

Management Report

for

City of New Hope
Hennepin County, Minnesota

December 31, 2010



PRINCIPALS

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City Council and Management
City of New Hope, Minnesota

We have prepared this management report in conjunction with our audit of the City of New Hope, Minnesota's (the City) financial statements for the year ended December 31, 2010. The purpose of this report is to provide comments resulting from our audit process and to communicate information relevant to city finances in Minnesota. We have organized this report into the following sections:

- Audit Summary
- Funding Cities in Minnesota
- Governmental Funds Overview
- Financial Trends and Conditions of Selected Funds
- Accounting and Auditing Updates

We would be pleased to further discuss any of the information contained in this report or any other concerns that you would like us to address. We would also like to express our thanks for the courtesy and assistance extended to us during the course of our audit.

This report is intended solely for the information and use of those charged with governance of the City, management, and those who have responsibility for oversight of the financial reporting process and is not intended to be, and should not be, used by anyone other than these specified parties.

Malloy, Montague, Karnowski, Radosevich & Co., P.A.

May 12, 2011

AUDIT SUMMARY

The following is a summary of our audit work, key conclusions, and other information that we consider important or that is required to be communicated to the City Council, administration, or those charged with governance of the City.

OUR RESPONSIBILITY UNDER AUDITING STANDARDS GENERALLY ACCEPTED IN THE UNITED STATES OF AMERICA, *GOVERNMENT AUDITING STANDARDS*, AND THE U.S. OFFICE OF MANAGEMENT AND BUDGET (OMB) CIRCULAR A-133

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 as of and for the year ended December 31, 2010. Professional standards require that we provide you with information about our responsibilities under auditing standards generally accepted in the United States of America, *Government Auditing Standards*, and OMB Circular A-133, as well as certain information related to the planned scope and timing of our audit. We have communicated such information to you verbally and in our audit engagement letter. Professional standards also require that we communicate the following information related to our audit.

PLANNED SCOPE AND TIMING OF THE AUDIT

We performed the audit according to the planned scope and timing previously discussed and coordinated in order to obtain sufficient audit evidence and complete an effective audit.

AUDIT OPINION AND FINDINGS

Based on our audit of the City's financial statements for the year ended December 31, 2010:

- We have issued an unqualified opinion on the City's financial statements.
- We noted no matters involving the City's internal control over financial reporting that we consider to be material weaknesses.
- The results of our testing disclosed no instances of noncompliance required to be reported under *Government Auditing Standards*.
- We reported that the Schedule of Expenditures of Federal Awards is fairly stated, in all material respects, in relation to the basic financial statements.
 - We noted no matters involving the internal control over compliance and its operation that we consider to be material weaknesses in our testing of major federal programs.
- The results of our tests indicate that the City has complied, in all material respects, with the requirements applicable to each major federal program.
- We reported no findings based on our testing of the City's compliance with Minnesota laws and regulations.

OTHER RECOMMENDATIONS

We offer the following observations and recommendations for the continued improvement of the City's internal controls over financial reporting:

- During our audit, we noted that the journal entries initiated and posted to the City's general ledger by its contracted financial consultant are not being reviewed and approved by city management. The use of a contracted professional accounting service does not change the fact that the City Council and management are ultimately responsible for the City's financial transactions and the accuracy of its financial records. Appropriate review and approval controls should be maintained over adjustments and transactions initiated by consultants, just as with those initiated by an employee. We recommend that a member of management, such as the City Manager, review and document approval of all journal entries initiated by the City's financial consultants.
- One important element of internal accounting control is an adequate segregation of duties such that no individual has responsibility to execute a transaction, has physical access to the related assets, and has the responsibility or authority to record the transaction. One city employee has access to all parts of the transaction cycle related to utility receipts and credit memos. The City has a mitigating control in place requiring department manager approval of utility credit memos, which is being followed for all credit memos presented for review. However, the review procedure does not include a control whereby the manager verifies that all credit memos entered into the utility billing system have been presented for review. We recommend that the manager responsible for this review process also cross-check the credit memos approved to a report of all credit memos processed from the utility billing system.
- As part of our audit process, management provided us with descriptions of the internal control policies and procedures in place at the City, which we review and test to assure they are implemented and functioning as designed. We noted that in some cases, in particular the procedures for performing the year-end closing of the City's general ledger, policies and procedures are not documented in writing. Implied or verbal policies and procedures are subject to greater variation of meaning and the likelihood of misinterpretation increases when a policy is not written. A lack of documentation may also impair management's ability to communicate control procedures to those responsible for their performance or to monitor control performance effectively. Therefore, we recommend that the City establish written internal control policies and procedures for all relevant areas, including the year-end closing process.

SIGNIFICANT ACCOUNTING POLICIES

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 of the notes to basic financial statements. No new accounting policies were adopted and the application of existing policies was not changed during the year.

We noted no transactions entered into by the City during the year for which there is a lack of authoritative guidance or consensus. All significant transactions have been recognized in the financial statements in the proper period.

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. Where applicable, management has corrected all such misstatements. In addition, none of the misstatements detected as a result of audit procedures and corrected by management, when applicable, were material, either individually or in the aggregate, to each opinion unit's financial statements taken as a whole.

ACCOUNTING ESTIMATES AND MANAGEMENT JUDGMENTS

Accounting estimates are an integral part of the basic 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 as follows:

- **Value of Land Held for Resale** – These assets are stated at the lower of cost or net realizable value based on management's estimates.
- **Depreciation** – Management's estimates of depreciation expense are based on the estimated useful lives of the assets.
- **Net Other Post-Employment Benefit (OPEB) Liabilities** – Actuarial estimates of the net OPEB obligation is based on eligible participants, estimated future health insurance premiums, and estimated retirement dates.

We evaluated the key factors and assumptions used by management in the areas discussed above in determining that they are reasonable in relation to the financial statements taken as a whole.

DIFFICULTIES ENCOUNTERED IN PERFORMING THE AUDIT

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

DISAGREEMENTS WITH MANAGEMENT

For purposes of this report, 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 May 12, 2011.

MANAGEMENT CONSULTATIONS WITH OTHER INDEPENDENT ACCOUNTANTS

In some cases, management may decide to consult with other accountants about auditing and accounting matters, similar to obtaining a "second opinion" on certain situations. If a consultation involves application of an accounting principle to the City's financial statements or a determination of the type of auditor's opinion that may be expressed on those statements, our professional standards require the consulting accountant to check with us to determine that the consultant has all the relevant facts. To our knowledge, there were no such consultations with other accountants.

OTHER AUDIT FINDINGS OR ISSUES

We generally discuss a variety of matters, including the application of accounting principles and auditing standards, with management each year prior to retention as the City's auditors. However, these discussions occurred in the normal course of our professional relationship and our responses were not a condition to our retention.

FUNDING CITIES IN MINNESOTA

LEGISLATION

The following is a summary of significant legislative activity passed in calendar year 2010 affecting the finances of Minnesota cities:

Local Government Aid and Market Value Homestead Credit – The 2009 legislative session ended without an agreement on how to address significant projected state budget deficits for the 2009 and 2010 fiscal years. The Governor vetoed the budget bill proposed by the Legislature and balanced the budget using his power of unallotment. The Governor’s unallotment plan included delays in the payment of state revenues to school districts, and a reduction in appropriations to other state programs, including local government aid (LGA) and market value homestead credit (MVHC) to Minnesota cities. The unallotments included reductions of approximately \$128 million to calendar year 2010 LGA and MVHC, calculated at 7.64 percent of the total calendar year 2009 aggregated levy and LGA of the city, not to exceed \$55 per capita. Cuts were to be first taken from LGA and then from MVHC, as necessary. Cities with populations below 1,000 and below the state-wide average tax base per capita were exempted from these cuts.

The February 2010 state budget forecast predicted an additional shortfall of \$994 million for the remainder of the 2010–2011 biennium. The 2010 Legislature passed a supplemental budget bill in April that addressed roughly \$312 million of the additional shortfall. The bill reduced fiscal 2010 LGA and MVHC for cities by an additional \$52.5 million, calculated at 3.43 percent of the total 2010 aggregated levy, LGA, and taconite aid of the city, not to exceed \$28 per capita. These cuts were to be first taken from MVHC and then from LGA, as necessary. Cities with populations below 1,000 exempted from previous LGA and MVHC cuts were included in this round of cuts.

