Management Letter

City of North Mankato

North Mankato, Minnesota

For the Year Ended
December 31, 2016

ABDO EICK & MEYERS LLP
Certified Public Accountants & Consultants

People + Process. Going Beyond the Numbers

ABDO EICK & MEYERS LLP
Certified Public Accountants & Consultants

June 27, 2017

Management, Honorable Mayor and City Council
City of North Mankato, 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 North Mankato (the City) for the year ended December 31, 2016 and have issued our report thereon dated June 27, 2017. Professional standards require that we provide you with information about our responsibilities under generally accepted auditing standards and *Government Auditing Standards* and the Uniform Guidance, 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 December 13, 2016. 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, *Government Auditing Standards and the Uniform Guidance*

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

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

Significant Audit Findings

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

Our consideration of internal control was for the limited purpose described in the preceding paragraph and was not designed to identify all deficiencies in internal control that might be material weaknesses or significant deficiencies and therefore, material weaknesses or significant deficiencies may exist that were not identified. However, as described in the accompanying Schedule of Findings, Responses and Questioned Costs, we identified a certain deficiency in internal control that we consider to be a material weakness and another deficiency that we consider to be a significant deficiency.

A *deficiency in internal control* exists when the design or operation of a control does not allow management or employees, in the normal course of performing their assigned functions, to prevent, or detect and correct, misstatements on a timely basis. A *material weakness* is a deficiency, or a combination of deficiencies, in internal control such that there is a reasonable possibility that a material misstatement of the entity's financial statements will not be prevented, or detected and corrected on a timely basis. We consider the deficiencies described on the following pages as item 2016-002 to be a material weakness.

A *significant deficiency* is a deficiency, or a combination of deficiencies, in internal control that is less severe than a material weakness, yet important enough to merit attention by those charged with governance. We consider the deficiency described on the following pages as item 2016-001 to be a significant deficiency.

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P.O. Box 3166
Mankato, MN 56002-3166
507.625.2727 | Fax 507.388.9139

2016-001 Preparation of financial statements

Condition: As in prior years, we were requested to draft the audited financial statements and related footnote disclosures as part of our regular audit services. Auditing standards require auditors to communicate this situation to the Council as an internal control deficiency. Ultimately, it is management's responsibility to provide for the preparation of your statements and footnotes, and the responsibility of the auditor to determine the fairness of presentation of those statements. However, based on auditing standards, it is our responsibility to inform you that this deficiency could result in a material misstatement to the financial statements that could have been prevented or detected by your management. Essentially, the auditors cannot be part of your internal control process.

Criteria: Internal controls should be in place to ensure adequate internal control over the reliability of financial records and reporting.

Cause: From a practical standpoint, we prepare the statements and determine the fairness of the presentation at the same time in connection with our audit. This is not unusual for us to do with organizations of your size.

Effect: The effectiveness of the internal control system relies on enforcement by management. The effect of deficiencies in internal controls can result in undetected errors. As in prior years, we have instructed management to review a draft of the auditor prepared financials in detail for accuracy; we have answered any questions that management might have, and have encouraged research of any accounting guidance in connection with the adequacy and appropriateness of classification of disclosures in your statements. We are satisfied that the appropriate steps have been taken to provide you with the completed financial statements.

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

Management response:

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

2016-002 Material audit adjustments

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

- To adjust capital assets.
- To adjust the coding of transfers.

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

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

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

Recommendation: We recommend that management review each journal entry, obtain an understanding of why the entry was necessary and modify current procedures to ensure that future corrections are not needed.

Management response:

Management will continue to review and gain an understanding of the audit adjustments in order to reduce the number of entries necessary for future audits.

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Compliance and Other Matters

As part of obtaining reasonable assurance about whether the City's financial statements are free of material misstatement, we performed tests of its compliance with certain provisions of laws, regulations, contracts, grant agreements, and other matters noncompliance with which could have a direct and material effect on the determination of financial statement amounts. However, providing an opinion on compliance with those provisions was not an objective of our audit. Also in accordance with the Uniform Guidance, we examined, on a test basis, evidence about the City's compliance with the types of compliance requirements described in the "*U.S. Office of Management and Budget (OMB) Compliance Supplement*" applicable to each of its major federal programs for the purpose of expressing an opinion on the City's compliance with those requirements and for compliance with federal statutes, regulations, and the terms and conditions of its federal awards applicable to its federal programs. While our audit provides a reasonable basis for our opinion, it does not provide a legal determination on the City's compliance with those requirements. The results of our tests disclosed one instance of noncompliance or other matters that is required to be reported under *Government Auditing Standards,* the Uniform Guidance or Minnesota statutes which is described below:

2016-003 Uniform Guidance written policies and procedures

Condition: During our audit, we discovered the City did not develop written procedures as required by the Uniform Guidance for the following:

- Determination of Allowable of Costs - §200.302(b)(7)
- Time and Effort - §200.430(a)
- Cash Management of Federal Funds - §200.302(b)(6)
- Conflict of Interest - §200.318(c)(1-2)

The City must also ensure that existing written procedures are in compliance with:

- General Procurement Standards - §200.318-.326
- Equipment Management Requirements - §200.313

Criteria: The City "must" establish and maintain effective internal control over Federal awards that provides reasonable assurance that the City is managing Federal awards in compliance with Federal statutes, regulations, and the terms and conditions of the Federal awards.

Cause: The City did not have these written policies and procedures in place sufficient to comply with the Uniform Guidance requirements.

Effect: The City was out of compliance with this requirement.

Recommendation: The City should implement written policies and procedures to adhere to the above mentioned Uniform Guidance requirements.

Management response:

The City will establish written policies and procedures to ensure future compliance with the Uniform Guidance requirements.

Qualitative Aspects of Accounting Practices

Management is responsible for the selection and use of appropriate accounting policies. The significant accounting policies used by the City are described in Note 1 to the financial statements. The City changed accounting policies during 2016 related to fair market value and application (GASB 72), accounting and financial reporting for pension and related assets not within the scope of GASB 68, including amendments to certain provisions GASB Statement No. 67 and No. 68 (GASB 73), and certain external investment pools and pool participants (GASB 79). Accordingly, the cumulative effect of the accounting change as of the beginning of the year is disclosed in Note 8. 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.

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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. Significant estimates affecting the financial statements include the capital asset basis, the depreciation on capital assets, allowance for doubtful accounts and the liabilities for the City's Other Post-employment Benefits (OPEB) and City's pensions.

- Capital asset basis is based on estimated historical cost of the capital assets.

- Depreciation is based on the estimated useful lives of capital assets.

- Management's estimate of the allowance is based on past uncollectible accounts.

- OPEB liability is based on several factors including, but not limited to, anticipated retirement age for active employees, life expectancy, turnover, and healthcare cost trend rate.

