

# Management Letter

**City of Isanti**  
Isanti, Minnesota

For the Year Ended  
December 31, 2017

April 6, 2018

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

We have audited the financial statements of the governmental activities, the business-type activities, each major fund and the aggregate remaining fund information of the City of Isanti, 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, *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 October 31, 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 the financial statements does not relieve you or management of your responsibilities.

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

**Significant Audit Findings**

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

Our consideration of internal control was for the limited purpose described in the preceding paragraph and was not designed to identify all deficiencies in internal control that might be material weaknesses or significant deficiencies and therefore, material weaknesses or significant deficiencies may exist that were not identified 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.

A deficiency in internal control exists when the design or operation of a control does not allow management or employees, in the normal course of performing their assigned functions, to prevent, or detect and correct, misstatements on a timely basis. A material weakness is a deficiency, or a combination of deficiencies, in internal control such that there is a reasonable possibility that a material misstatement of the entity's financial statements will not be prevented, or detected and corrected on a timely basis.

A significant deficiency is a deficiency, or a combination of deficiencies, in internal control that is less severe than a material weakness, yet important enough to merit attention by those charged with governance. We consider the deficiency described on the following pages as item 2017-001 to be a significant deficiency.

<i>Condition:</i>	We were requested to draft the audited financial statements and related footnote disclosures as part of our regular audit services. Ultimately, it is management's responsibility to provide for the preparation of your statements and footnotes, and the responsibility of the auditor to determine the fairness of presentation of those statements. It is our responsibility to inform you that this deficiency could result in a material misstatement to the financial statements that could have been prevented or detected by your management. Essentially, the auditors cannot be part of your internal control process.
<i>Criteria:</i>	Internal controls should be in place to provide reasonable assurance over the reliability of financial records and reporting.
<i>Cause:</i>	From a practical standpoint, we both prepare your statements and determine the fairness of that presentation at the same time in connection with our audit. This is not unusual for us to do with organizations of your size.
<i>Effect:</i>	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. 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.
<i>Recommendation:</i>	Under these circumstances, the most effective controls lie in management's knowledge of the City's financial operations. It is the responsibility of management and those charged with governance to make the decision whether to accept the degree of risk associated with this condition because of cost and other considerations. Regarding the specific situations listed above, we would offer the following specific recommendations: 1) Utilize a disclosure checklist to ensure all required disclosures are present and agree to work papers, and 2) Agree your accounting information from your accounting software to the amounts reported in the financial statements.

*Management Response:*

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

**Compliance and Other Matters**

As part of obtaining reasonable assurance about whether the City's financial statements are free of material misstatement, we performed tests of its compliance with certain provisions of laws, regulations, contracts and grant agreements, noncompliance with which could have a direct and material effect on the determination of financial statement amounts. However, providing an opinion on compliance with those provisions was not an objective of our audit, and accordingly, we do not express such an opinion. While our audit provides a reasonable basis for our opinion, it does not provide a legal determination on the City's compliance with those requirements. 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.

**Summary of Prior Year Findings****2016-002****Material Audit Adjustments**

<i>Condition:</i>	During our audit, several material audit adjustments were necessary to adjust accounts receivable, record contract payables and record an additional interfund loan.
<i>Criteria:</i>	The financial statements are the responsibility of the City's management; therefore, the City must be able to prevent or detect a material misstatement in the financial statements including footnote disclosures.
<i>Current Year Status:</i>	No similar adjustments were needed during the current year audit.

## 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 were depreciation on capital assets, allocation of payroll and compensated absences, liability for other post-employment benefit, and the liability of the City's pensions.

- Management's estimate of depreciation is based on estimated useful lives of the assets. Depreciation is calculated using the straight-line method.
- Allocations of gross wages and payroll benefits are approved by City Council within the City's budget and are derived from each employee's estimated time to be spent servicing the respective functions of the City. These allocations are also used in allocating accrued compensated absences payable.
- The City's liability for other post-employment benefits was estimated to be zero primarily based on the assumption that employees, whom participate in the health insurance plan, will retire after the age of 65 and not continue to participate in the plan following retirement.
- 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 allocation of the pension liability related to Minnesota Public Employee Retirement Association (PERA) is based on the City's proportionate share of employer contributions to the PERA cost-sharing multiple employer Coordinated and Police and Fire pension plans.

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

## Difficulties Encountered in Performing the Audit

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

## **Corrected and Uncorrected Misstatements**

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

## **Disagreements with Management**

For purposes of this letter, professional standards define a disagreement with management as a financial accounting, reporting, or auditing matter, whether or not resolved to our satisfaction, that could be significant to the financial statements or the auditor's report. We are pleased to report that no such disagreements arose during the course of our audit.

## **Management Representations**

We have requested certain representations from management that are included in the management representation letter dated April 6, 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 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 and the Schedules of Employer's Contributions), which is information that supplements the basic financial statements. Our procedures consisted of inquiries of management regarding the methods of preparing the information and comparing the information for consistency with management's responses to our inquiries, the basic financial statements, and other knowledge we obtained during our audit of the basic financial statements. We did not audit the RSI and do not express an opinion or provide any assurance on the RSI.

We were engaged to report on the supplementary information (combining and individual fund financial statements and schedules), which accompany the financial statements but are not RSI. With respect to this supplementary information, we made certain inquiries of management and evaluated the form, content, and methods of preparing the information to determine that the information complies with accounting principles generally accepted in the United States of America, the method of preparing it has not changed from the prior period, and the information is appropriate and complete in relation to our audit of the financial statements. We compared and reconciled the supplementary information to the underlying accounting records used to prepare the financial statements or to the financial statements themselves.

We were not engaged to report on the introductory section, which accompanies the financial statements but is not RSI. We did not audit or perform other procedures on this other information and we do not express an opinion or provide any assurance on it.

## 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.

During our audit it was discovered that the Palomino Road Improvement Project performance and payment bonds were less than the contract price. Per state statute 574.26, contractors doing public work are required to give both a performance bond and a payment bond in an amount not less than the contract price. Based on discussions with City staff and the City's engineers, this issue was due to a typo on the bonds that the contractor prepared. The City will implement a process in 2018 to review all construction contract documents.

