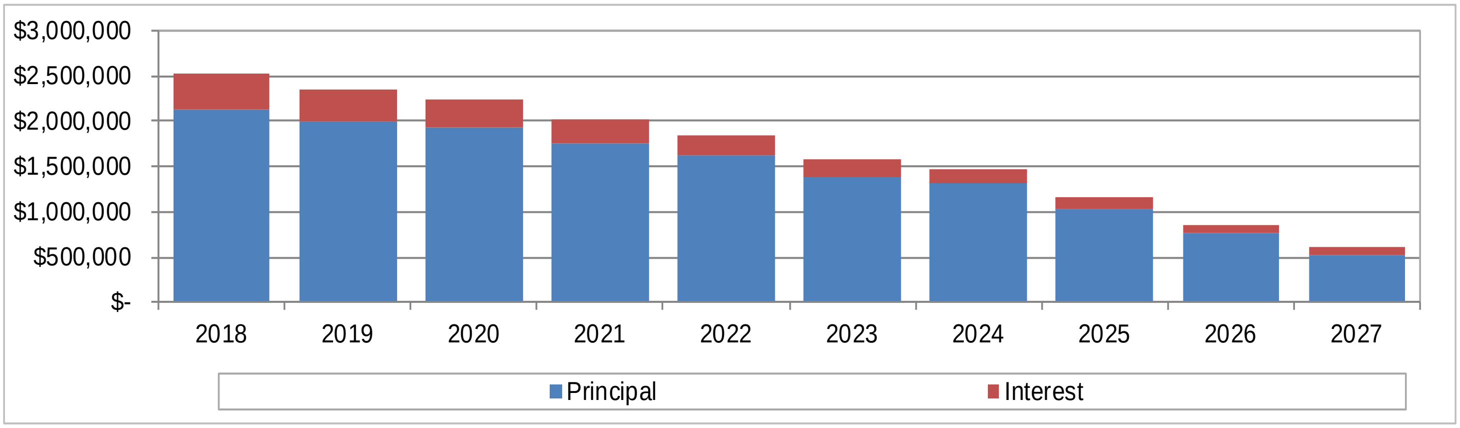
In addition to the above pledged assets, other funding sources may be received by Debt Service funds as follows:

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

The following is a summary of Debt Service fund assets and outstanding debt as of December 31, 2017:

Debt Description	Total Cash and Investments	Total Assets	Outstanding Debt	Maturity Date
General Obligation Bonds				
2012C Equipment Certificates	$ 116,197	$ 116,412	$ 200,000	2019
2016C Equipment Certificates	133,980	134,225	630,000	2022
Total G.O. Bonds	250,177	250,637	830,000	
G.O. Tax Increment Bonds				
GO Taxable Tax Increment Refunding Bonds of 2017B	13,820	13,861	460,000	2025
2002 Hiley Neff Tax Increment Bonds	-	9	67,500	2027
Total G.O. Tax Increment Bonds	13,820	13,870	527,500	
G.O. Special Assessment Bonds				
2002A G.O. Improvement Bonds	9,803	40,438	-	Matured
2007A G.O. Improvement Bonds	277,354	291,738	255,000	2018
2015A (2008B) G.O. Improvement Bonds	124,936	134,839	250,000	2020
2009A G.O. Improvement Bonds	223,125	262,247	350,000	2020
2010A G.O. Improvement Bonds	155,250	210,434	622,046	2026
2011A G.O. Improvement Bonds	332,046	452,163	615,000	2022
2012A G.O. Improvement Bonds	173,078	341,580	570,000	2023
2013A G.O. Improvement Bonds	229,346	331,280	590,000	2024
2014A G.O. Improvement Bonds	322,359	661,912	970,000	2025
2015A G.O. Improvement Bonds	499,870	748,207	1,450,000	2026
2016C G.O. Improvement Bonds	476,528	596,704	795,000	2027
2017A G.O. Improvement Bonds	178,343	489,127	945,000	2028
Total G.O. Special Assessment Bonds	3,002,038	4,560,669	7,412,046	
G.O. Revenue Bonds				
2014A Public Project Revenue Refunding Bonds	206,269	206,647	1,470,000	2024
Other General Obligation Debt				
2012B Certificates of Participation	398,355	399,091	5,295,000	2033
Riverfront TIF	227,922	231,149	1,256,212	2033
Total Other General Obligation Debt	626,277	630,240	6,551,212	
Total All Debt Service Funds	$ 4,098,581	$ 5,662,063	$ 16,790,758	
Future Interest on Debt			$ 2,445,634	

The City's outstanding debt is required to be funded by various resources such as special assessments, tax increments, property taxes, transfers from enterprise funds, etc. Special assessments and tax increments are usually certified once to the County for collection, but tax levies need to be certified annually. We recommend management pay particular attention to annual tax levies and transfers listed in each bond issue book to ensure proper funding of debt service.