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

The disclosures in the financial statements are neutral, consistent, and clear. Certain financial statement disclosures are particularly sensitive because of their significance to financial statement users.

Difficulties Encountered in Performing the Audit

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

Corrected and Uncorrected Misstatements

Professional standards require us to accumulate all known and likely misstatements identified during the audit, other than those that are trivial, and communicate them to the appropriate level of management. During our audit a material adjustment was needed to record additional contracts and retainages payable. Management has corrected all such misstatements. We also assisted in preparing a number of year end accounting entries. These were necessary to adjust the City's records at year end to correct ending balances. The City should establish more detailed processes and procedures to reduce the total number of entries in each category. The City will receive better and timelier information if the preparation of year-end entries is completed internally.

Disagreements with Management

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

Management Representations

We have requested certain representations from management that are included in the management representation letter dated June 27, 2017.

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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.

Other Matters

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

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

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

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Financial Position and Results of Operations

Our principal observations and recommendations are summarized below. These recommendations resulted from our observations made in connection with our audit of the City's financial statements for the year ended December 31, 2016.

General Fund

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

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

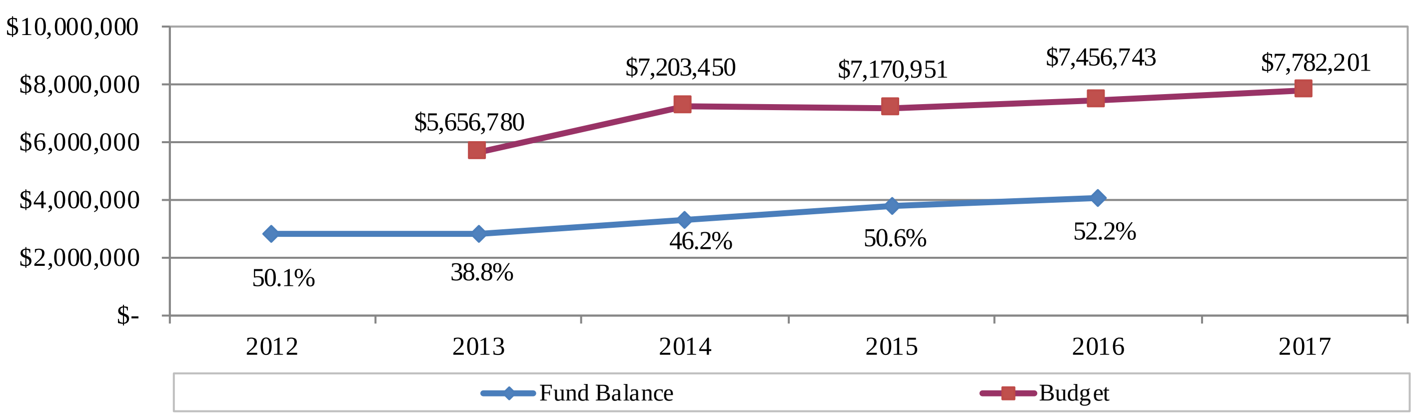
As you can see from the following information, it is necessary to maintain fund balance in order to keep pace with the increasing operating budget. *This information is also presented in graphic form below.*

Year	Fund Balance December 31	Budget Year	General Fund Budget	Percent of Fund Balance to Budget
2012	$ 2,836,811	2013	5,656,780	50.1 %
2013	2,794,394	2014	7,203,450 *	38.8
2014	3,315,595	2015	7,170,951	46.2
2015	3,776,206	2016	7,456,743	50.6
2016	4,064,351	2017	7,782,201	52.2

* Starting in 2014, certain special revenue funds were closed and budgeted into the General fund causing the percent of fund balance to budget for 2013 to decrease. Also, the General fund balance includes interfund receivable offset that is nonspendable.

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

Fund Balance/Budget Comparison



The General fund balance increased by $288,145 in 2016. The total fund balance of $4,064,351 represents 52.2 percent of the 2017 budget. Many other organizations, including the Office of the State Auditor (the OSA) and League of Minnesota Cities (LMC) recommend that unassigned fund balance be anywhere from 35 to 50 percent of planned expenditures. We concur with those recommendations.

Although there is no legislation regulating fund balance, it is a good policy to assign intended use of fund balance. This helps address citizen concerns as to the use of fund balance and tax levels. The City should consider documenting assignments for intended use of fund balance at and above the fifty percent level. This documentation could be accomplished by an annual resolution to identify intended use of available fund balance. We recommend a minimum unassigned fund balance be approximately 40 percent to 50 percent of planned disbursements. So at the current level, the fund balance is considered about what is recommended.

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

- Expenditures are incurred somewhat evenly throughout the year. However, property tax and state aid revenues are not received until the second half of the year. An adequate fund balance will provide the cash flow required to finance the governmental fund expenditures.
- The City is vulnerable to legislative actions at the State and Federal level. The State continually adjusts the local government aid formulas. We also have seen the State mandate levy limits for cities over 2,500 in population. An adequate fund balance will provide a temporary buffer against those aid adjustments or levy limits.
- Expenditures not anticipated at the time the annual budget was adopted may need immediate Council action. These would include capital outlay, replacement, lawsuits and other items. An adequate fund balance will provide the financing needed for such expenditures.
- A strong fund balance will assist the City in maintaining, improving or obtaining its bond rating. The result will be better interest rates in future bond sales.

The 2016 General fund operations are summarized as follows:

	Final Budgeted Amounts	Actual Amounts	Variance with Final Budget
Revenues	$ 7,518,482	$ 7,557,518	$ 39,036
Expenditures	7,456,743	7,362,694	94,049
Excess (deficiency) of revenues over (under) expenditures	61,739	194,824	133,085
Other financing sources (uses)			
Transfers in	286,954	279,350	(7,604)
Transfers out	(220,770)	(186,029)	34,741
Total other financing sources (uses)	66,184	93,321	27,137
Net change in fund balances	$ 127,923	288,145	$ 160,222
Fund balances, January 1		3,776,206	
Fund balances, December 31		$ 4,064,351	

Some of the larger variance items are as follows:

- Tax revenue was under budget by $122,232 due to over budgeting of franchise fees
- Intergovernmental revenue was over budget by $56,796 mainly due to increases in police and fire aids
- Charges for services revenue was over budget by $75,779 attributable to concession sales at Caswell Park
- Miscellaneous revenue was over budget by $46,578 due to a larger than anticipated insurance dividend
- Public works expenditures were under budget by $97,399 due to less street maintenance than expected
- Culture and recreation expenditures were over budget by $240,250 attributable to increased activity at Caswell Park which were partially offset with additional revenue at the park
- Capital outlay expenditures were under budget by $263,814 due to the timing of purchases