The April 2010 supplemental budget bill also reduces city LGA and MVHC for fiscal 2011 by \$56.5 million. About \$25.4 million of this reduction is a permanent extension of the MVHC portion of the cuts originally made through the Governor’s unallotments. The Legislature also made a permanent reduction of \$31.1 million to the state’s annual LGA appropriation for cities, beginning in 2011.

In May 2010, the Minnesota Supreme Court issued a ruling on a lawsuit overturning the Governor’s unallotment of funding to a state special nutrition program. The decision, which applied only to the cuts to this specific program, called into question all of the Governor’s July 2009 unallotments. In a one-day special session in May, the 2010 Legislature took action to ratify the majority of the Governor’s 2010 unallotments, and dealt with the remaining projected shortfall.

Levy Limitations – A 2008 law limited general operating property tax levy increases for cities with populations over 2,500 to an inflationary increase based on the state determined implicit price deflator (IPD) to a maximum of 3.9 percent annually for the next three calendar years. Modifications were made in subsequent legislative sessions to allow cities subject to levy limitation to declare “special levies” to replace the LGA and MVHC losses described above. The 2010 Legislature also established a floor of zero percent for the inflationary increase, so levies would not be reduced in the event of IPD deflation. The Governor’s proposal to extend levy limits was not adopted by the 2010 Legislature, and levy limits remain set to expire after the 2011 tax year. However, the extension of levy limits is expected to be revisited by the 2011 Legislature.

State Stimulus/Jobs Bill – This jobs creation bill included a number of provisions that applied to cities, including:

- Authority for local governments to finance energy conservation improvements and collect repayments as special assessments at the request of the property owner.
- Creation of a new “compact development” type of tax increment financing (TIF) district.
- Expanded authority to use TIF for general economic development for one year.
- Expanded authority to use excess TIF to finance new private development.
- Expanded authority for certain cities to use TIF for housing replacement in response to the foreclosure crisis.

Interest Rates on Awards and Judgments – The 2010 Legislature exempted government entities from a 2009 law change that increased the required interest rate on awards and judgments over \$50,000 to 10 percent, returning the rate to the pre-2009 maximum of the greater of 4 percent or the secondary market rate of one year U.S. Treasury bills as determined in December each year.

Pension Funding and Sustainability – The 2010 Legislature made a number of changes to improve the sustainability of state-wide pension plans, including those administered by the Public Employees Retirement Association (PERA). Among the changes to the Public Employee Retirement Fund Coordinated Plan were required increases to the employer and employee contribution rates of 0.25 percent of salary each, effective January 1, 2011. Public Employee’s Police and Fire Fund employee and employer contribution rates also increased 0.2 percent and 0.3 percent of salary, respectively, effective January 1, 2011.

STATE OUTLOOK AND IMPORTANCE OF INTERNAL CONTROLS

The state of Minnesota has experienced a series of major budget shortfalls and a steadily deteriorating financial condition in recent years. Local governments and other entities dependent on the state for funding have, in turn, had to deal with the resulting state aid cuts, holdbacks, and unallotments. For the fiscal year 2010–2011 biennium, the state budget was balanced using several large accounting “shifts” and one-time federal stabilization funds that greatly reduced the amount of actual aid reductions necessary. The accounting shifts included delaying state aid payments to and accelerating property tax revenue recognition of Minnesota school districts, essentially utilizing cash “borrowed” from the districts to help balance the state budget. The state intends to pay these shifts back when it has the financial ability.

Current state budget projections for 2011–2012 predict further significant shortfalls that will need to be addressed. Realistically, the state has already used up most of the accounting shifts available for this purpose, and additional federal assistance cannot be counted on. The economy, while showing some signs of recovery, is unlikely to turn around quickly enough to solve the state’s budget issues in the short-term. All of this adds up to a period of continued financial uncertainty and a strong likelihood of further funding cuts for Minnesota municipalities.

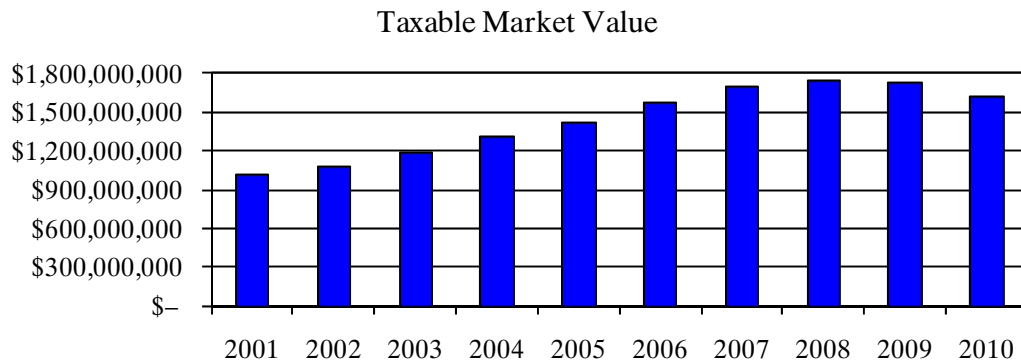
These circumstances have resulted in a sustained cycle of budget reductions for most Minnesota cities. Among our clients, we have seen numerous examples of staffing cuts and reassignments that have potentially weakened internal controls by reducing the segregation of accounting duties or delaying the performance of key control procedures. Unfortunately, the economic downturn has also placed additional financial strain on many individuals, elevating the risk of fraud and theft. Recent communications from the Minnesota Office of the State Auditor have reported a substantial increase in incidents of fraud and theft involving local governments reported to their office recently. A sound system of internal controls is critical to safeguarding city assets and assuring that accurate and timely financial information is available to manage the City. When faced with difficult budgetary decisions, we encourage our clients to remain mindful of these factors and to continue to make sound financial controls a top priority.

PROPERTY TAXES

Minnesota cities rely heavily on local property tax levies to support their governmental fund activities. In recent years this dependence has been heightened, as revenue from state aids and fees related to new development have dwindled due to the struggling economy. This has placed added pressure on local taxpayers already beset by higher unemployment, lower property values, and tighter credit markets. As a result, municipalities in general are experiencing increases in tax delinquencies, abatements, and foreclosures. This instability has led to significant fiscal challenges for many local governments, and increased the investing public's concerns about the security of the municipal debt market.

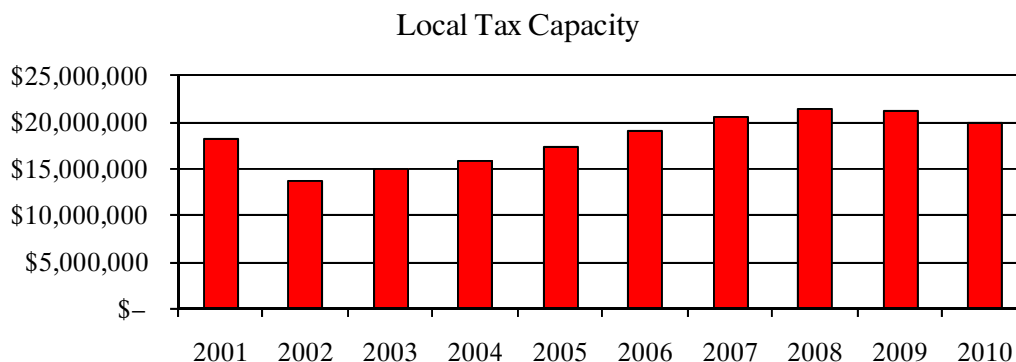
Property values within Minnesota cities experienced an average increase of 1.5 percent for taxes payable in 2009 and an average decrease of 3.0 percent for those payable in 2010, reflecting the weak housing market and economic recession experienced in recent years. In comparison, the City's market value decreased 1.1 percent and 5.9 percent in 2009 and 2010, respectively. It is important to remember that the 2010 market value is based on estimated values as of January 1, 2009, and the housing market is still experiencing difficult times.