Capital Projects Funds

Capital projects funds are used to account for the acquisition and construction of major capital facilities other than those financed by proprietary funds. The table below compares 2017 fund balances with 2016:

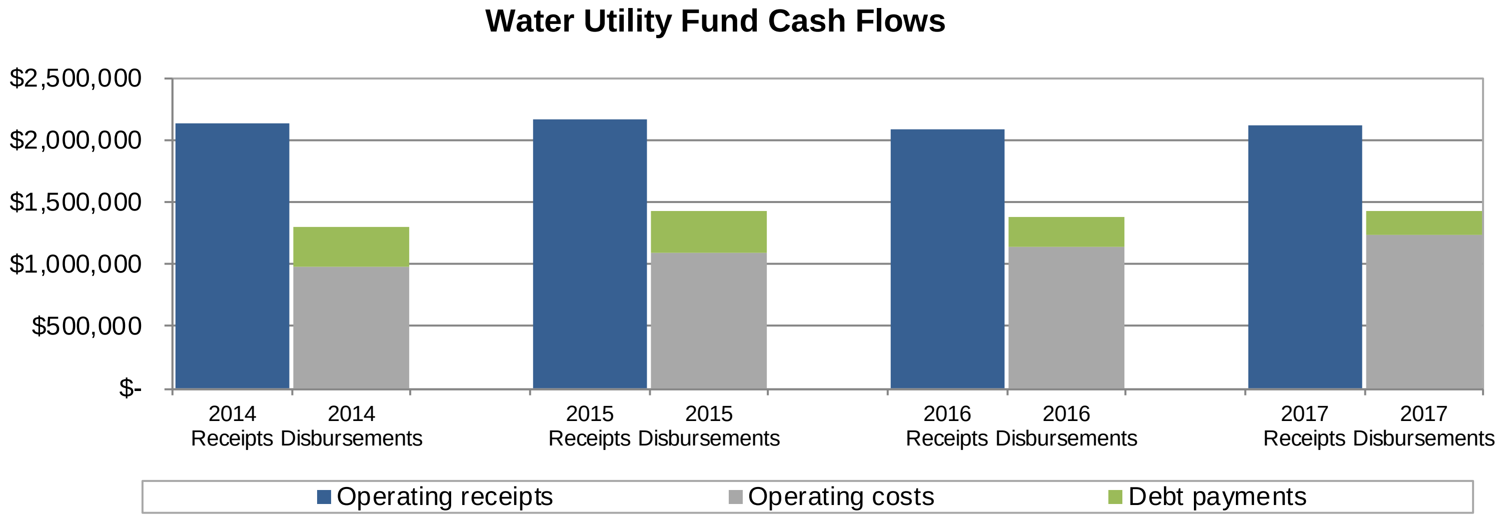
Fund	Fund Balances December 31, 2017	2016	Increase (Decrease)
Major funds			
2018 Capital Project Fund	$ (170,063)	$ -	$ (170,063)
Nonmajor funds			
2015 Capital Project Fund	-	163,735	(163,735)
2016 Capital Project Fund	-	186,917	(186,917)
2017 Capital Project Fund	41,225	(8,938)	50,163
Park	123,389	230,988	(107,599)
Fire Replacement Fund	75,986	75,238	748
City Facilities Fund	37,180	58,281	(21,101)
Equipment and Vehicle Replacement Fund	436,084	460,883	(24,799)
Hauberg Park	3,715	2,554	1,161
Public Safety Center Project Fund	963,225	964,755	(1,530)
Library Capital Project Fund	-	(197,382)	197,382
NAFRS Building	(102,432)	-	(102,432)
Capital Reserve Fund	832,520	917,181	(84,661)
Total	$ 2,240,829	$ 2,854,212	$ (613,383)