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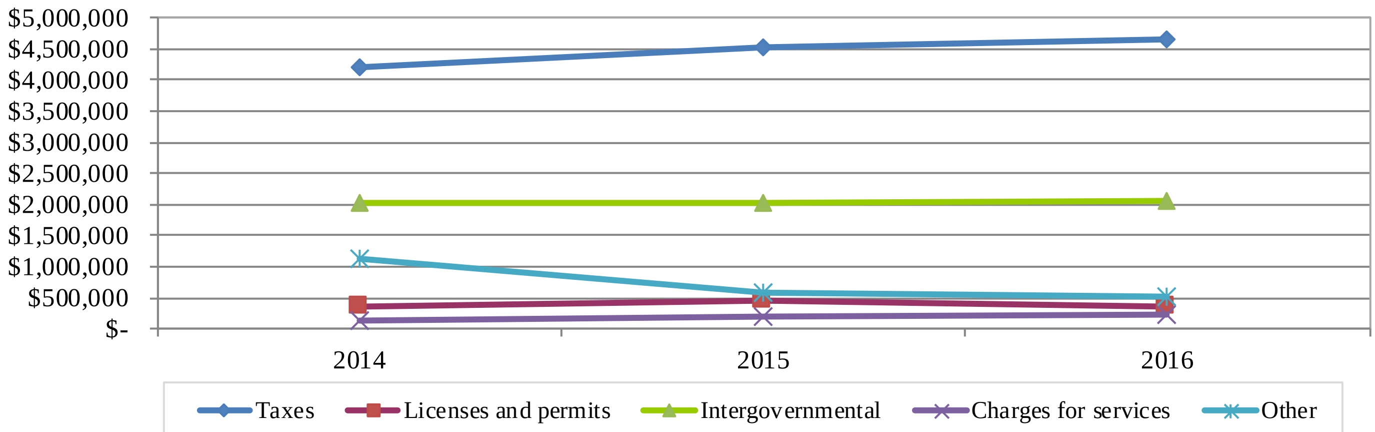
A comparison of General fund revenues and transfers for the last three years is presented below:

Source	2014	2015	2016	Percent of Total	Per Capita
Taxes	$ 4,220,158	$ 4,521,694	$ 4,664,566	59.5 %	$ 343
Special assessments	13,949	29,140	26,985	0.3	2
Licenses and permits	357,809	448,871	360,412	4.6	27
Intergovernmental	2,011,965	2,036,034	2,056,525	26.2	151
Charges for services	134,075	199,242	242,214	3.1	18
Fines and forfeits	20,068	27,578	31,247	0.4	2
Investment earnings	2,504	3,926	3,978	0.1	-
Miscellaneous	229,902	259,152	171,591	2.2	13
Transfers in	868,516	271,750	279,350	3.6	21
Total revenues and transfers	$ 7,858,946	$ 7,797,387	$ 7,836,868	100.0 %	$ 577

General Fund Revenues by Source



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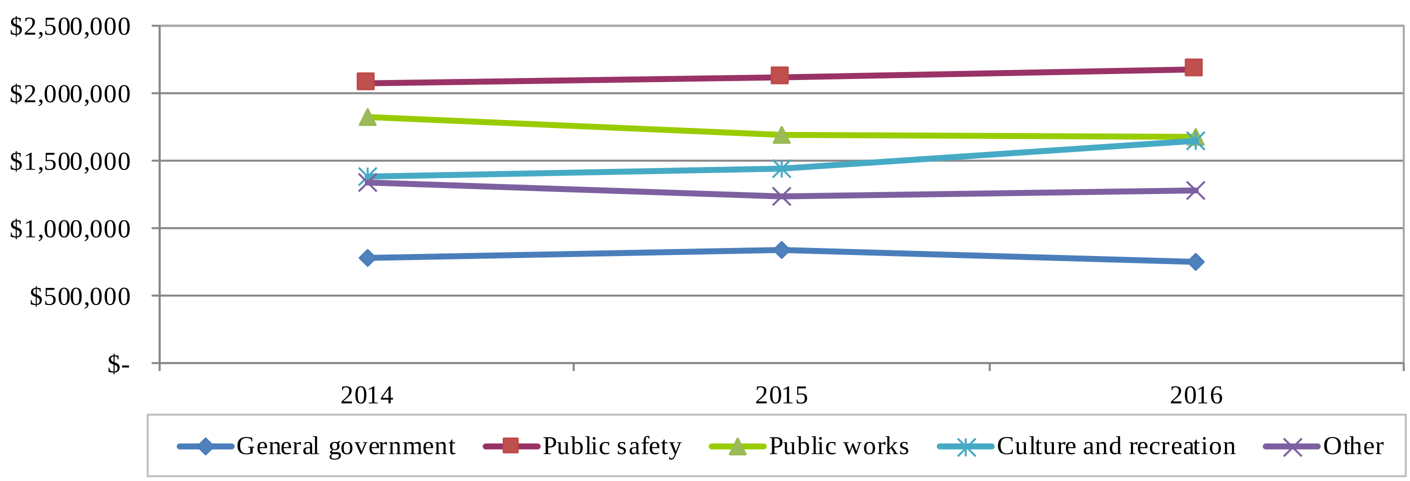
A comparison of General fund expenditures and transfers for the last three years is presented below:

Program	2014	2015	2016	Percent of Total	Per Capita	Peer Group Per Capita
Current						
General government	$ 785,958	$ 839,835	$ 752,144	10.0 %	$ 55	$ 109
Public safety	2,071,785	2,120,907	2,183,726	28.9	161	232
Public works	1,831,894	1,693,925	1,675,017	22.2	123	103
Culture and recreation	1,389,252	1,444,506	1,647,680	21.8	121	60
Housing and economic development	454,594	555,517	500,854	6.6	37	6
Miscellaneous	250,780	358,907	288,787	3.8	21	14
Total current	6,784,263	7,013,597	7,048,208	93.3	518	524
Capital outlay	389,745	243,875	314,486	4.2	23	15
Debt service	17,918	79,513	-	-	-	-
Transfers out	235,000	-	186,029	2.5	14	-
Total expenditures and transfers	$ 7,426,926	$ 7,336,985	$ 7,548,723	100.0 %	$ 555	$ 539

General Fund Expenditures by Program



Special Revenue Funds

Special revenue funds have revenue from specific sources to be used for specific purpose. Listed below are the special revenue funds of the City along with the fund balances for 2016 and 2015 and the net change:

	Fund Balances December 31,		
Fund	2016	2015	Increase (Decrease)
Nonmajor			
Library Endowment	$ 50,000	$ 41,168	$ 8,832
Community Development Block Grant	12,849	37,086	(24,237)
Local Option Sales Tax	140,734	62,795	77,939
Park Development	5,866	10,911	(5,045)
Port Authority	211,734	138,428	73,306
Federal Revolving Loan	1,715,558	1,631,436	84,122
Local Revolving Loan	228,395	245,928	(17,533)
Joint Economic Development	361,337	171,649	189,688
Marigold TIF #8	(397,107)	(397,107)	-
Webster Redevelopment TIF #14	54,901	39,885	15,016
National Dentex TIF #17	-	-	-
Webster Avenue TIF #2	1,015	1,015	-
LJP Enterprises TIF #18	-	3,978	(3,978)
Ziegler Caterpillar TIF #20	-	2,127	(2,127)
422 Belgrade TIF #19	12,562	21,886	(9,324)
Lindsay TIF #22	-	402	(402)
Allstate Peterbuildt TIF #21	-	634	(634)
Total	$ 2,397,844	$ 2,012,221	$ 385,623

Debt Service Funds

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

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

- Property taxes - Primarily for general City benefit projects such as parks and municipal buildings. Property taxes may also be used to fund special assessment bonds which are not fully assessed.

- Tax increments - Pledged exclusively for tax increment/economic development districts.

- Capitalized interest portion of bond proceeds - After the sale of bonds, the project may not produce revenue (tax increments or special assessments) for a period of one to two years. Bonds are issued with this timing difference considered in the form of capitalized interest.

- Special assessments - Charges to benefited properties for various improvements.

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

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

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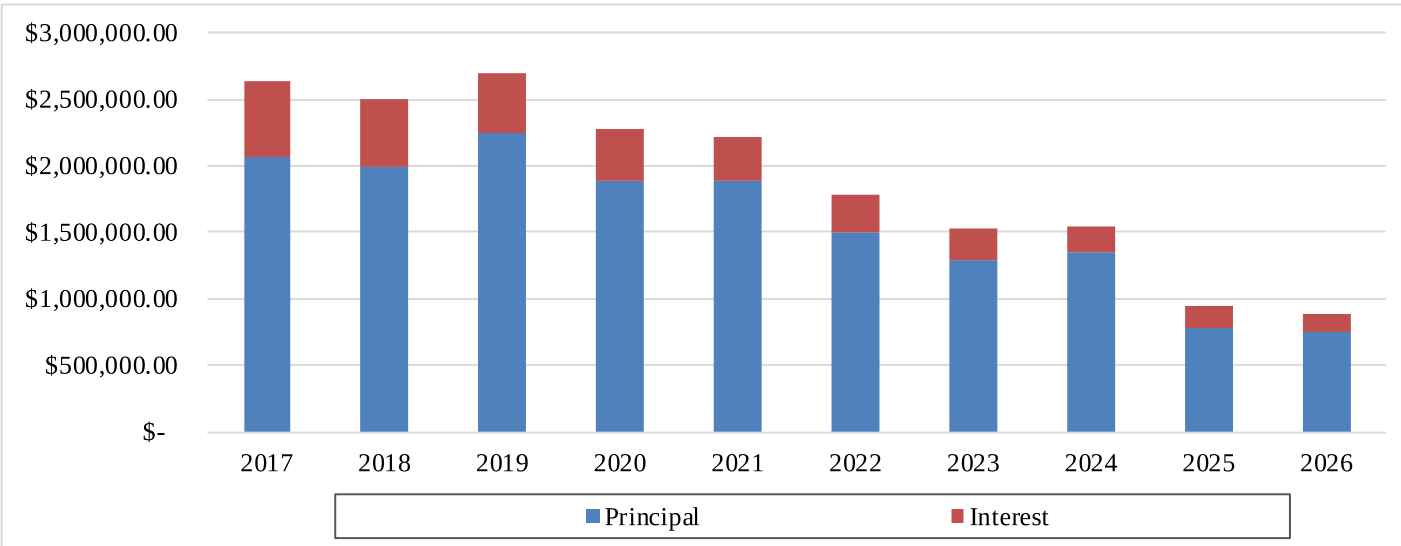
The following is a summary of Debt Service fund assets and outstanding debt as of December 31, 2016:

Debt Description	Total Cash and Temporary Investments	Total Assets	Outstanding Debt	Maturity Date
General Obligation Bonds				
Bond Reserve	$ 629,255	$ 1,258,482	$ -	N/A
G.O. Capital Improvements - 2008C	-	-	600,000	02/01/19
General Obligations - 2011A	-	-	2,955,000	02/01/34
G.O. Capital Improvements - 2012A	-	-	345,000	02/01/20
General Obligations - 2014A	-	19,264	820,000	12/01/29
General Obligations - 2015A	-	-	550,000	12/01/30
General Obligations - 2016A	-	-	465,000	12/01/26
Total G.O. Bonds	629,255	1,277,746	5,735,000	
Tax Increment Bonds				
Taxable G.O. Tax Increment Bonds of 2010D	50,762	50,762	755,000	02/01/37
Taxable G.O. Tax Increment Revenue Bonds of 2011B	31,883	31,883	425,000	02/01/35
Total Tax Increment Bonds	82,645	82,645	1,180,000	
G.O. Special Assessment Bonds				
2005D G.O. Improvement Bonds	110,620	872,935	-	Matured
2007A G.O. Improvement Bonds	311,872	798,361	235,000	02/01/18
2008A G.O. Improvement Bonds	-	41,257	525,000	02/01/19
2009D G.O. Improvement Bonds	1,943,868	4,048,287	2,055,000	04/01/17
2010A G.O. Improvement Bonds	95,871	710,049	1,860,000	12/01/27
2010C G.O. Refunding Bonds	538,765	1,285,612	2,495,000	02/01/22
2015A G.O. Improvement Bonds (West Carlson)	-	348,286	-	
2015A G.O. Improvement Bonds	195,121	195,121	1,410,000	12/01/30
2015B G.O. Crossover Refunding Bonds	-	-	1,970,000	12/01/28
2010A G.O. Improvement Bonds	64,373	239,933	1,335,000	12/01/32
Total G.O. Special Assessment Bonds	3,260,490	8,539,841	11,885,000	
G.O. Revenue Bonds				
G.O. Port Authority Taxable Refunding Bonds of 2009A	-	-	505,000	02/01/19
2009C G.O. Sales Tax Revenue Bonds	-	-	1,575,000	12/01/24
2010B G.O. Sales Tax Revenue Bonds	-	-	500,000	12/01/25
Total G.O. Revenue Bonds	-	-	2,580,000	
Total All Debt Service Funds	$ 3,972,390	$ 9,900,232	$ 21,380,000	
Future Interest on Debt			$ 3,733,994	

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

Any funds whose debt has matured can be closed to other funds. At December 31, 2016, the City has the 2005D Improvement Bonds fund that can be closed.