## Financial Position and Results of Operations

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

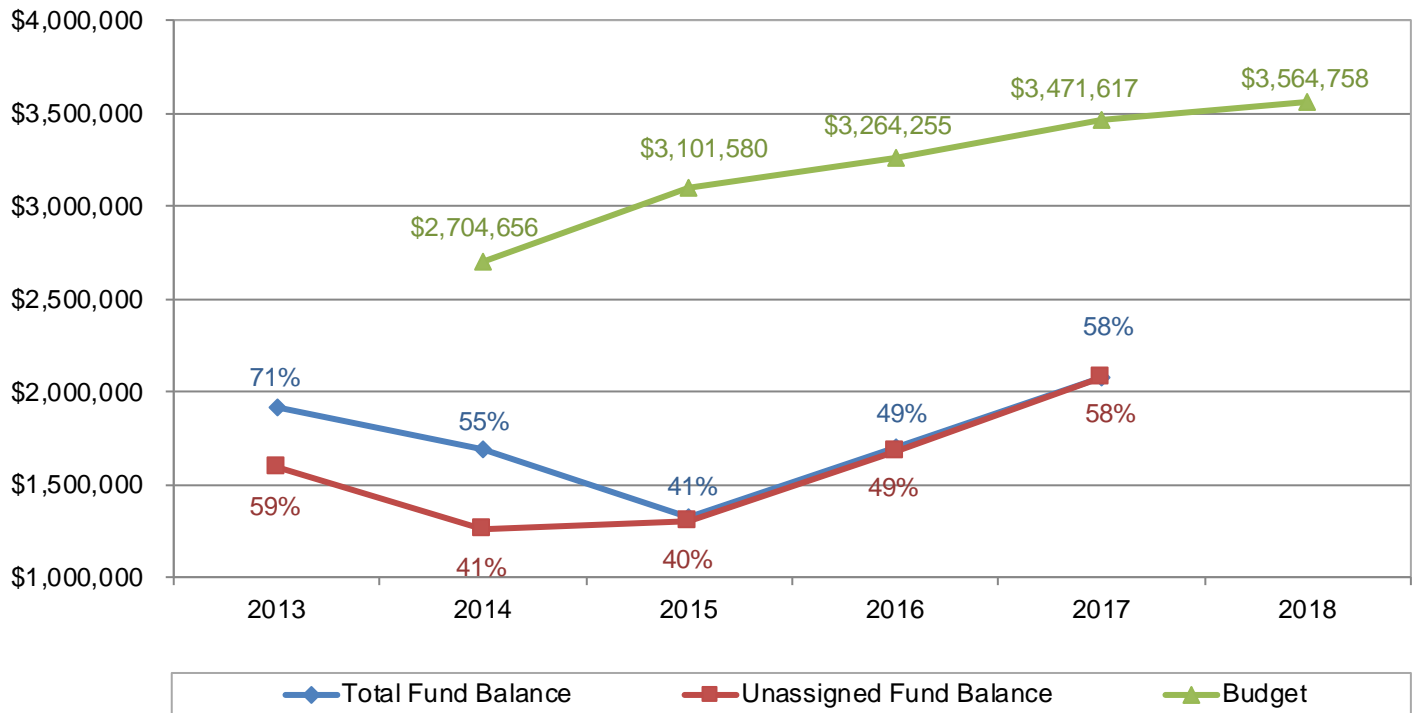
### General Fund

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 fund balance increased \$383,647 from 2016. 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 for the General fund identifies a minimum unassigned fund balance of 50 percent of the following year's budgeted expenditures and transfers out. The City's ending unassigned fund balance is above this target level from the policy.

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

- Expenditures are incurred somewhat evenly throughout the year. However, property tax and state aid revenues are not received until the second half of the year. An adequate fund balance will provide the cash flow required to finance the General fund expenditures.
- The City is vulnerable to legislative actions at the state and federal level. The State continually adjusts the local government aid formulas. An adequate fund balance will provide a temporary buffer against aid adjustments.
- Expenditures not anticipated at the time the annual budget was adopted may need immediate City Council action. These would include capital outlay, replacement, lawsuits and other items. An adequate fund balance will provide the financing needed for such expenditures.
- A strong fund balance will assist the City in maintaining, improving or obtaining its bond rating. The result will be better interest rates in future bond sales.

## Fund Balance as a Percent of Next Year's Budgeted Expenditures and Transfers Out



The 2017 General fund operations are summarized as follows:

	Final Budgeted Amounts	Actual Amounts	Variance with Final Budget
Revenues	\$ 3,133,759	\$ 3,393,338	\$ 259,579
Expenditures	3,324,217	3,258,474	65,743
Excess (Deficiency) of Revenues Over (Under) Expenditures	(190,458)	134,864	325,322
Other Financing Sources (Uses)			
Transfers in	369,150	396,183	27,033
Transfers out	(147,400)	(147,400)	-
Total Other Financing Sources (Uses)	221,750	248,783	27,033
Net Change in Fund Balances	31,292	383,647	352,355
Fund Balances, January 1	1,697,940	1,697,940	-
Fund Balances, December 31	<u>\$ 1,729,232</u>	<u>\$ 2,081,587</u>	<u>\$ 352,355</u>

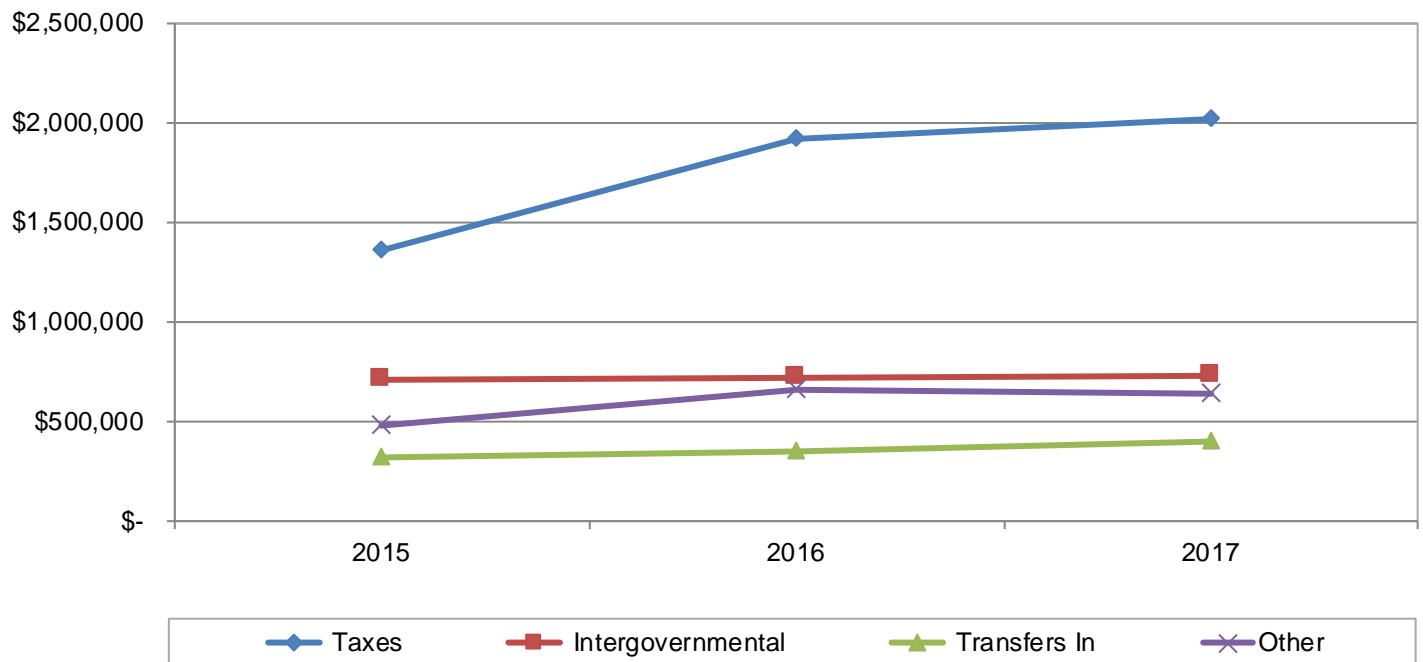
Some of the line items with significant variances are highlighted below:

- Revenues were \$259,579 over budget. This is primarily due to licenses and permits being more than budget by \$228,430.
- Expenditures were under budget by \$65,743. The majority of departments were under budget with the general government department coming in over budget by \$52,026.