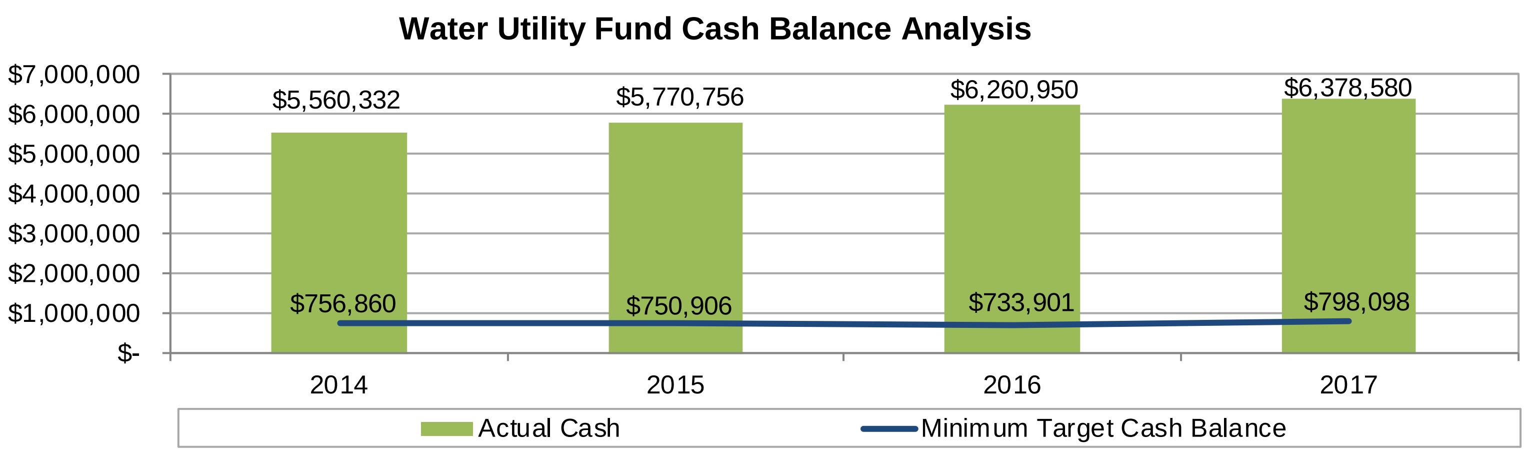
The City should analyze project's status each year and close those that are completed. The deficits, if any, in the other funds should be evaluated to ensure they are consistent with financing expectations.

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.

A comparison of enterprise fund cash flows and cash balances for the past four years is as follows:

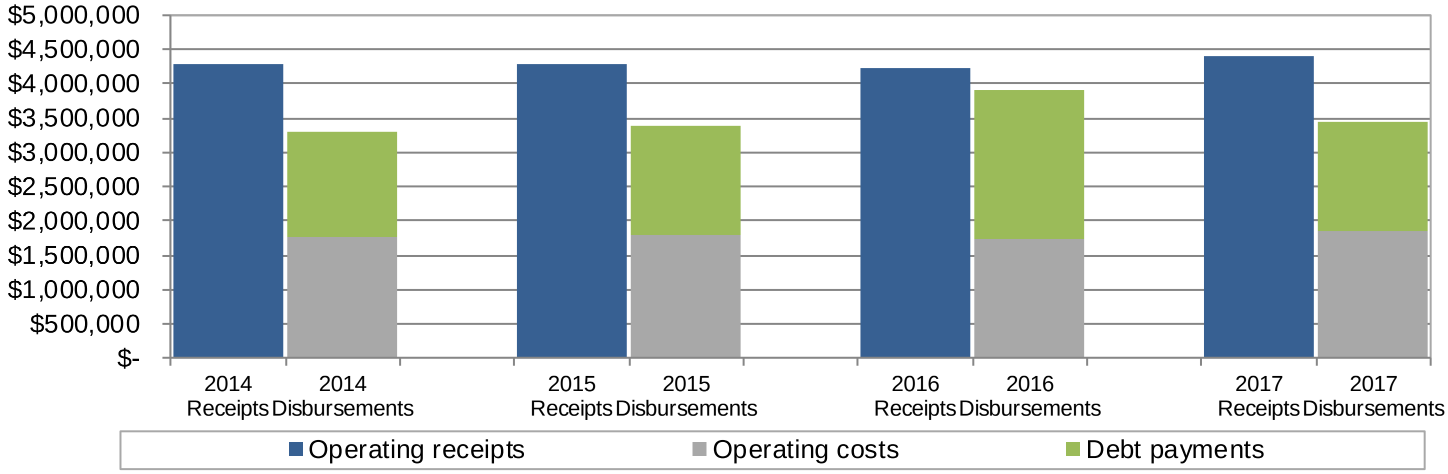




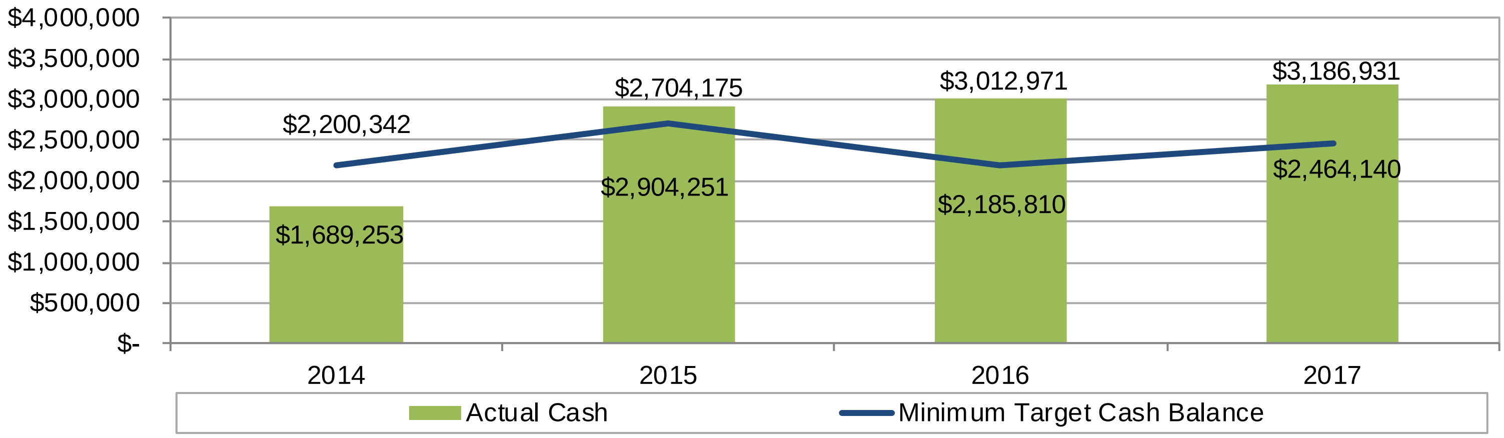
The minimum target cash balance is based off of 50 percent of operating costs plus 5/6 of the next year's debt payments for the fund.

	2014	2015	2016	2017
Bonds Payable	$ 967,691	$ 668,020	$ 443,351	$ 258,680

Wastewater Utility Fund Cash Flows



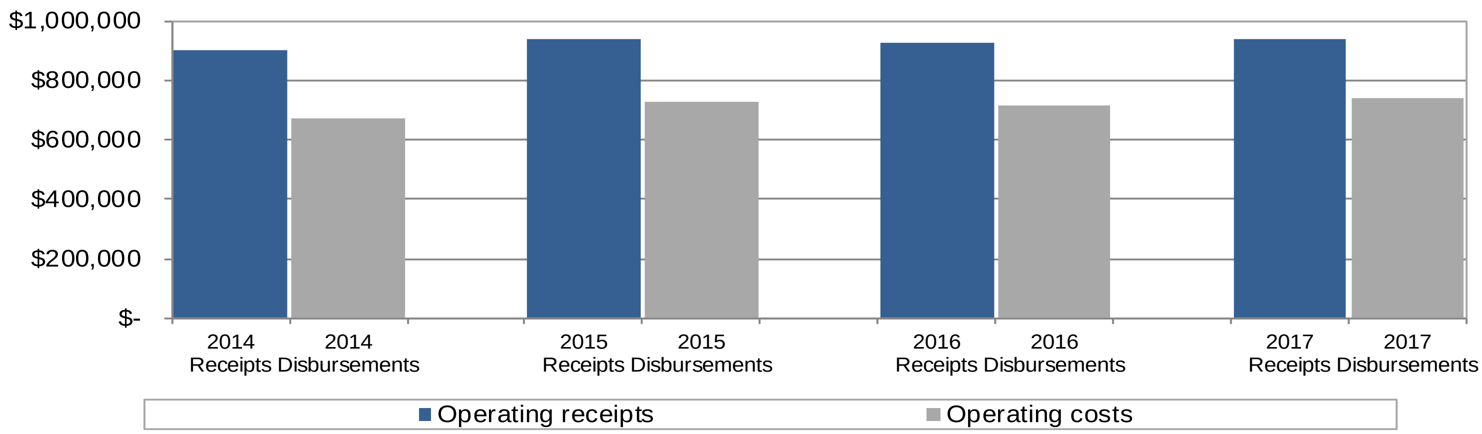
Wastewater Utility Fund Cash Balance Analysis