The annual debt service requirements for the next 10 years for the debt (excluding refunded bonds) detailed above are as follows:



Capital Projects Funds

Capital projects funds are used to account for the acquisition and construction of major capital facilities other than those financed by proprietary funds. The table below compares 2016 fund balances with 2015:

Fund	Fund Balances December 31, 2016	2015	Increase (Decrease)
Major			
2014 Construction	$ 175,174	$ 175,174	$ -
2015 Construction	(1,482,589)	(1,478,131)	(4,458)
2016 Construction	258,050	(22,672)	280,722
Nonmajor			
Capital Facilities and Equipment Replacement - General	65,107	213,738	(148,631)
2011 Construction	(10,581)	(6,840)	(3,741)
Total	$ (994,839)	$ (1,118,731)	$ 123,892

The City should analyze project's status each year and close those that are completed. The 2015 Construction fund deficit was caused by the State advancing Municipal State Aid Funds for Streets that were received in cash by the City in 2015 and 2016 but will not be recognized as revenue until available in future years.

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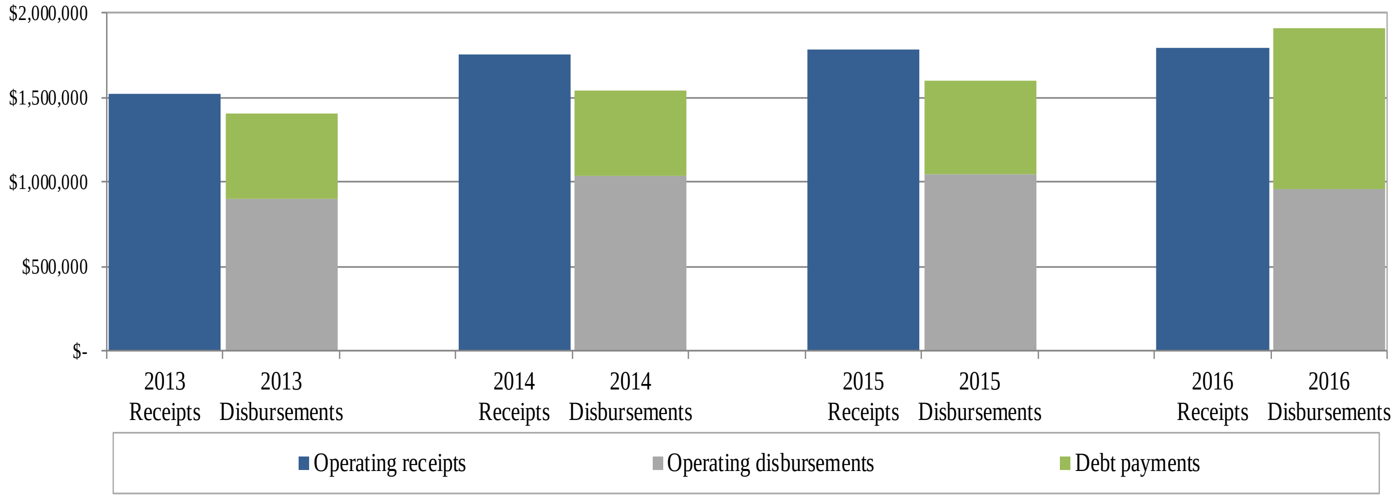
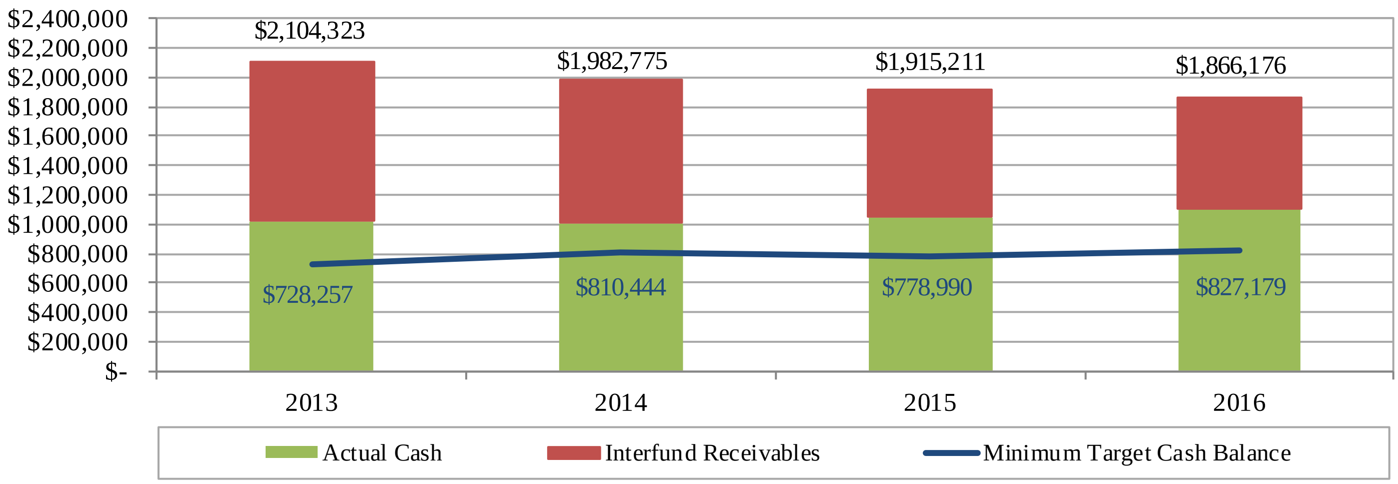
Enterprise Funds

Enterprise funds are used to account for operations that are financed and operated in a manner similar to private business enterprises- where the intent is that the costs of providing goods or services to the general public on a continuing basis be financed or recovered primarily through user charges. A comparison of enterprise fund cash flows and cash balances for the past four years is as follows:

Water Utility Fund Cash Flows



Water Utility Fund Cash Balances



The minimum target cash balance is based off 25 percent of operating costs plus the next year's debt payments for the fund.