A comparison between General fund 2015, 2016, and 2017 revenues and other sources is presented below:

Source	2015	2016	2017	Percent of Total	Per Capita
Taxes	\$ 1,357,265	\$ 1,921,734	\$ 2,018,262	53.3 %	\$ 360
Licenses and Permits	190,909	369,324	361,430	9.5	64
Intergovernmental	712,120	719,481	731,449	19.3	130
Charges for Services	159,409	198,768	205,370	5.4	37
Fines and Forfeitures	37,310	41,181	47,217	1.2	8
Investment Earnings	16,767	11,862	13,640	0.4	2
Miscellaneous	30,801	35,487	15,970	0.4	3
Transfers In	316,150	346,510	396,183	10.5	71
Sale of Capital Assets	47,156	2,500	-	-	-
<b>Total Revenues and Other Sources</b>	<b>\$ 2,867,887</b>	<b>\$ 3,646,847</b>	<b>\$ 3,789,521</b>	<b>100.0 %</b>	<b>\$ 675</b>

A graphical presentation of 2015, 2016, and 2017 revenues and other sources follows:



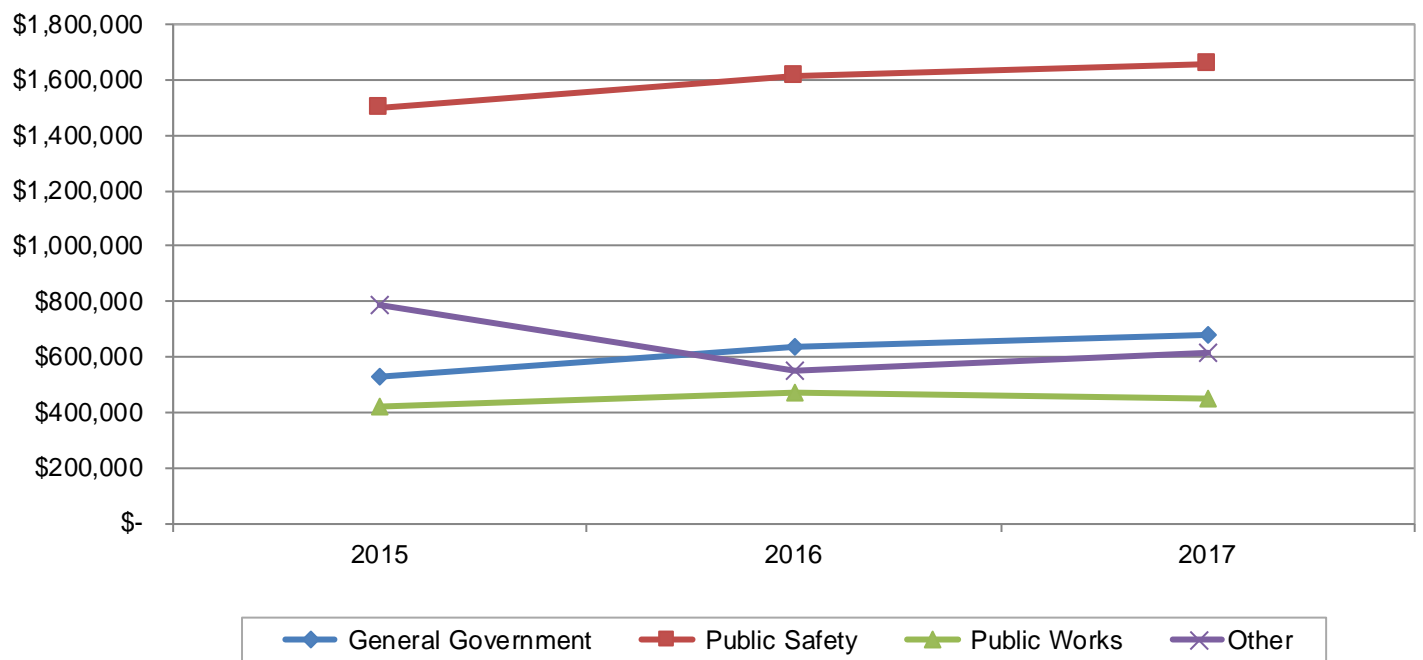


A comparison between General fund expenditures and transfers out for 2015, 2016, and 2017 is presented below:

Program	2015	2016	2017	Percent of Total	Per Capita	Peer Group Per Capita
General Government	\$ 529,679	\$ 639,261	\$ 682,050	20.2 %	\$ 121	\$ 148
Public Safety	1,495,583	1,615,031	1,656,388	48.6	295	233
Public Works	417,763	472,758	452,609	13.3	81	118
Culture and Recreation	259,295	278,862	320,634	9.4	57	62
Economic Development	11,353	11,631	5,084	0.1	1	6
Capital Outlay	117,717	110,901	140,748	4.1	25	29
Debt Service	1,552	1,261	961	-	-	-
Transfers Out	399,818	146,563	147,400	4.3	26	-
<b>Total Expenditures and Transfers</b>	<b>\$ 3,232,760</b>	<b>\$ 3,276,268</b>	<b>\$ 3,405,874</b>	<b>100.0 %</b>	<b>\$ 606</b>	<b>\$ 596</b>

The above chart compares the amount the City spends per capita in comparison to a peer group. The peer group average is compiled from 2016 information from the 4<sup>th</sup> Class Cities (populations 2,500 to 10,000) that we have requested from the Office of the State Auditor.

The expenditures and transfers out summarized above are presented graphically as follows:



## Special Revenue Funds

Special revenue funds receive revenue from specific sources and expenditures are for specific purposes. A summary of the special revenue fund balances is shown below:

Fund	Fund Balances December 31,		Increase (Decrease)
	2016	2017	
Nonmajor			
Redbirds Maintenance	\$ 12,448	\$ 7,677	\$ (4,771)
Economic Development Authority	16,966	(8,914)	(25,880)
Park	(89,832)	(67,262)	22,570
Revolving Loan	608,610	555,061	(53,549)
Forfeiture	6,162	3,171	(2,991)
Youth Rec Education Safety	3,100	3,128	28
Cambridge Isanti Joint Event	1,472	1,472	-
Utility Franchise Fund	269,247	313,460	44,213
Isanti Indoor Arena	-	(176,727)	(176,727)
TIF 9	94,555	108,614	14,059
TIF 10	64,404	61,530	(2,874)
TIF 11	626	129	(497)
City Technology Improvement	(1,419)	5,202	6,621
Total	<u>\$ 986,339</u>	<u>\$ 806,541</u>	<u>\$ (179,798)</u>

The largest increase was the Utility Franchise Fund, which will provide funding for future capital improvements and in 2017, paid for the 2017 Pavement Management Improvements.

The Revolving Loan fund decreased due to regular loan payments.

The deficit in the Park fund increased over the prior year. It is our understanding that future park dedication fees will be received in the next five years to eliminate the deficit.

In 2017, the Isanti Indoor Arena fund was created to fund maintenance and operation costs for the Isanti Indoor Arena. Through transfers to the General fund and the BMX & Bluebird Improvement fund, the new fund absorbed prior year maintenance and operation costs. Going forward, a portion of arena lease revenue receipts will be allocated to this fund.