The following graph shows the City's changes in taxable market value over the past 10 years:



Tax capacity is considered the actual base available for taxation. It is calculated by applying the state's property classification system to each property's market value. Each property classification, such as commercial or residential, has a different calculation and uses different rates. Consequently, a city's total tax capacity will change at a different rate than its total market value, as tax capacity is affected by the proportion of the City's tax base that is in each property classification from year-to-year, as well as legislative changes to tax rates. The City's tax capacity decreased 0.7 percent and 5.8 percent for taxes payable in 2009 and 2010, respectively.

The following graph shows the City's change in tax capacities over the past 10 years:



The following table presents the average tax rates applied to city residents for each of the last two levy years, along with comparative state-wide and metro-area rates. The general increase in rates reflects both the increased reliance of local governments on property taxes and the recent decline in tax capacities previously discussed.

Rates expressed as a percentage of net tax capacity						
	All Cities State-Wide		Seven-County Metro Area		City of New Hope	
	2009	2010	2009	2010	2009	2010
Average tax rate						
City	36.9	39.2	33.7	36.0	41.3	46.0
County	39.3	41.0	34.7	36.8	40.4	42.6
School	22.0	23.0	22.1	24.0	27.2	28.6
Special taxing	<u>5.5</u>	<u>5.9</u>	<u>5.9</u>	<u>6.5</u>	<u>7.4</u>	<u>8.5</u>
Total	<u><u>103.7</u></u>	<u><u>109.1</u></u>	<u><u>96.4</u></u>	<u><u>103.3</u></u>	<u><u>116.3</u></u>	<u><u>125.7</u></u>

The City's portion, as well as the total of the tax capacity rates for New Hope residents has been higher than the state-wide and metro area averages in recent years. The City's rate has been above average since it began using annual levies rather than special assessment bonds to finance street and park improvements. The increase in the City's levy for 2010 was to offset the loss of LGA and MVHC state aid as described earlier in this report.

GOVERNMENTAL FUNDS OVERVIEW

This section of the report provides you with an overview of the financial trends and activities of the City's governmental funds. Governmental funds include the General Fund, special revenue, debt service, and capital projects funds. We have also included the most recent comparative state-wide averages available from the Office of the State Auditor. The reader needs to consider the effect of inflation and other known changes or differences when comparing this data. Also, certain data on these tables may be classified differently than how they appear on the City's financial statements in order to be more comparable to the state-wide information, particularly in separating capital expenditures from current expenditures.

We have designed this section of our management report using per capita data in order to better identify unique or unusual trends and activities of your city. We intend for this type of comparative and trend information to complement, rather than duplicate, information in the Management's Discussion and Analysis. An inherent difficulty in presenting per capita information is the accuracy of the population count, which for most years is based on estimates.

GOVERNMENTAL FUNDS REVENUE

The amounts received from the typical major sources of revenue will naturally vary between cities based on their particular situation. This would include the City's stage of development, location, size and density of its population, property values, services it provides, and other attributes. The following table presents the City's revenue per capita of its governmental funds for the past three years, together with state-wide averages:

Governmental Funds Revenue per Capita						
With State-Wide Averages by Population Class						
Year	State-Wide			City of New Hope		
	December 31, 2009			2008	2009	2010
Population	2,500–10,000	10,000–20,000	20,000–100,000	20,860	20,718	20,339
Property taxes	\$ 367	\$ 365	\$ 391	\$ 387	\$ 403	\$ 427
Tax increments	46	62	59	88	75	69
Franchise and other taxes	23	34	36	21	21	21
Special assessments	86	47	62	10	8	13
Licenses and permits	21	19	27	20	11	12
Intergovernmental revenues	284	273	168	50	68	87
Charges for services	82	80	77	54	56	67
Other	81	76	61	57	50	35
Total revenue	<u>\$ 990</u>	<u>\$ 956</u>	<u>\$ 881</u>	<u>\$ 687</u>	<u>\$ 691</u>	<u>\$ 732</u>

Total revenue in the City's governmental funds for 2010 was \$14,883,370, an increase of \$567,250, or 4.0 percent, from the previous year. The City's governmental funds revenue for fiscal 2010 was \$732 on a per capita basis, up \$41 per capita from last year. The City's general property tax levy revenue went up by \$24 per capita, as the City increased its general levy for 2010 to make up for state aid reductions. Intergovernmental revenue increased by \$19 per capita due to the City earning about \$556,000 of federal grant revenue for road improvements this year. Revenue from other sources decreased by \$15 per capita, mainly due to a decline of about \$386,000 in investment income.

GOVERNMENTAL FUNDS EXPENDITURES

The expenditures of governmental funds will vary from state-wide averages and from year-to-year, based on the City's circumstances. Expenditures are classified into three types as follows:

- **Current** – These are typically the general operating-type expenditures occurring on an annual basis, and are primarily funded by general sources such as taxes and intergovernmental revenues.
- **Capital Outlay and Construction** – These expenditures do not occur on a consistent basis, more typically fluctuating significantly from year-to-year. Many of these expenditures are project-oriented which are often funded by specific sources that have benefited from the expenditure, such as special assessment improvement projects.
- **Debt Service** – Although the expenditures for the debt service may be relatively consistent over the term of the respective debt, the funding source is the important factor. Some debt may be repaid through specific sources such as special assessments or redevelopment funding, while other debt may be repaid with general property taxes.

The City's expenditures per capita of its governmental funds for the past three years, together with state-wide averages, are presented in the following table:

Governmental Funds Expenditures per Capita With State-Wide Averages by Population Class							
Year	State-Wide			City of New Hope			
	December 31, 2009			2008	2009	2010	
Population	2,500–10,000	10,000–20,000	20,000–100,000	<u>20,860</u>	<u>20,718</u>	<u>20,339</u>	
Current							
General government	\$ 120	\$ 107	\$ 79	\$ 93	\$ 83	\$ 93	
Public safety	217	233	241	282	286	285	
Public works	112	106	82	40	36	49	
Culture and recreation	61	81	86	81	82	79	
All other	81	81	96	–	–	9	
	<u>\$ 591</u>	<u>\$ 609</u>	<u>\$ 584</u>	<u>\$ 496</u>	<u>\$ 487</u>	<u>\$ 514</u>	
Capital outlay and construction	<u>\$ 336</u>	<u>\$ 325</u>	<u>\$ 267</u>	<u>\$ 117</u>	<u>\$ 55</u>	<u>\$ 128</u>	
Debt service							
Principal	\$ 196	\$ 135	\$ 126	\$ 39	\$ 43	\$ 25	
Interest and fiscal	73	51	39	17	13	13	
	<u>\$ 268</u>	<u>\$ 188</u>	<u>\$ 165</u>	<u>\$ 56</u>	<u>\$ 56</u>	<u>\$ 38</u>	

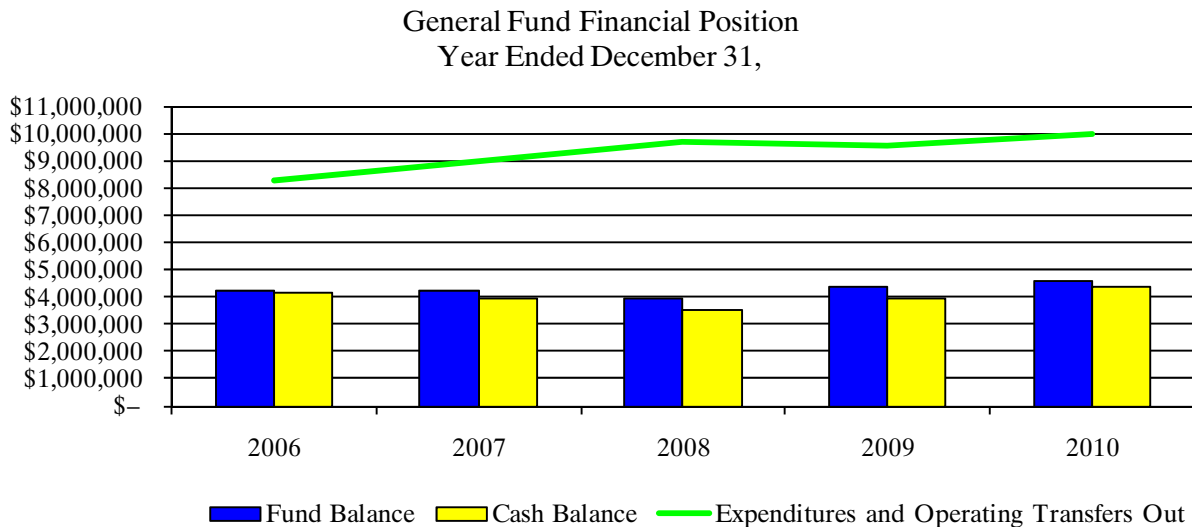
The City's total governmental funds expenditures were \$13,850,564 for 2010, an increase of \$1,455,937, or 11.8 percent, from the prior year. The largest increase was in capital outlay expenditures, which were \$73 higher per capita in 2010. The City spent about \$985,000 more on street infrastructure projects than the previous year, mainly due to the reconstruction of Winnetka Avenue, which was partially funded with a federal grant. Current operating costs also increased \$30 per capita in 2010. General government expenditures were up \$10 per capita, mainly in salaries and contracted services. Public works costs, mainly street maintenance salaries and supplies, were also \$13 per capita higher than last year.