	2013	2014	2015	2016
Bonds payable	$ 4,118,250	$ 3,758,750	$ 7,048,815	$ 6,496,523

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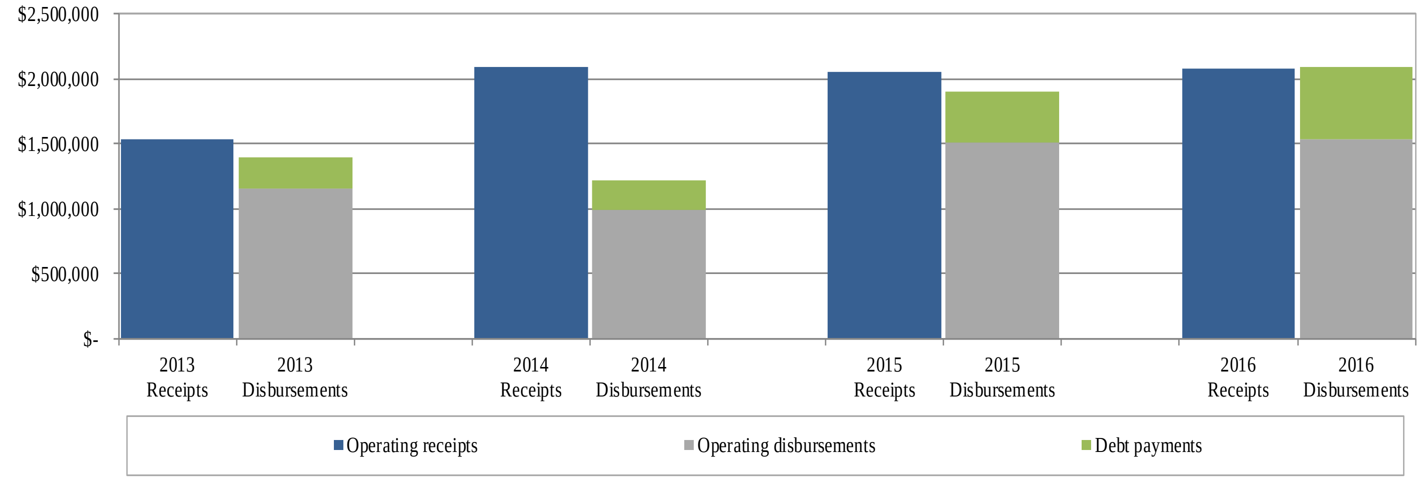
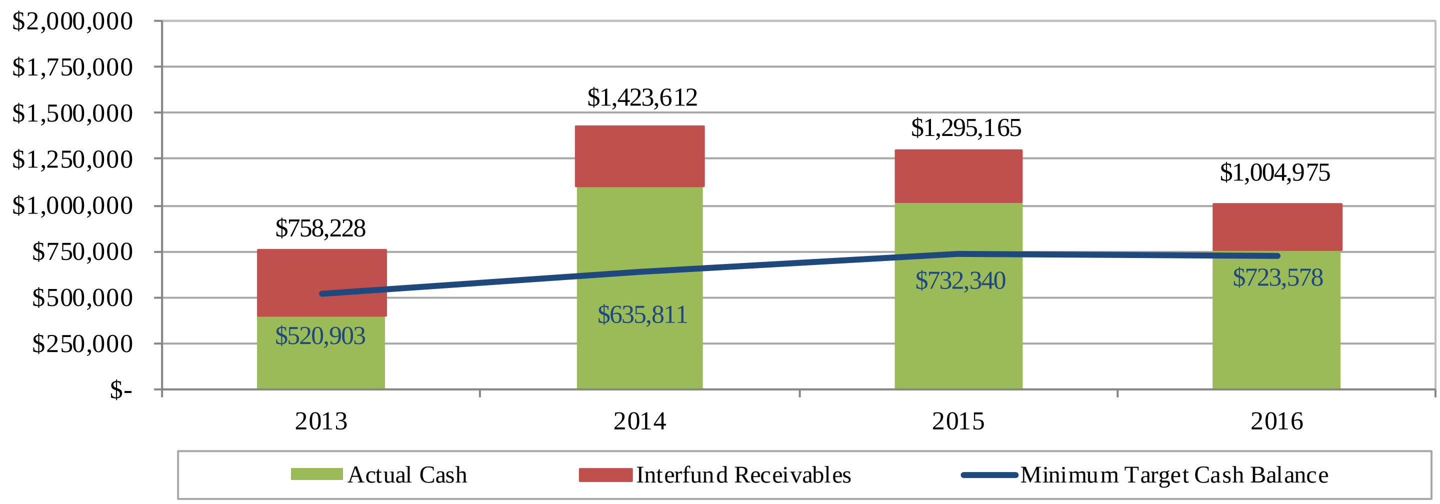
Sewer Utility Fund Cash Flows