## Capital Projects Funds

The fund balances of all capital projects funds are summarized below:

Capital Projects Fund	Fund Balances December 31,		Increase (Decrease)
	2016	2017	
Major			
2017 Palomino Road Street Improvements	\$ (7,130)	\$ (687,938)	\$ (680,808)
Nonmajor			
Signal Light Improvement	292,429	340,347	47,918
Fairway Blvd/County 5 Signal	190,124	191,986	1,862
Railroad Avenue Improvements	40,614	44,156	3,542
2013 Railroad Avenue and Walk Improvements	(379,203)	(202,959)	176,244
BMX & Bluebird Improvements	(148,335)	-	148,335
Public Works 2014 Site Improvements	(5,766)	(5,819)	(53)
Pavement Management Improvements	30,929	31,212	283
City Parking Improvements	(73,853)	(74,554)	(701)
2017 Pavement Management Improvements	(24,209)	-	24,209
Capital Replacement	455,531	452,130	(3,401)
Total	<u>\$ 371,131</u>	<u>\$ 88,561</u>	<u>\$ (282,570)</u>

The City should monitor funds with deficits to ensure that future revenues will be sufficient to cover all expenditures incurred.

The 2017 Palomino Road Street Improvement fund will be funded with future Municipal State Contribution Aid.

The BMX & Bluebird Improvements fund was closed into the Isanti Indoor Arena special revenue fund.

City staff have identified that the deficit in the 2013 Railroad Avenue and Walk Improvements fund will be covered by future Municipal State Construction Aid. Currently, the fund has \$207,556 recorded as a deferred inflow. This will be recognized as revenue when the timing requirements are met.

## 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.

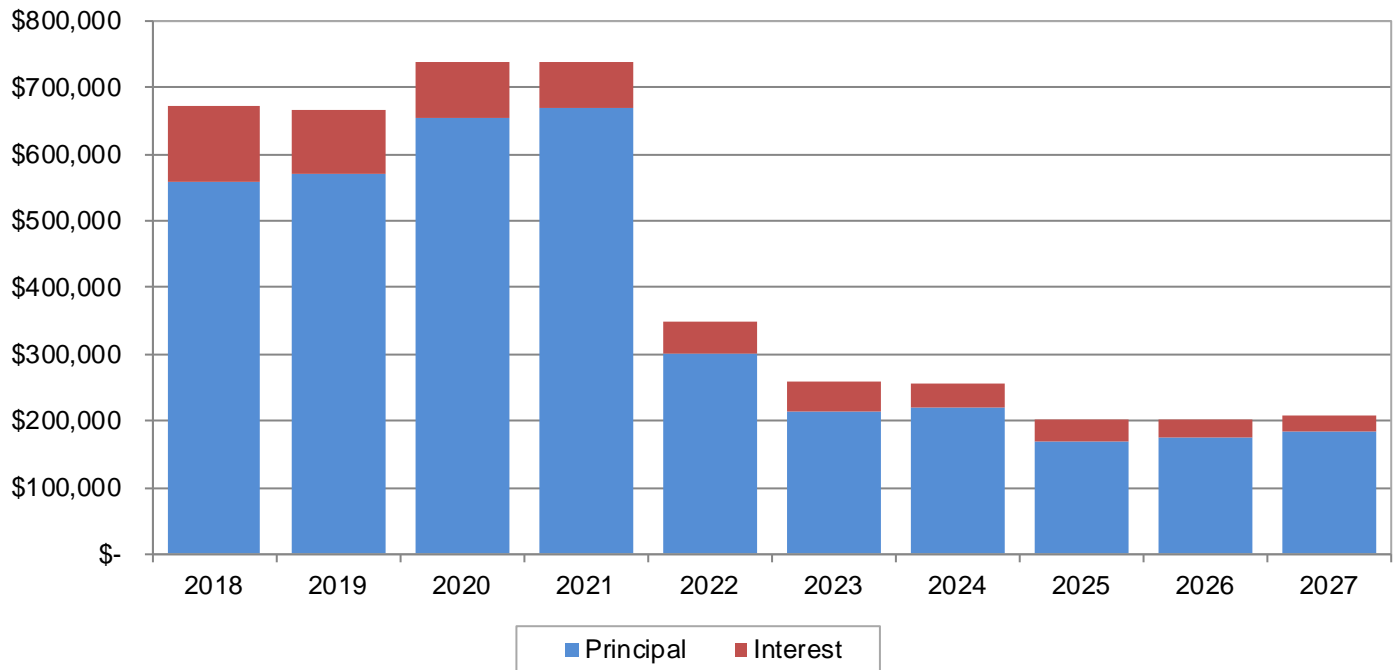
In addition to the above pledged assets, other funding sources may be received by Debt Service funds as follows: residual project proceeds from the related capital projects fund, investment earnings, state or federal grants, and transfers from other funds.

The following is a summary of the cash, total assets and bonds outstanding at year end for the governmental debt service funds:

Debt Service Fund	Cash Balance	Total Assets	Bonds Outstanding	Maturity Date
2006A Improvement Bonds	\$ 59,936	\$ 206,466	\$ -	01/01/17
2008A Improvement Bonds	84,736	431,893	90,000	12/01/18
2009A Crossover Refunding Bonds	44,983	364,922	-	12/01/17
2010B G.O. Improvement Refunding Bonds	736,060	1,043,203	1,225,000	12/01/21
2011A G.O. Improvement Bonds	190,111	279,069	420,000	02/01/22
2014A G.O. Tax Abatement Bonds	217,055	217,546	2,275,000	02/01/30
2014B G.O. Improvement Bonds	49,925	50,038	310,000	02/01/24
Total	<u>\$ 1,382,806</u>	<u>\$ 2,593,137</u>	<u>\$ 4,320,000</u>	

The City should review debt service funds with retired bonds and transfer any remaining cash to funds with existing cash deficits.

## Debt Service Scheduled Principal and Interest for the next 10 years



A summary of non-enterprise fund bonds outstanding relative to market value and population follows:

Fiscal Year	Population (1)	Taxable Market Value (2)	Bonds Payable in Debt Service Funds (3)	Less Amount Available (4)	Net Debt	Ratio of Net Debt to Market Value	Net Debt per Capita
2017	5,614	\$310,685,500	\$ 4,320,000	\$ 1,384,791	\$ 2,935,209	0.9 %	\$ 523
2016	5,497	305,306,900	4,890,000	1,329,979	3,560,021	1.2	648
2015	5,409	269,093,600	5,710,000	1,507,296	4,202,704	1.6	777
2014	5,385	258,315,600	6,330,000	1,441,936	4,888,064	1.9	908
2013	5,369	271,579,700	4,005,000	1,401,796	2,603,204	1.0	485