FINANCIAL TRENDS AND CONDITIONS OF SELECTED FUNDS

GENERAL FUND

The City's General Fund accounts for the financial activity of the basic services provided to the community. The primary services included within this fund are the administration of the municipal operation, police and fire protection, building inspection, streets and highway maintenance, and culture and recreation.

The graph below illustrates the change in the General Fund financial position over the last five years. We have also included a line representing annual expenditures and operating transfers out to reflect the change in the size of the General Fund operation over the same period:

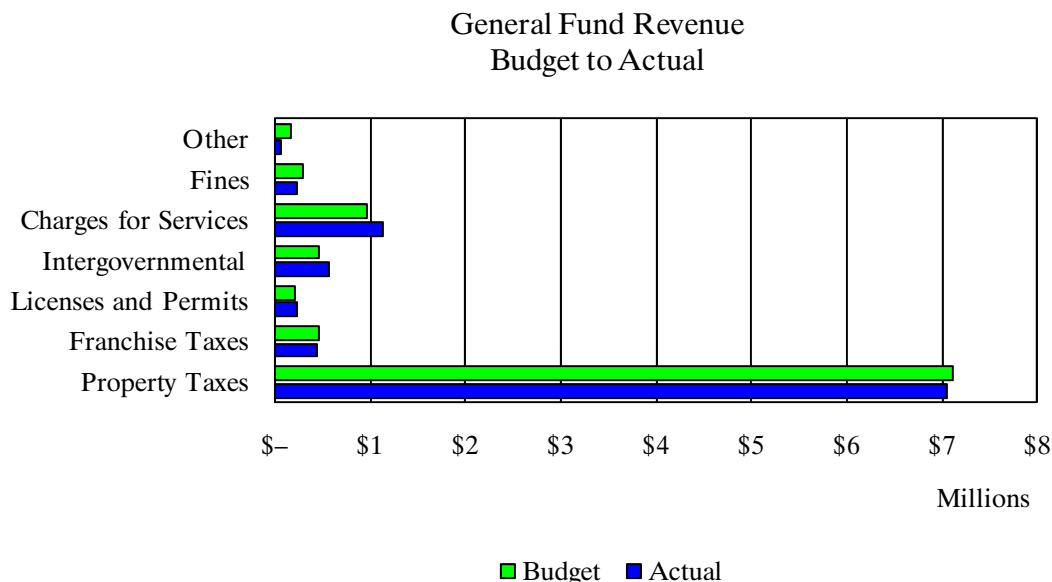


The City's General Fund cash and investment balance at December 31, 2010 was \$4,355,041, an increase of \$444,445 from last year. The General Fund total fund balance at December 31, 2010 was \$4,591,600, an increase of \$237,249 from the previous year. Unreserved fund balance at year-end was \$4,527,847, which represents approximately 44.5 percent of annual expenditures and transfers out based on 2010 levels. By comparison, unreserved fund balance at the end of the previous year represented 45.6 percent of expenditures and transfers out. All but \$188,522 of the year-end unreserved fund balance is designated for working capital in accordance with city policy.

Over the last few years, the City has generally been able to maintain stable cash and fund balance levels, despite significant legislative cuts to state aid. This is an important factor because a government, like any organization, requires a certain amount of equity to operate. Generally, the amount of equity required typically increases as the size of the operation increases.

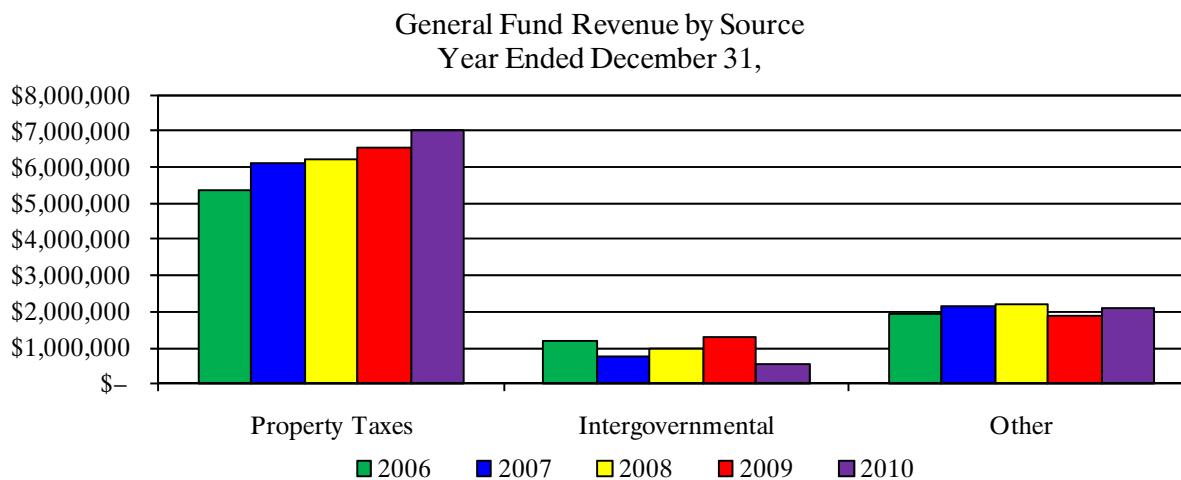
A healthy financial position allows the City to avoid volatility in tax rates; helps minimize the impact of state funding changes; allows for the adequate and consistent funding of services, repairs, and unexpected costs; and can be a factor in determining the City's bond rating and resulting interest costs. Maintaining an adequate fund balance has become increasingly important given the fluctuations in state funding for cities in recent years.

The following chart reflects the City's General Fund revenue sources for 2010 compared to budget:



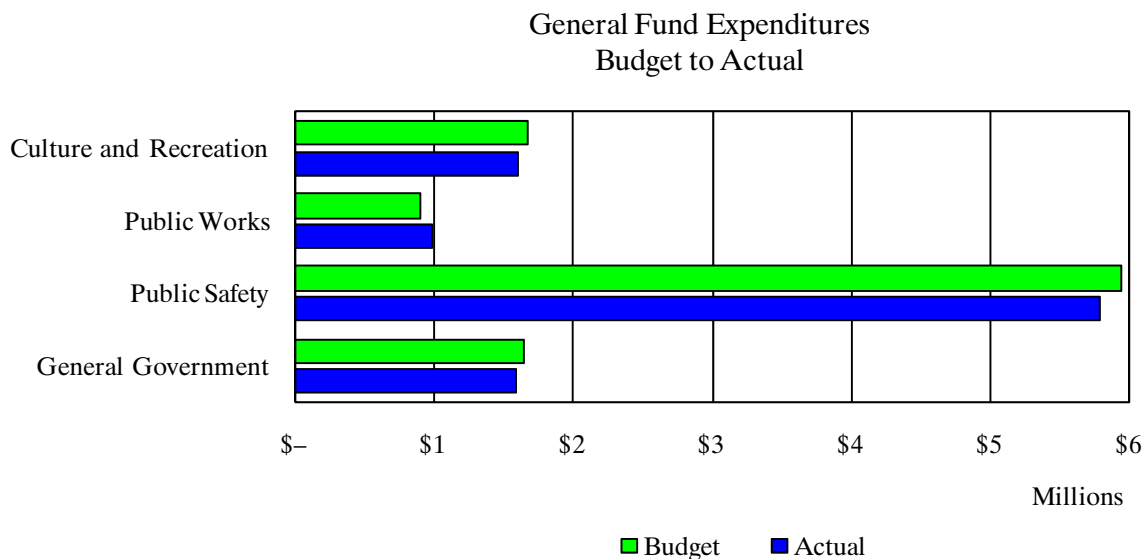
Total General Fund revenue for 2010 was \$9,701,993, which was \$36,563 (0.4 percent) higher than the final budget. Property tax revenue was \$62,750 under budget due to abatements and delinquencies. Intergovernmental revenue was over budget by \$99,718 due to a forest protection grant that was not anticipated in the budgeted. Charges for governmental services were over budget by \$160,134, mainly due to a \$74,600 pilot agreement fee received and an increase in recreation program fees. Revenue from court fines were \$62,239 less than projected. Investment income (included in "Other" above) was also under budget by \$93,453 due to declines in investment market values.