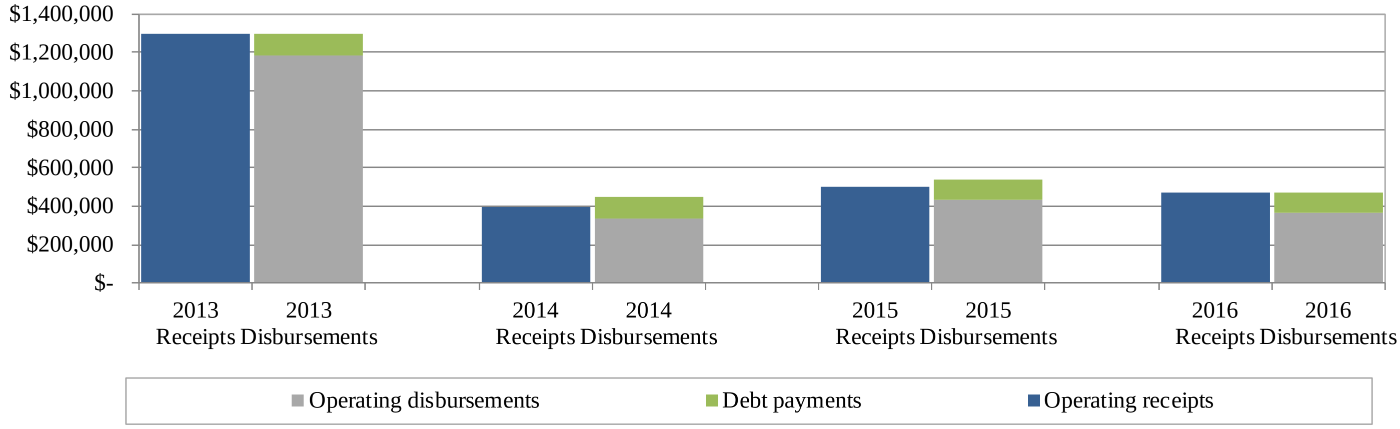
Sewer Utility Fund Cash Balances



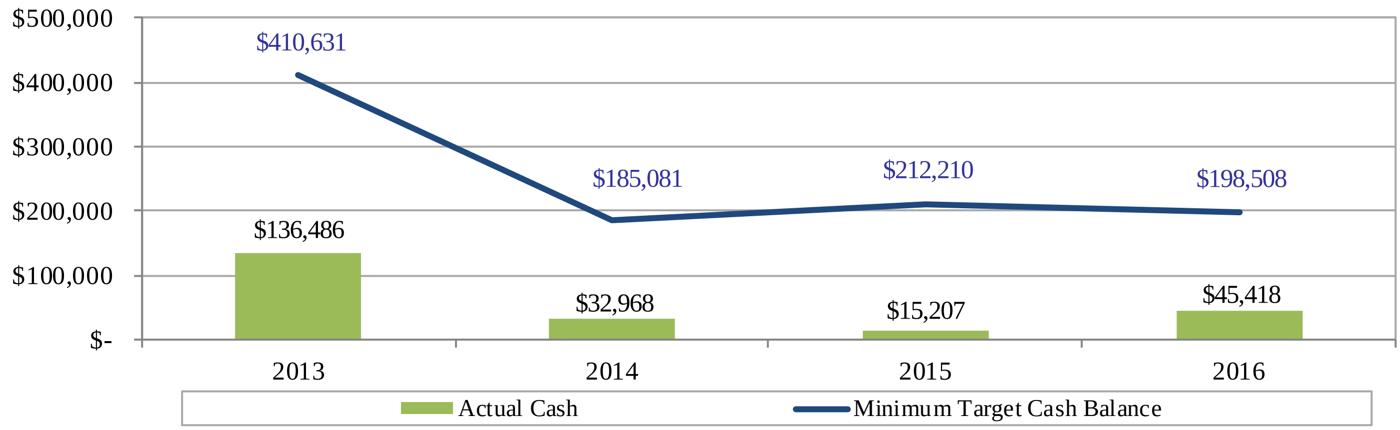
The minimum target cash balance is based off of 25 percent of operating costs plus the next year's debt payments for the fund.

	2013	2014	2015	2016
Bonds payable	$ 1,446,926	$ 1,268,847	$ 2,762,216	$ 2,280,458

Sanitary Collection Fund Cash Flows



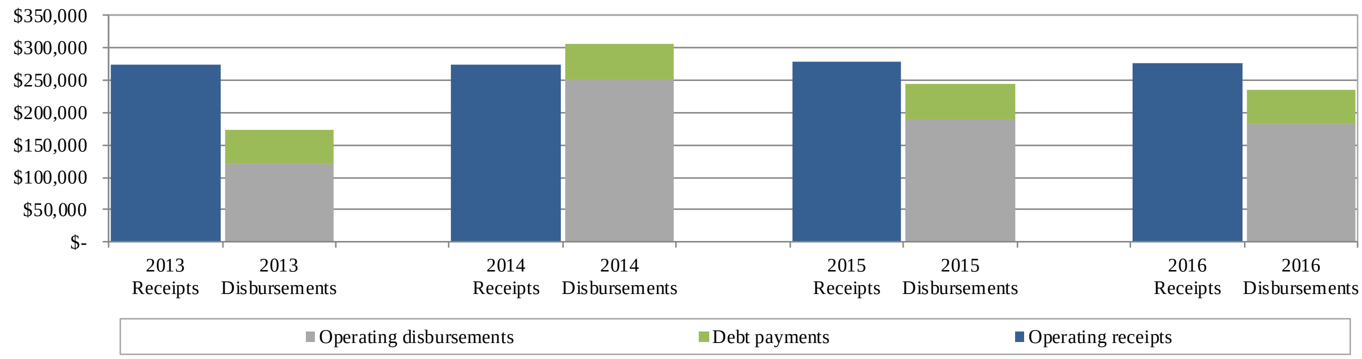
Sanitary Collection Fund Cash Balances



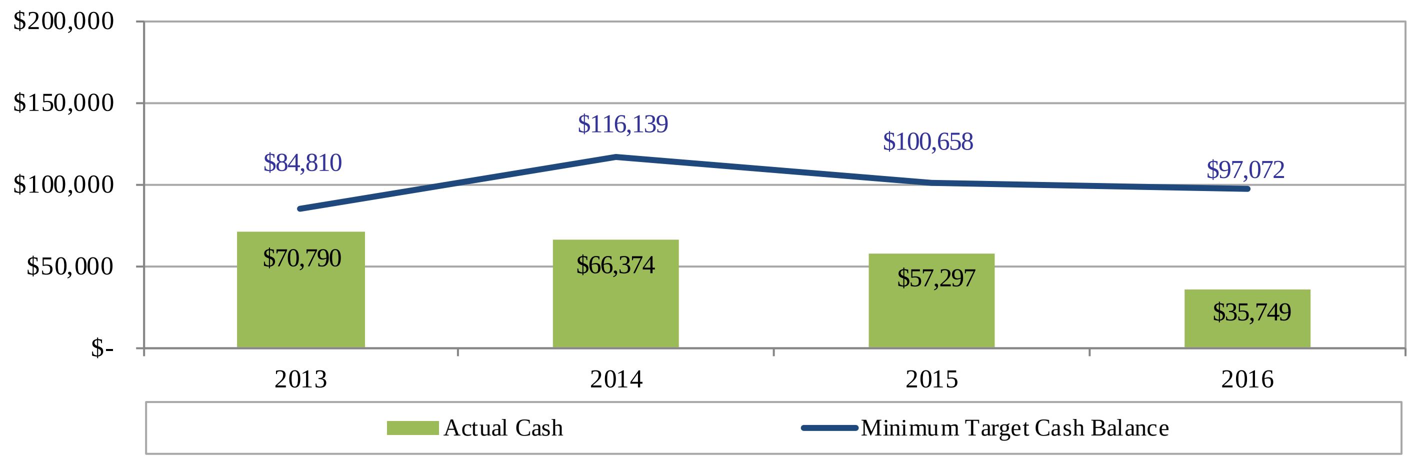
The minimum target cash balance is based off of 25 percent of operating costs plus the next year's debt payments for the fund.

	2013	2014	2015	2016
Bonds payable	$ 1,930,000	$ 1,865,000	$ 935,000	$ 850,000

Storm Water Fund Cash Flows



Storm Water Fund Cash Balances



The minimum target cash balance is based off of 25 percent of operating costs plus the next year's debt payments for the fund.