(1) Provided by City

(2) Provided by County

(3) Bonds reported in Debt Service funds

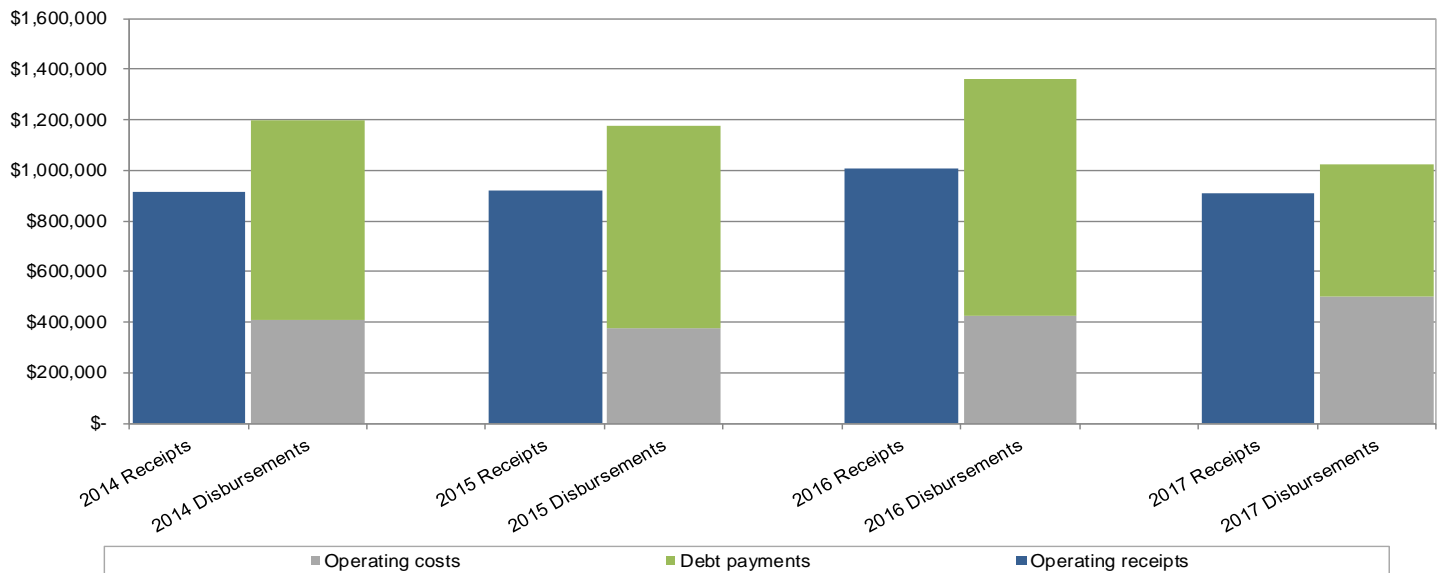
(4) Available fund balance in the Debt Service funds

## Enterprise Funds

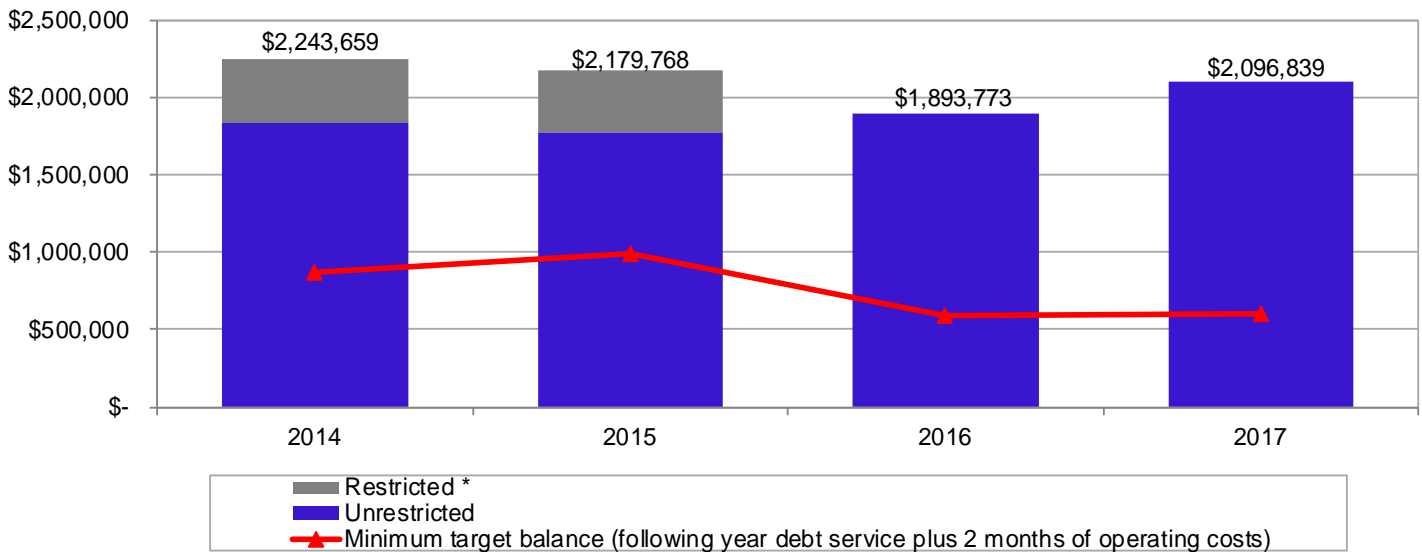
Enterprise funds are used to account for operations that are financed and operated in a manner similar to private business enterprises-where the intent is that the costs of providing goods or services to the general public on a continuing basis be financed or recovered primarily through user charges.