The following graph presents the City's General Fund revenue sources for the last five years. The graph reflects the City's reliance on property taxes and other local sources of revenue.



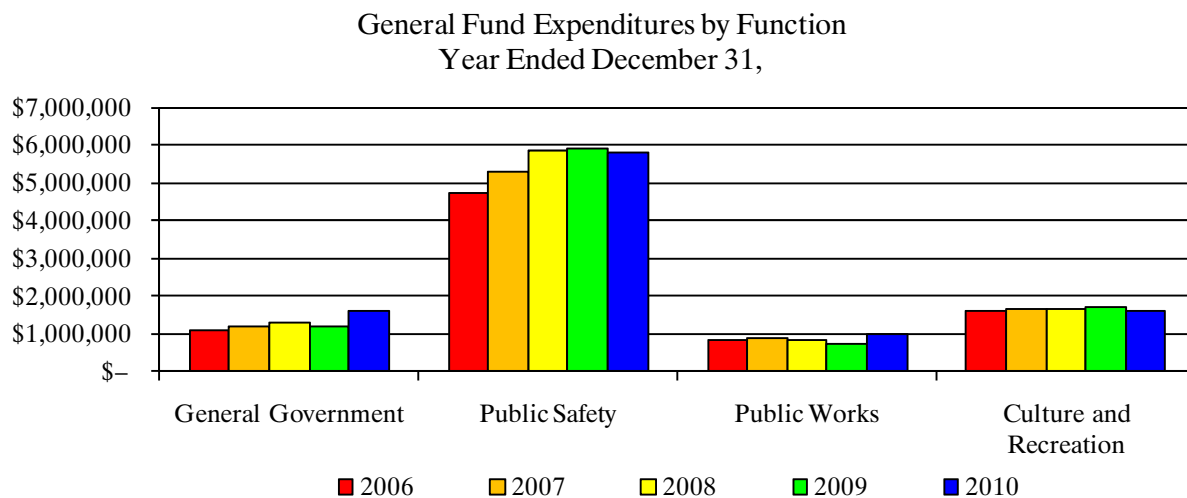
Total General Fund revenue for 2010 was \$23,475 (0.2 percent) lower than the prior year. Property tax revenue increased \$519,873 from the prior year due to the previously discussed increase in the City's general tax levy. Intergovernmental revenues were \$736,181 lower than last year, mainly due to reductions of almost \$687,000 in LGA and MVHC. Other revenue increased \$192,833, mainly due to increases in franchise taxes (\$89,997) and charges for services (\$127,280).

The following graphs illustrate the components of General Fund spending for 2010 compared to budget:



Total General Fund expenditures for 2010 were \$9,950,521, which was \$201,435 (2.0 percent) under the final budget. Public safety expenditures were \$148,737 under budget, primarily due to police and police reserve salaries and benefits not increasing as much as anticipated. Culture and recreation expenditures were under budget by \$69,526, as tree removal costs (salaries and benefits) in the parks department were lower than expected. Public works expenditures exceeded budget by \$84,768, but this was offset by unbudgeted grant proceeds related to the Emerald Ash Borer Grant Program.

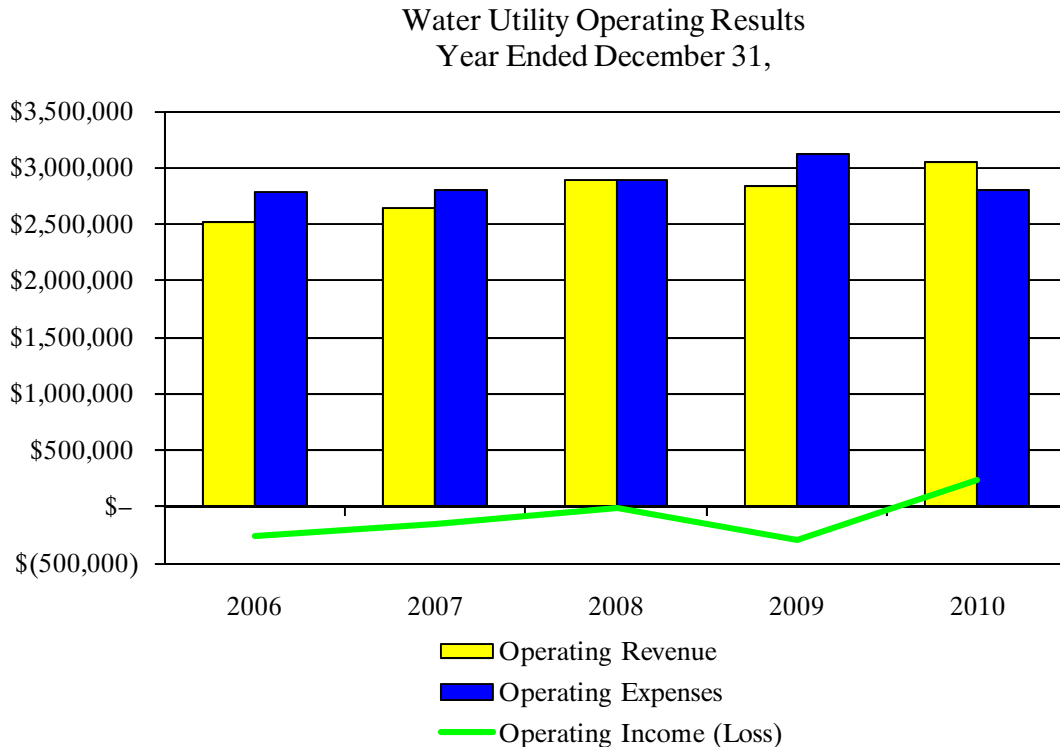
The following graph illustrates the City’s General Fund expenditures by function over the last five years:



Total General Fund expenditures increased by \$411,417, or about 4.3 percent. General government and public works expenditures increased by \$398,106 and 249,720, respectively, both primarily due to changes in the City’s method of budgeting and allocating salaries and benefits. Labor costs are now allocated to the various city departments based on the actual hours employees work in each department, rather than using preset labor pool allocations, as in the past.

WATER UTILITY FUND

The following graph presents five years of operating results for the City's water utility operation. Information for the fiscal years 2006 through 2009 is based on an estimated split of the City's water and sewer operations, which were reported in a single fund during those years.