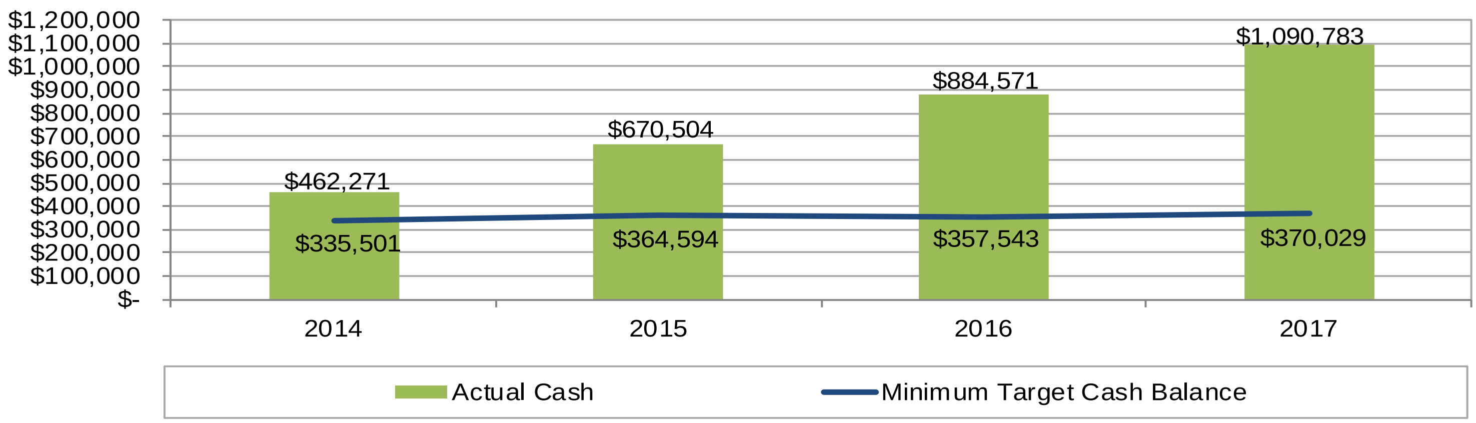
The minimum target cash balance is based off 50 percent of operating costs plus 5/6 of the next year's debt payments for the fund.

	2014	2015	2016	2017
Bonds Payable	$ 9,842,764	$ 8,970,262	$ 8,087,500	$ 6,705,000