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

### Water Utility Fund Cash Flows



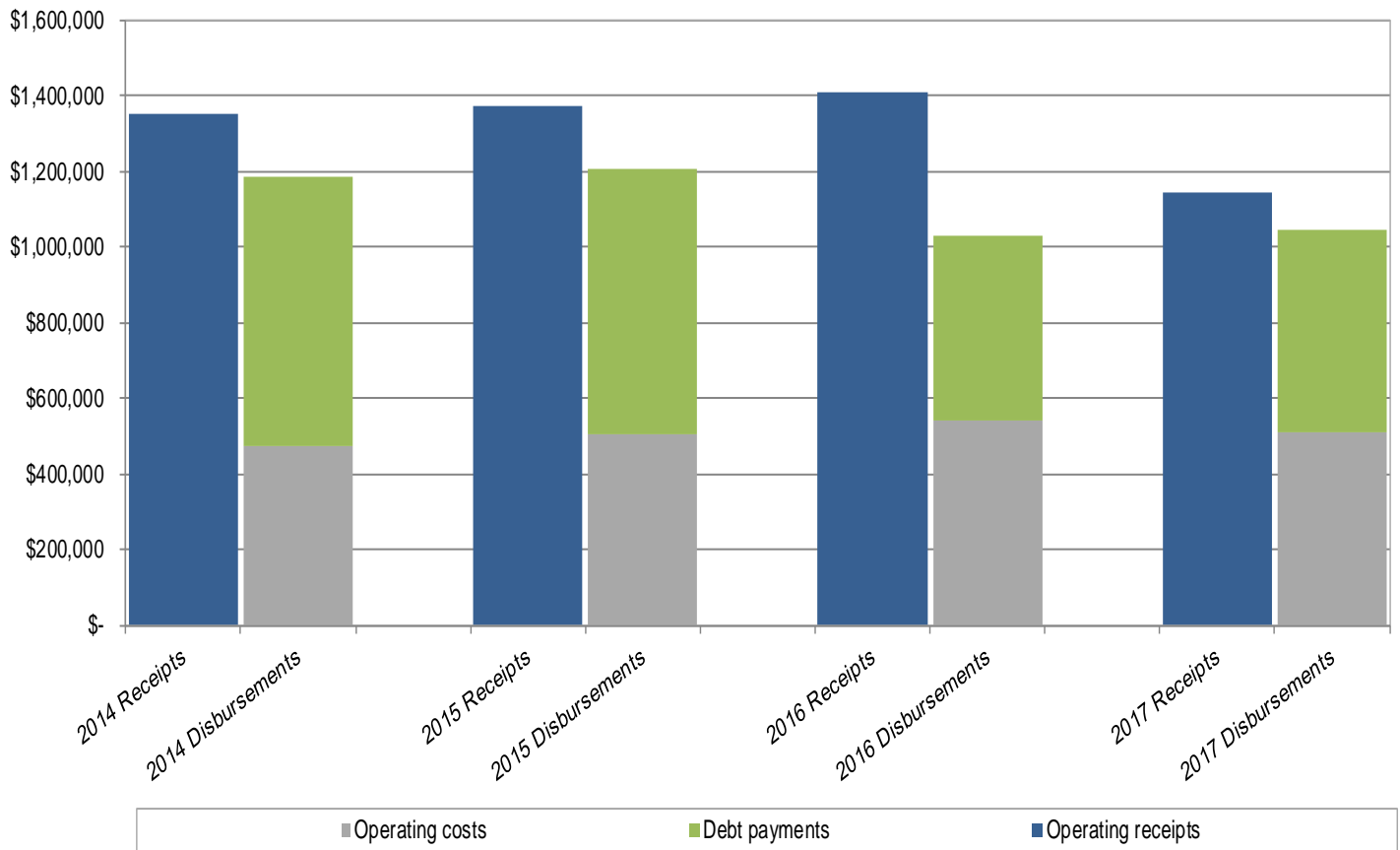
### Water Utility Fund Cash Balances



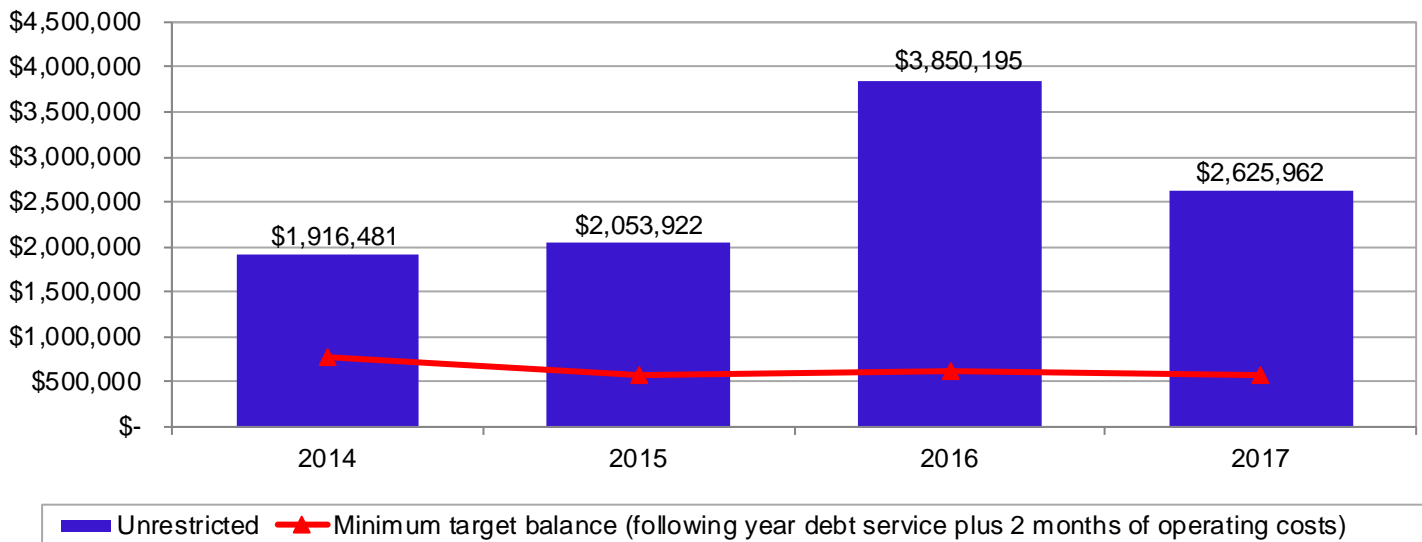
\* Restricted cash was being held in escrow for debt payments. The last escrow debt payment was made in 2016.

	2014	2015	2016	2017
Bonds Payable	<u>\$ 6,535,056</u>	<u>\$ 5,922,056</u>	<u>\$ 5,161,056</u>	<u>\$ 4,781,056</u>