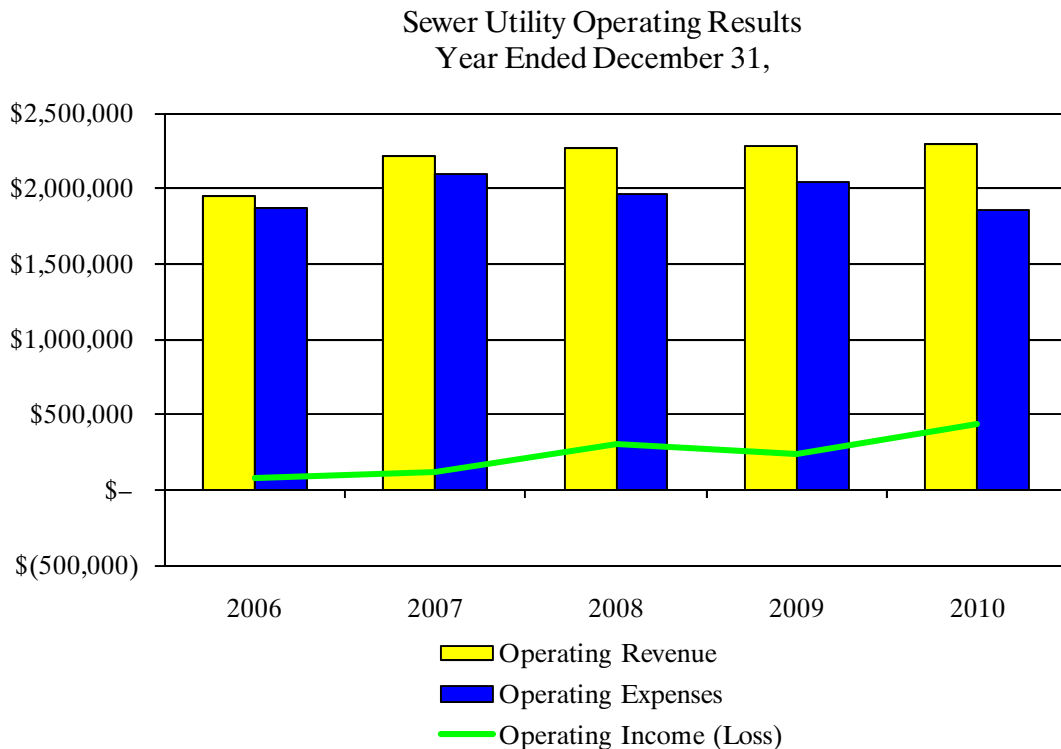
The Water Utility Fund ended 2010 with net assets of \$3,030,170, of which \$2,561,908 represents the fund's investment in water distribution system capital assets, and \$468,262 is unrestricted net assets. The City elected to begin accounting for its water and sewer enterprise operations in separate funds in 2010. A transfer of \$1,427,361 from the Water Utility Fund to the Sewer Utility Fund has been reported in 2010 to reflect the transfer of the City's sewer related net assets to a separate new fund. Excluding this transfer, Water Utility Fund net assets increased \$474,905 in 2010.

Operating revenue in the Water Utility Fund for 2010 was \$3,047,304, an increase of \$216,001 (7.6 percent) from the previous year. The increase was due to the City adopting a new tiered water rate system to incent water conservation, as required by state law. Water rates were increased a minimum of 5.2 percent for monthly usage.

Operating costs for 2010 were \$2,807,197, a decrease of \$318,291 from the prior year. Most of this decrease was due to a \$295,894 decline in the cost of water purchased due to a consumption decrease of 9.1 percent.

SEWER UTILITY FUND

The following graph presents five years of operating results for the City's sewer utility operation. Information for the fiscal years 2006 through 2009 is based on an estimated split of the City's water and sewer operations, which were reported in a single fund during these years.



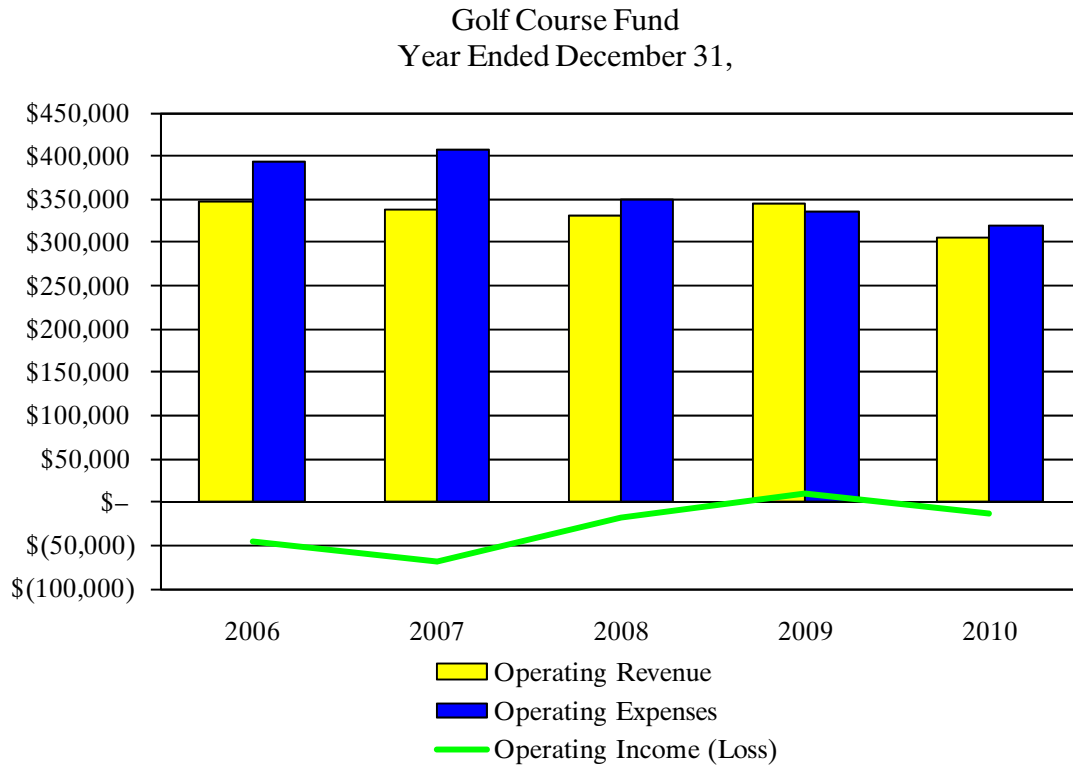
The Sewer Utility Fund ended 2010 with net assets of \$1,808,905, of which \$1,308,743 represents the investment in sewer collection system capital assets, and \$500,162 is unrestricted net assets. Excluding the \$1,427,361 transfer to establish this fund, net assets increased \$381,554 in 2010.

Operating revenue in the Sewer Utility Fund for 2010 was \$2,292,300, an increase of \$12,658 (0.6 percent) from the previous year. The City increased sewer rates 4.8 percent for 2010, but the increase was offset by a decrease in usage.

Operating costs for 2010 were \$1,862,007, a decrease of \$178,191 from the prior year. Sewer disposal charges paid to the Metropolitan Council Environmental Services decreased by \$177,837.

GOLF COURSE FUND

The following graph presents five years of operating results for the City's Golf Course Fund:

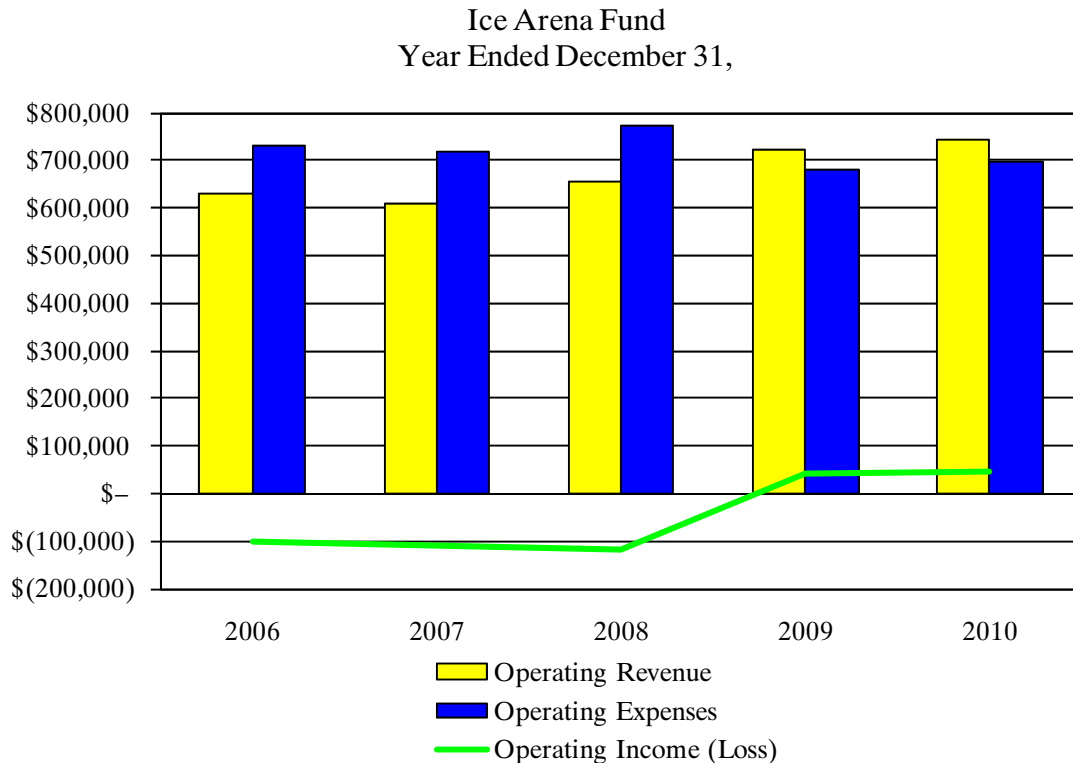


The Golf Course Fund ended 2010 with net assets of \$398,629, a decrease of \$28,109 from the prior year. Of this, \$721,367 represents the investment in capital assets, leaving a (\$322,738) deficit in unrestricted net assets.