Garbage Fund Cash Flows

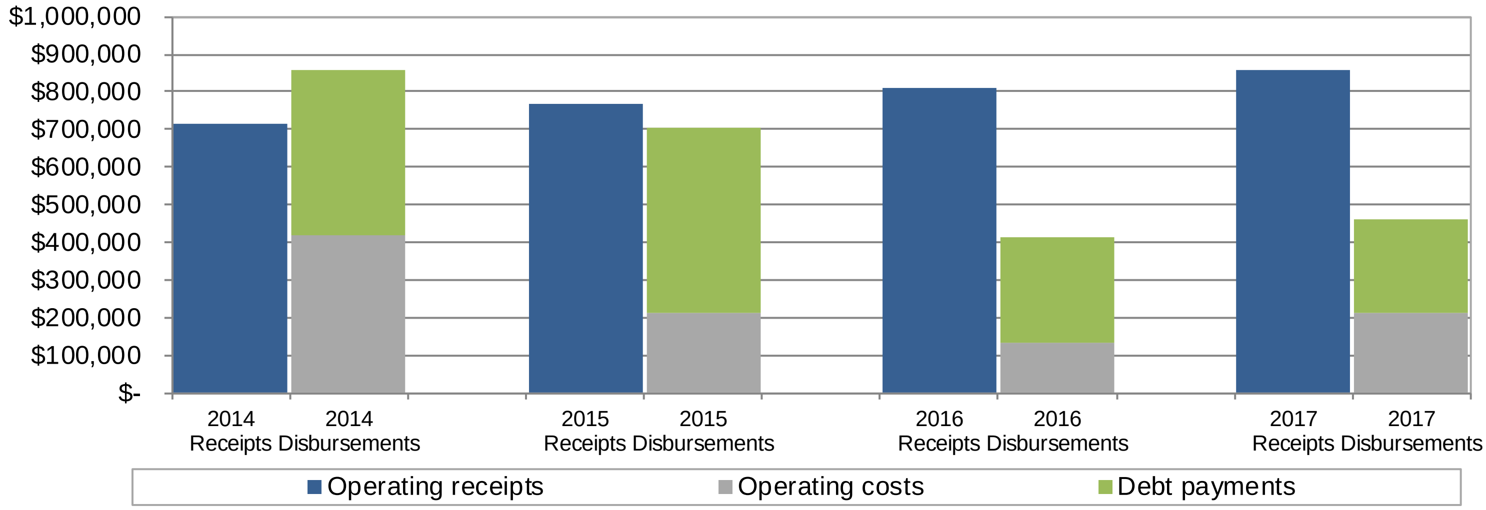


Garbage Fund Cash Balance Analysis

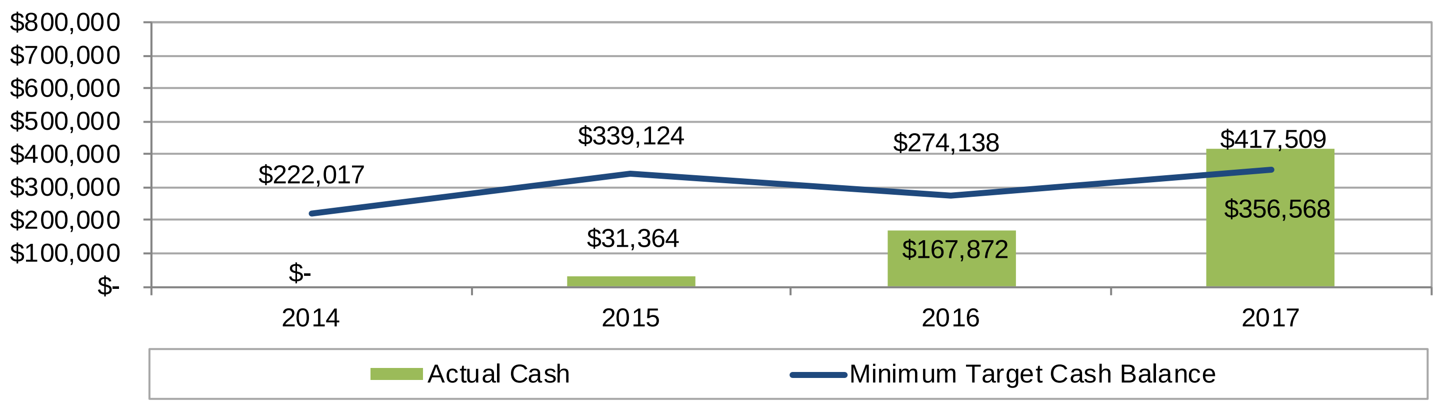


The minimum target cash balance is based off 50 percent of operating costs.