## Sewer Utility Fund Cash Flows



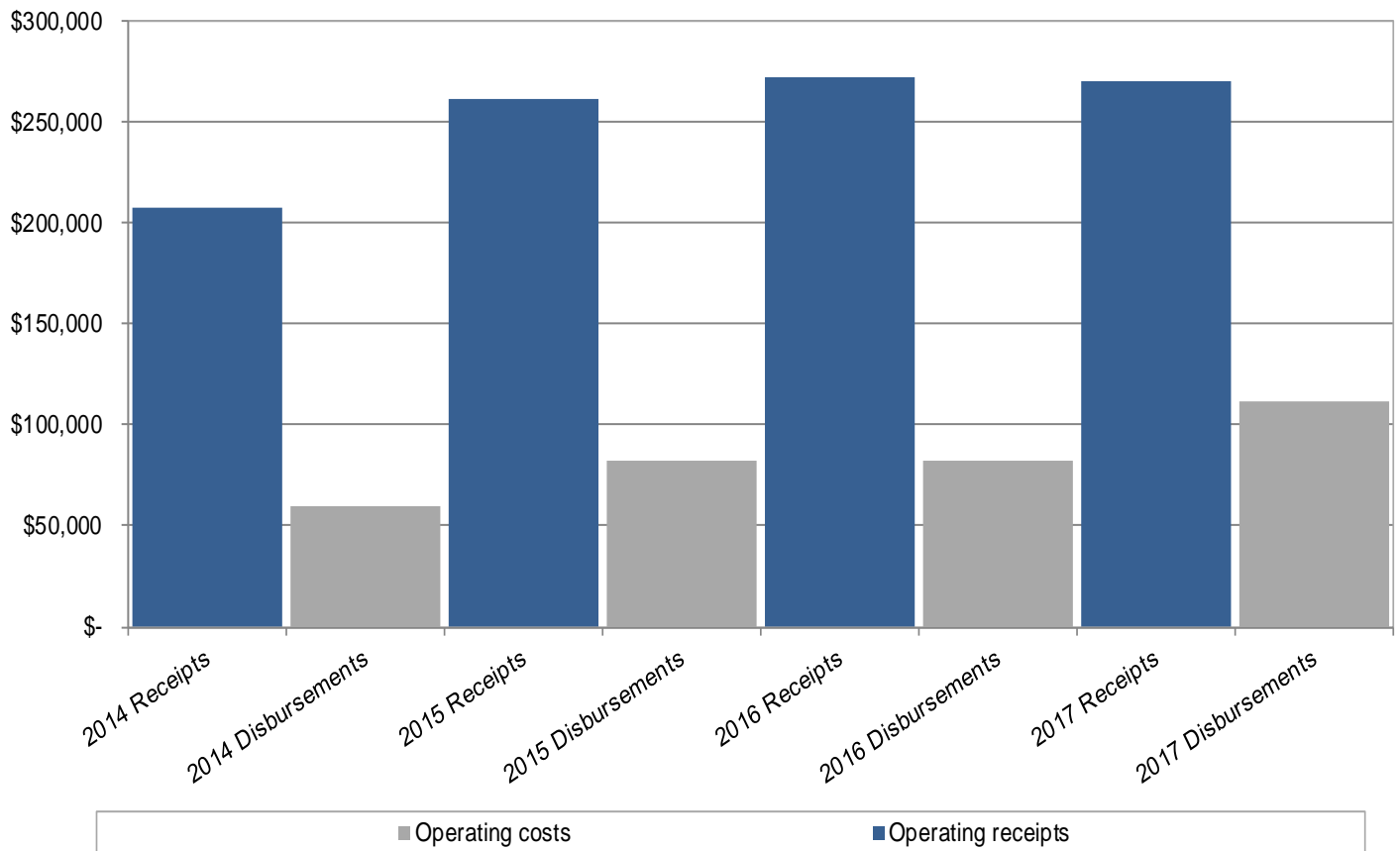
## Sewer Utility Fund Cash Balances



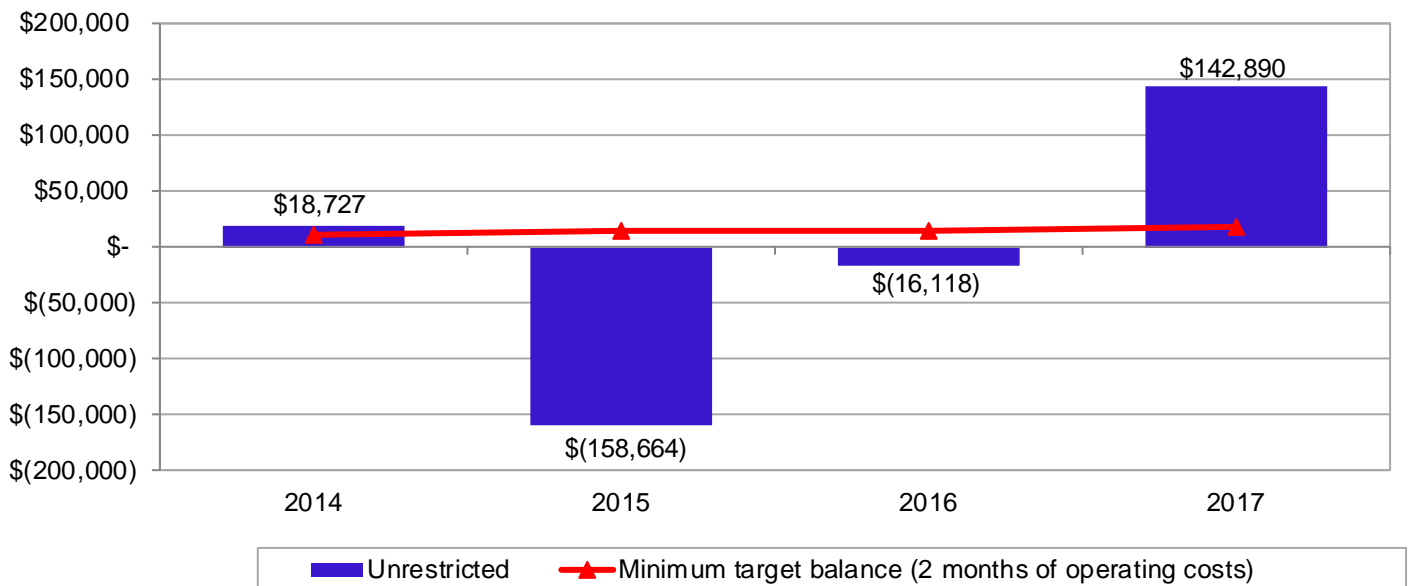
	2014	2015	2016	2017
Bonds Payable	<u>\$ 3,431,159</u>	<u>\$ 2,609,199</u>	<u>\$ 4,612,208</u>	<u>\$ 3,985,434</u>

In 2016, Sewer revenue bonds were issued, causing a large increase in cash. Approximately \$776,000 in unspent bond proceeds are included in the total 2016 cash. All bond proceeds were spent in 2016-2017.

### Storm Water Utility Fund Cash Flows



### Storm Water Utility Fund Cash Balances



2014 was the first year of operations for the storm water fund.

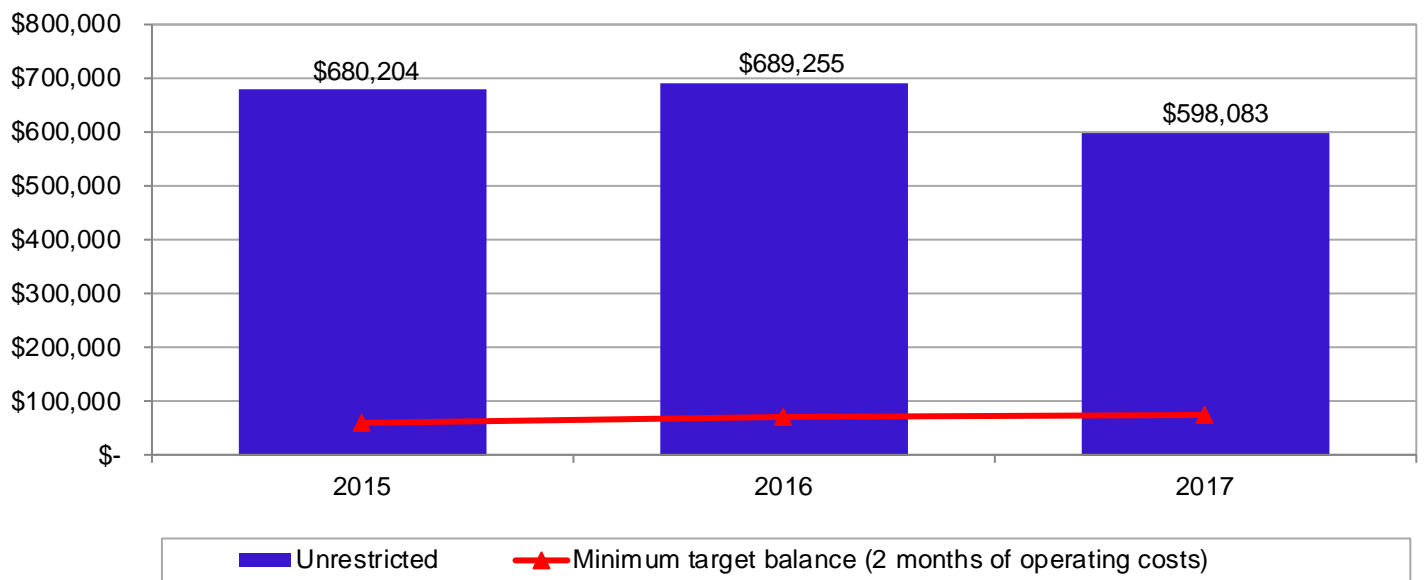


## Liquor Store Fund

The following is a summary of operations in the Liquor fund for the past three years:

	2015		2016		2017	
	Total	Percent	Total	Percent	Total	Percent
Sales	\$ 2,474,708	100.0 %	\$ 2,609,087	100.0 %	\$ 2,787,316	100.0 %
Cost of Sales	1,806,637	73.0	1,900,656	72.8	2,021,151	72.5
Gross Profit	668,071	27.0	708,431	27.2	766,165	27.5
Operating Expenses	357,002	14.4	423,429	16.2	456,402	16.4
Operating Income	311,069	12.6	285,002	11.0	309,763	11.1
Nonoperating Revenues (Expenses)	9,182	0.4	10,124	0.4	6,679	0.2
Income Before Transfers	320,251	13.0	295,126	11.4	316,442	11.3
Transfers Out	(300,000)	(12.1)	(330,360)	(12.7)	(350,000)	(12.6)
Change in Net Position	\$ 20,251	0.9 %	\$ (35,234)	(1.3) %	\$ (33,558)	(1.3) %

### Liquor Store Fund Cash Balances



Net cash from operations over the last three years have been \$360,797, \$339,948, and \$301,344 for 2017, 2016, and 2015, respectively.