Golf Course Fund operating revenue for 2010 was \$305,558, a decrease of \$39,922 (11.6 percent), mainly due to a decrease in the number of rounds played. Operating expenses were \$318,389, a decrease of \$17,427 from the prior year. Costs were reduced in all areas, including personnel, supplies and maintenance, utility costs, and depreciation.

ICE ARENA FUND

The following graph presents five years of operating results for the City's Ice Arena Fund:

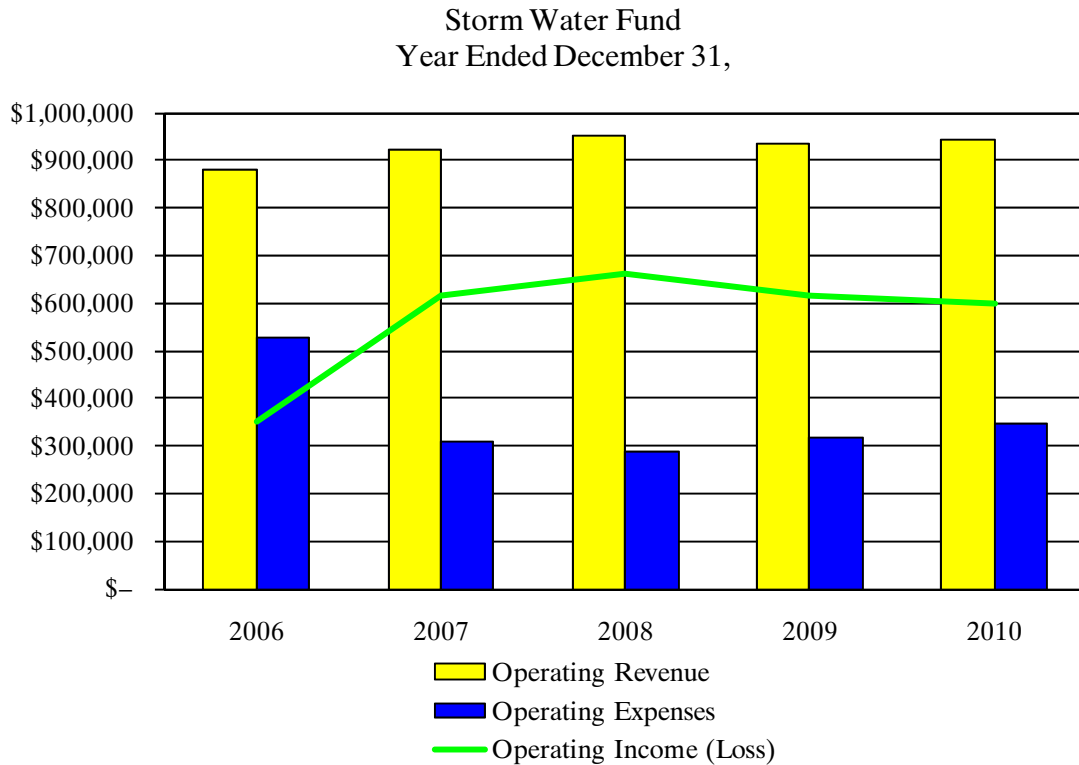


The Ice Arena Fund ended 2010 with net assets of \$3,486,482, an increase of \$46,767 from the prior year. Of this, \$3,074,801 represents the investment in capital assets, leaving \$411,681 of unrestricted net assets.

Ice Arena Fund operating revenue for 2010 was \$741,266, an increase of \$17,790 (2.5 percent) from the prior year, with the increase coming mainly from increased ice rental to area school districts. Operating expenses were \$697,321, which was \$17,045 higher than the prior year. The largest increase was in internal charges from the Central Garage Internal Service Fund for use of city vehicles, which was \$14,256 higher than last year.

STORM WATER FUND

The following graph presents five years of operating results for the City's Storm Water Fund:

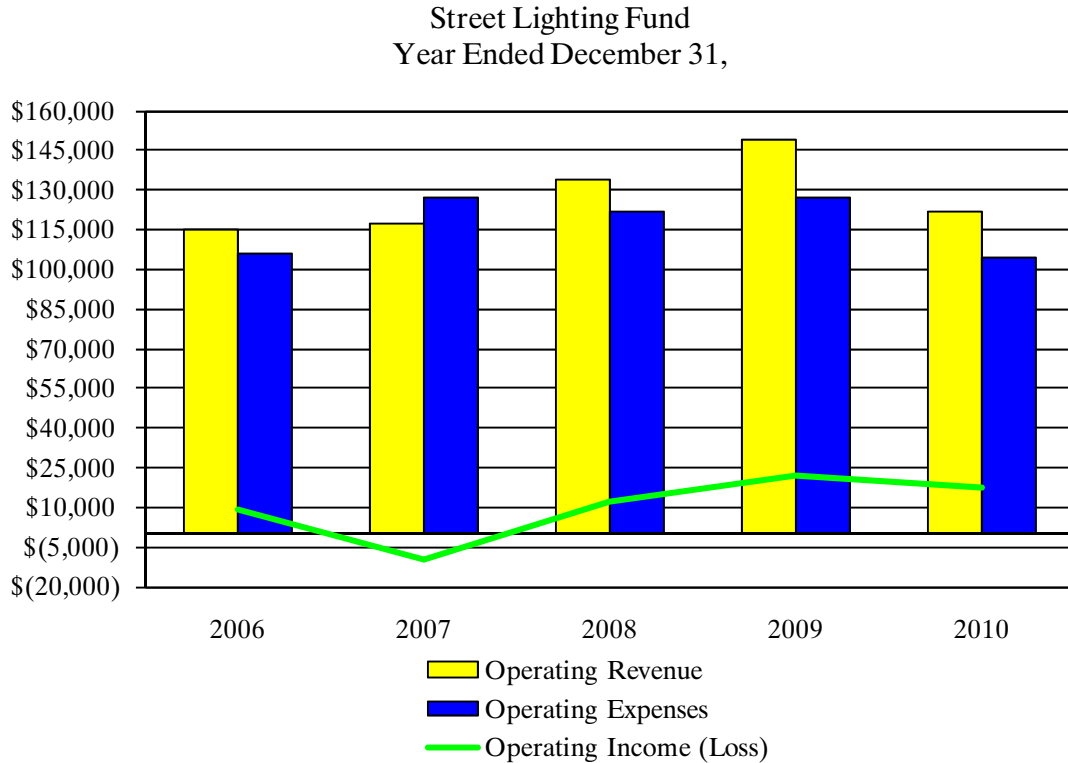


The Storm Water Fund ended 2010 with net assets of \$4,035,217, an increase of \$772,021 from the prior year. Of this, \$2,322,586 represents the investment in storm water collection system capital assets, leaving \$1,712,631 in unrestricted net assets.

Storm Water Fund operating revenues for 2010 were \$943,883, an increase of \$10,055 (1.1 percent) from the previous year. Operating expenses were \$347,152, an increase of \$30,936, mainly due to higher repair and maintenance costs.