Storm Water Fund Cash Flows



Storm Water Fund Cash Balance Analysis

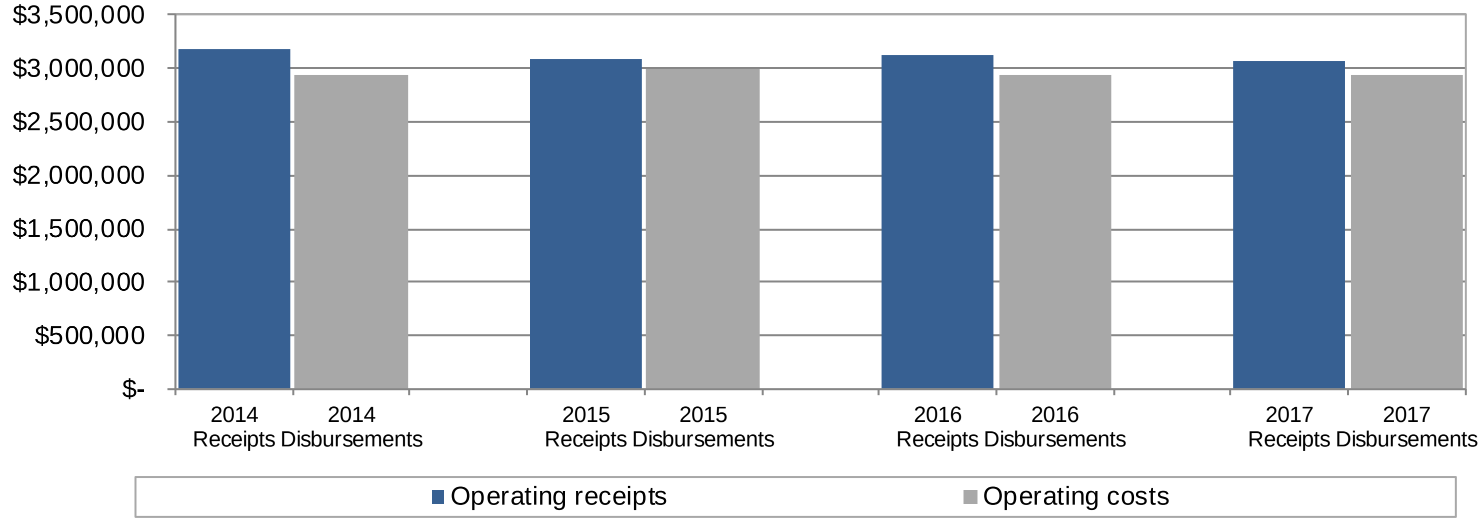


The minimum target cash balance is based off 50 percent of operating costs plus 5/6 of the next year's debt payments for the fund.

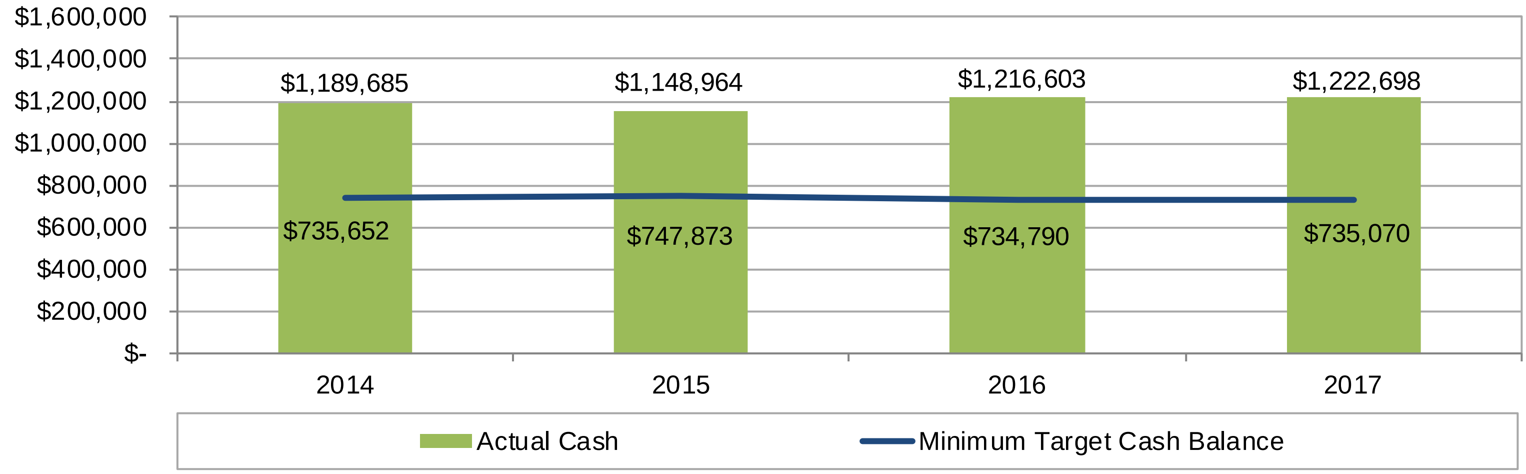
	2014	2015	2016	2017
Bonds Payable	$ 1,282,869	$ 990,414	$ 848,346	$ 614,889

People + Process Going Beyond the Numbers

Municipal Liquor Store Fund Cash Flows



Municipal Liquor Store Fund Cash Balance Analysis



The minimum target cash balance is based off 25 percent of operating costs.

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The Office of the State Auditor annually publishes a report analyzing the operation of municipal liquor stores in the State. The last most recent year of published information is for the year ended December 31, 2017. The statewide averages for only off-sale operations are summarized below:

	Off-Sale Only		
	2014	2015	2016
	Percent of Sales	Percent of Sales	Percent of Sales
Sales	100.0 %	100.0 %	100.0 %
Cost of Sales	73.9	74.3	74.1
Gross profit	26.1	25.7	25.9
Operating Expenses	17.1	17.6	18.6
Operating income	9.0	8.1	7.3
Nonoperating Revenues (Expenses)	-	0.4	0.4
Income before transfers	9.0 %	8.5 %	7.7 %

Source: Analysis of Municipal Liquor Store Operations, for the year ended December 31, 2016.
Published by the Minnesota Office of the State Auditor.