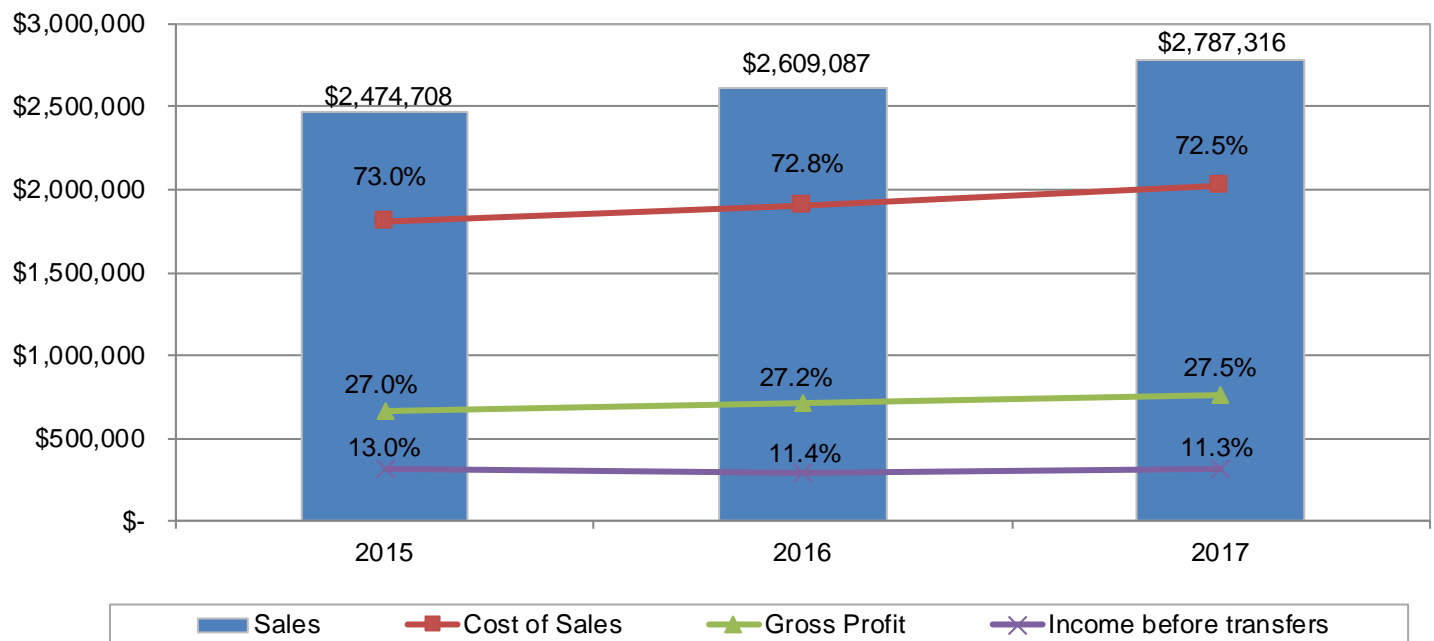
We recommend that the City continue reviewing gross profit margins as well as operating expenses to achieve profitability at a level sufficient to cover any major repairs, planned capital related projects, and support budgeted transfers to the General fund.

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, 2016. The statewide averages for all operations are summarized below.

	Off Sale Only Stores		
	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 Revenue (Expense)	-	-	-
Income Before Transfers	9.0 %	8.1 %	7.3 %

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

### Liquor Fund Operations



Sales have continuously increased over the past three years. The gross profit remained fairly consistent with the previous year.

The City's gross profit percentages of 27.0, 27.2 and 27.5 percent for 2015, 2016 and 2017, respectively, are above the statewide averages. Additionally, the percentage of income before transfers was significantly higher for 2015 - 2017 than 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 we have requested from the Office of the State Auditor. Different peer group averages are used for cities of the 4<sup>th</sup> class (population 2,500 to 10,000). The majority of these ratios facilitate the use of economic resources focus and accrual basis of accounting at the government-wide level. A combination of liquidity (ability to pay its most immediate obligations), solvency (ability to pay its long-term obligations), funding (comparison of financial amounts and economic indicators to measure changes in financial capacity over time) and common-size (comparison of financial data with other cities regardless of size) ratios are shown below.

Ratio	Calculation	Source	2014	2015	2016	2017
Debt to assets	Total liabilities/total assets	Government-wide	28% 32%	28% 34%	32% 34%	26% N/A
Debt Service Coverage	Net cash provided by operations enterprise fund debt payments	Enterprise funds	92% 114%	95% 119%	102% 105%	99% N/A
Debt Per Capita	Bonded debt/population	Government-wide	\$ 3,026 \$ 2,506	\$ 2,633 \$ 2,517	\$ 2,653 \$ 2,068	\$ 2,318 N/A
Taxes Per Capita	Tax revenues/population	Government-wide	\$ 348 \$ 484	\$ 381 \$ 510	\$ 525 \$ 510	\$ 521 N/A
Current Expenditures Per Capita	Governmental fund current expenditures / population	Governmental fund	\$ 542 \$ 674	\$ 584 \$ 688	\$ 587 \$ 725	\$ 607 N/A
Capital Expenditures Per Capita	Governmental fund capital expenditures / population	Governmental fund	\$ 539 \$ 320	\$ 253 \$ 354	\$ 62 \$ 338	\$ 191 N/A
Capital Assets % Left to Depreciate - Governmental	Net capital assets/ gross capital assets	Government-wide	66% 63%	63% 63%	59% 61%	56% N/A
Capital Assets % Left to Depreciate - Business-type	Net capital assets/ gross capital assets	Government-wide	78% 61%	76% 61%	75% 60%	74% N/A

Represents the City of Isanti

Represents Peer Group Average

### **Debt-to-Assets Leverage Ratio (Solvency Ratio)**

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

### **Debt Service Coverage Ratio (Solvency Ratio)**

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

### **Bonded Debt per Capita (Funding Ratio)**

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

### **Taxes per Capita (Funding Ratio)**

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

### **Current Expenditures per Capita (Funding Ratio)**

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

### **Capital Expenditures per Capita (Funding Ratio)**

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

### **Capital Assets Percentage (Common-size Ratio)**

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

## Future Accounting Standard Changes

The following Governmental Accounting Standards Board (GASB) Statements have been issued and may have an impact on future City financial statements: <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.

## **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.



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

### **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.

##### **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.

<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.

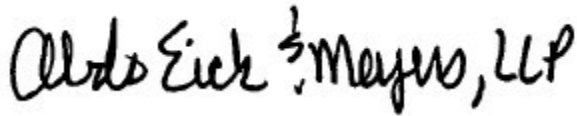
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### Restriction on Use

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

Our audit would not necessarily disclose all weaknesses in the system because it was based on selected tests of the accounting records and related data. The comments and 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 continued opportunity to be of service and for the courtesy and cooperation extended to us by your staff.



ABDO, EICK & MEYERS, LLP  
Minneapolis, Minnesota  
April 6, 2018