STREET LIGHTING FUND

The following graph presents five years of operating results for the City's Street Lighting Fund:



The Street Lighting Fund ended 2010 with unrestricted net assets of \$163,939, an increase of \$19,640 from the prior year.

Street Lighting Fund operating revenues for 2010 were \$121,647, a decrease of \$27,692 from the previous year. Operating expenses were \$104,099, which was \$22,932 lower than the previous year due to a decrease in electric utility costs of \$21,807.

GOVERNMENT-WIDE FINANCIAL STATEMENTS

The City's financial statements include fund-based information that focuses on budgetary compliance, and the sufficiency of the City's current assets to finance its current liabilities. The Governmental Accounting Standards Board (GASB) Statement No. 34 reporting model also requires the inclusion of two government-wide financial statements designed to present a clear picture of the City as a single, unified entity. These government-wide statements provide information on the total cost of delivering services, including capital assets and long-term liabilities of the City's governmental activities.

Statement of Net Assets

The Statement of Net Assets essentially tells you what your city owns and owes at a given point in time, the last day of the fiscal year. Theoretically, net assets represent the resources the City has leftover to use for providing services after its debts are settled. However, those resources are not always in spendable form, or there may be restrictions on how some of those resources can be used. Therefore, the Statement of Net Assets divides the net assets into three components: net assets invested in capital assets, net of related debt; restricted net assets; and unrestricted net assets.

The following table presents the components of City's net assets as of December 31, 2010 and 2009, for governmental activities and business-type activities:

	As of December 31,		Increase (Decrease)
	2010	2009	
Net assets			
Governmental activities			
Invested in capital assets, net of related debt	\$ 16,495,175	\$ 16,411,454	\$ 83,721
Restricted	4,572,601	6,730,905	(2,158,304)
Unrestricted	<u>26,678,018</u>	<u>21,875,703</u>	<u>4,802,315</u>
Total governmental activities	47,745,794	45,018,062	2,727,732
Business-type activities			
Invested in capital assets, net of related debt	9,989,405	9,395,068	594,337
Unrestricted	<u>2,541,156</u>	<u>1,650,590</u>	<u>890,566</u>
Total business-type activities	<u>12,530,561</u>	<u>11,045,658</u>	<u>1,484,903</u>
Total net assets	<u>\$ 60,276,355</u>	<u>\$ 56,063,720</u>	<u>\$ 4,212,635</u>

The City's total net assets at December 31, 2010 were \$4,212,635 higher than the beginning of the year. Governmental activities net assets increased \$2,727,728 in total, mainly due to positive operating results in the governmental funds. Business-type net assets increased \$1,484,903, mainly due to improved operating results in the Water Utility and Sewer Utility Funds.

Statement of Activities

The Statement of Activities tracks the City's yearly revenues and expenses, as well as any other transactions that increase or reduce total net assets. These amounts represent the full cost of providing services. The Statement of Activities provides a more comprehensive measure than just the amount of cash that changed hands, as reflected in the fund-based financial statements. This statement includes the cost of supplies used, depreciation of long-lived capital assets, and other accrual-based expenses.

The following table presents the change in net assets of the City for the years ended December 31, 2010 and 2009:

	2010		2009	
	Expenses	Program Revenues	Net Change	Net Change
Net (expense) revenue				
Governmental activities				
General government	\$ 2,552,425	\$ 1,264,431	\$ (1,287,994)	\$ (978,544)
Public safety	5,864,775	463,951	(5,400,824)	(5,848,371)
Public works	1,625,959	1,528,957	(97,002)	(1,050,622)
Culture and recreation	1,899,105	616,801	(1,282,304)	(1,517,847)
Economic development	192,431	139,882	(52,549)	—
Interest on long-term debt	252,224	—	(252,224)	(275,532)
Business-type activities				
Water utility	2,915,757	3,354,212	438,455	(54,513) *
Sewer utility	1,928,845	2,292,300	363,455	(54,513) *
Golf course	346,345	313,941	(32,404)	(23,329)
Ice arena	712,153	741,266	29,113	29,936
Storm water	430,899	1,173,364	742,465	666,838
Street lighting	104,099	121,647	17,548	22,356
Total net (expense) revenue	<u>\$ 18,825,017</u>	<u>\$ 12,010,752</u>	(6,814,265)	(9,084,141)
General revenues				
Property taxes and tax increments			10,139,235	10,023,080
Franchise taxes			430,494	438,744
Unrestricted grants and contributions			79,529	902,442
Unrestricted investment earnings			354,712	750,799
Gain on disposal of assets			22,930	—
Total general revenues			<u>11,026,900</u>	<u>12,115,065</u>
Change in net assets			<u>\$ 4,212,635</u>	<u>\$ 3,030,924</u>

* This represents half of the 2009 net change for the combined water and sewer activity of \$109,026.

One of the goals of this statement is to provide a side-by-side comparison to illustrate the difference in the way the City's governmental and business-type operations are financed. The table clearly illustrates the dependence of the City's governmental operations on general revenues such as property taxes. It also shows that, for the most part, the City's business-type activities are generating sufficient program revenues (service charges and program-specific grants) to cover expenses. This is critical given the current downward pressures on the general revenue sources.

ACCOUNTING AND AUDITING UPDATES

GASB STATEMENT NO. 54 – FUND BALANCE REPORTING AND GOVERNMENTAL FUND TYPE DEFINITIONS

The objective of this statement is to enhance the usefulness of fund balance information by providing clearer fund balance classifications that can be more consistently applied and by clarifying the existing governmental fund type definitions. This statement establishes fund balance classifications (nonspendable, restricted, committed, assigned, and unassigned) that comprise a hierarchy based primarily on the extent to which a government is bound to observe constraints imposed upon the use of the resources reported in governmental funds. The definitions of the general, special revenue, capital projects, debt service, and permanent fund types are clarified by the provisions in this statement; which could necessitate changes in fund structure, particularly for existing special revenue funds. Elimination of the reserved component of fund balance in favor of a restricted classification will enhance the consistency between information reported in the government-wide statements and information in the governmental fund financial statements and avoid confusion about the relationship between reserved fund balance and restricted net assets. The requirements of this statement are effective for financial statements for periods beginning after June 15, 2010.

GASB STATEMENT NO. 60 – ACCOUNTING AND FINANCIAL REPORTING FOR SERVICE CONCESSION ARRANGEMENTS

This statement provides accounting and financial reporting guidance for governments that participate as either a transferor or an operator in a service concession arrangement (SCA). SCAs are arrangements whereby a government transfers the rights to operate one of its capital assets to a third party operator (either a private party or another government) for consideration, with the operator then being compensated from the fees or charges collected in connection with the operation of the asset. To qualify as an SCA, an arrangement must meet all of the following criteria: 1) the transferor must convey to the operator both the right and the obligation to use one of its capital assets to provide services to the public; 2) the operator must provide significant consideration to the transferor; 3) the operator must be compensated from the fees or charges it collects from third parties; 4) the transferor must have the ability to either determine, modify, or approve what services are to be provided to whom at what price; and 5) the transferor must retain a significant residual interest in the service utility of the asset. This statement provides guidance to governments that are party to an SCA for reporting the assets, obligations, and flow of revenues that result from the arrangement; along with the required financial statement disclosures. The requirements of this statement must be implemented for fiscal year ending December 31, 2012, with earlier implementation encouraged.

GASB STATEMENT NO. 61 – THE FINANCIAL REPORTING ENTITY: OMNIBUS

This statement amends the current guidance in GASB Statement No. 14, “The Financial Reporting Entity,” for identifying and presenting component units. This statement changes the fiscal dependency criterion for determining component units. Potential component units that meet the fiscal dependency criterion for inclusion in the financial reporting entity under existing guidance will only be included if there is also “financial interdependency” (an ongoing relationship of potential financial benefit or burden) with the primary government. This statement also clarifies the types of relationships that are considered to meet the “misleading to exclude” criterion for inclusion as a component unit; changes the criteria for blending component units; gives direction for the determination and disclosure of major component units; and adds a requirement to report an explicit, measurable equity interest in a discretely presented component unit in a statement of position prepared using the economic resources measurement focus. The requirements of this statement must be implemented for fiscal year ending June 30, 2013, with earlier implementation encouraged.