The gross profit percent of the City remains comparable to the statewide average and is within 1 percent. Also, the City's income before transfers as a percentage of sales for 2016 and 2017 of 6.8 and 4.3 percent, respectively, were below the statewide averages.

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 requested from the Office of the State Auditor. The City's population places it in the group with cities of the 2nd class. However, since the population barely reaches the threshold for 2nd class cities, we have also provided peer group data for cities of the 3rd class size. The peer group averages used of the 2nd class have populations of 20,000-100,000. The peer group averages used of the 3rd class have populations of 10,000-20,000. 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) ratios are shown below.

Standard deviations have also been calculated for the 2016 peer group ratios. The standard deviation indicates the dispersion of the data.

			Year				Standard
Ratio	Calculation	Source	2014	2015	2016	2017	Deviation
Debt to assets	Total liabilities/total assets	Government-wide	32%	34%	37%	29%	
			21%	*26%*	*34%*	*N/A*	*13%*
			31%	*34%*	*36%*	*N/A*	*16%*
Debt service coverage	Net cash provided by operations/ enterprise fund debt payments	Enterprise funds	170%	190%	169%	220%	
			170%	*141%*	*173%*	*N/A*	*120%*
			142%	*122%*	*191%*	*N/A*	*43%*
Debt per capita	Bonded debt/population	Government-wide	$ 1,226	$ 1,031	$ 972	$ 848	
			$ 1,311	*$ 1,286*	*$ 1,274*	*N/A*	*$ 920*
			$ 2,369	*$ 2,400*	*$ 1,932*	*N/A*	*$ 1,641*
Taxes per capita	Tax revenues/population	Government-wide	$ 406	$ 396	$ 414	$ 419	
			$ 518	*$ 532*	*$ 523*	*N/A*	*$ 156*
			$ 492	*$ 504*	*$ 514*	*N/A*	*$ 188*
Current expenditures per capita	Governmental fund current expenditures / population	Governmental funds	$ 542	$ 547	$ 568	$ 586	
			$ 722	*$ 658*	*$ 642*	*N/A*	*$ 156*
			$ 650	*$ 633*	*$ 668*	*N/A*	*$ 223*
Capital expenditures per capita	Governmental fund capital expenditures / population	Governmental funds	$ 339	$ 185	$ 390	$ 134	
			$ 262	*$ 277*	*$ 288*	*N/A*	*$ 185*
			$ 260	*$ 374*	*$ 338*	*N/A*	*$ 234*
Capital assets % left to depreciate Governmental	Net capital assets/ gross capital assets	Government-wide	60%	60%	65%	64%	
			60%	*61%*	*60%*	*N/A*	*12%*
			58%	*58%*	*59%*	*N/A*	*9%*
Capital assets % left to depreciate Business-type	Net capital assets/ gross capital assets	Government-wide	64%	61%	60%	58%	
			61%	*61%*	*58%*	*N/A*	*10%*
			60%	*60%*	*60%*	*N/A*	*10%*

Represents City of Northfield

Represents Peer Group Ratio - 2nd class

Represents Peer Group Ratio - 3rd class

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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 would indicate half of the assets are financed with outstanding debt).

Debt Service Coverage Ratio (Solvency Ratio)

The debt coverage ratio compares 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 1.

Bonded Debt per Capita (Funding Ratio)

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

Taxes per Capita (Funding Ratio)

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

Current Expenditures per Capita (Funding Ratio)

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

Capital Expenditures per Capita (Funding Ratio)

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

Capital Assets Percentage (Common-size Ratio)

This percentage represents the percent of governmental or business-type capital assets that are left to be depreciated. The lower the 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. 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.

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.

Future Accounting Standard Changes (Continued)

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.

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.

Future Accounting Standard Changes (Continued)

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.

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.

Future Accounting Standard Changes (Continued)

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.

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.

Future Accounting Standard Changes (Continued)

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.

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Restriction on Use

This communication is intended solely for the information and use of the members of the City Council, management, and others within the administration of the City and is not intended to be and should not be used by anyone other than those specified parties.

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

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

Abdo Eick & Meyers, LLP

ABDO, EICK & MEYERS, LLP
Mankato, Minnesota
June 12, 2018

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