	2013	2014	2015	2016
Bonds payable	$ 458,250	$ 420,000	$ 435,000	$ 396,000

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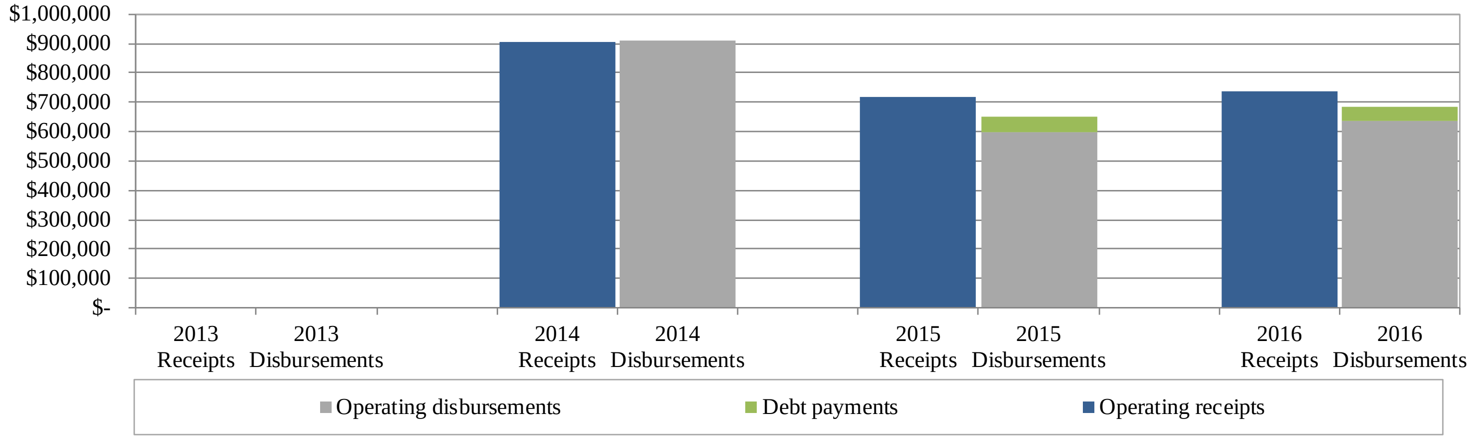
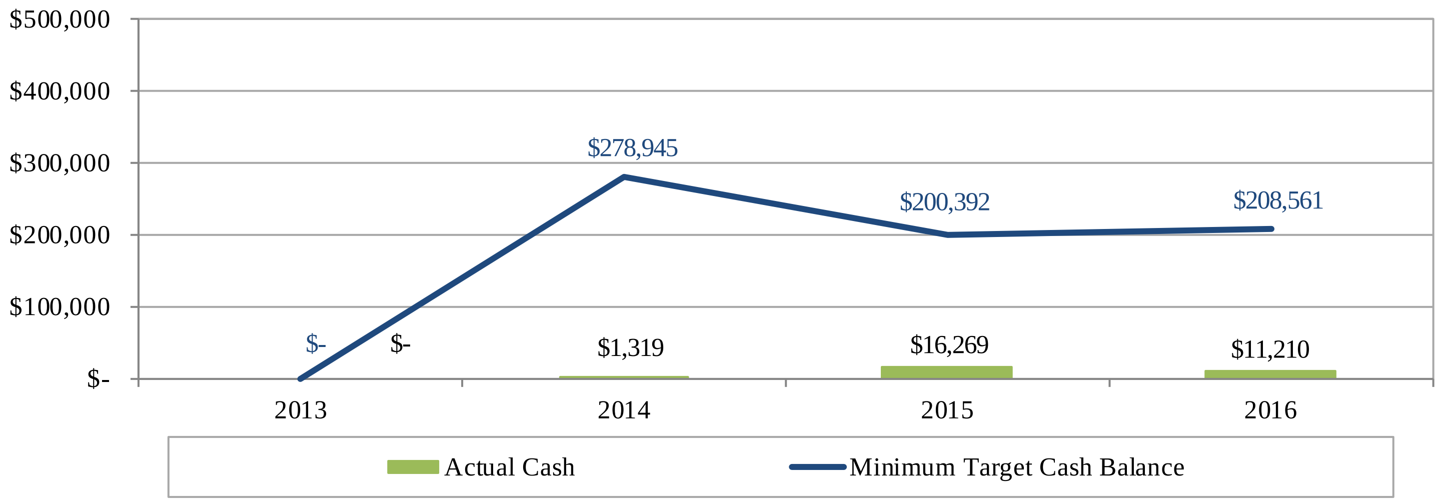
Solid Waste Fund Cash Flows



Solid Waste Fund Cash Balances



The minimum target cash balance is based off of 25 percent of operating costs plus the next year's debt payments for the fund.

	2013	2014	2015	2016
Bonds payable	$ -	$ -	$ 360,000	$ 320,000

We recommend the City continue to review rates annually and determine if increases are required to:

- Fund continuing operating expenses.
- Maintain contingency requirements for unexpected repairs.
- Provide for capital replacement requirements.

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Ratio Analysis

The following captures a few ratios from the City's financial statements that give some additional information for trend and peer group analysis. The peer group average is derived from information available from the Office of the State Auditor for cities of the 3rd class (10,000 to 20,000). The majority of these ratios facilitate the use of economic resources focus and accrual basis of accounting at the government-wide level. A combination of liquidity (ability to pay its most immediate obligations), solvency (ability to pay its long-term obligations), funding (comparison of financial amounts and economic indicators to measure changes in financial capacity over time) and common-size (comparison of financial data with other cities regardless of size) ratios are shown below.

Ratio	Calculation	Source	Year 2013	Year 2014	Year 2015	Year 2016
Debt to assets	Total liabilities/total assets	Government-wide	43%	40%	43%	45%
			32%	*31%*	*34%*	*N/A*
Debt service coverage	Net cash provided by operations/ enterprise fund debt payments	Enterprise funds	1.4	2.1	1.3	0.7
			1.4	*1.4*	*1.2*	*N/A*
Debt per capita	Bonded debt/population	Government-wide	$ 2,273	$ 2,576	$ 2,821	$ 2,708
			$ 2,637	*$ 2,369*	*$ 2,400*	*N/A*
Taxes per capita	Tax revenues/population	Government-wide	$ 494	$ 496	$ 514	$ 528
			$ 485	*$ 492*	*$ 504*	*N/A*
Current expenditures per capita	Governmental fund current expenditures / population	Governmental funds	$ 605	$ 584	$ 569	$ 571
			$ 633	*$ 650*	*$ 633*	*N/A*
Capital expenditures per capita	Governmental fund capital expenditures / population	Governmental funds	$ 181	$ 288	$ 666	$ 234
			$ 267	*$ 260*	*$ 374*	*N/A*
Capital assets % left to depreciate - Governmental	Net capital assets/ gross capital assets	Government-wide	54%	53%	55%	53%
			59%	*58%*	*58%*	*N/A*
Capital assets % left to depreciate - Business-type	Net capital assets/ gross capital assets	Government-wide	68%	66%	68%	67%
			61%	*60%*	*60%*	*N/A*

Represents City of North Mankato

Represents Peer Group Ratio

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Debt-to-Assets Leverage Ratio (Solvency Ratio)

The debt-to-assets leverage ratio is a comparison of a city's total liabilities to its total assets or the percentage of total assets that are provided by creditors. It indicates the degree to which the City's assets are financed through borrowings and other long-term obligations (i.e. a ratio of 50 percent would indicate half of the assets are financing 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 1.

Bonded Debt per Capita (Funding Ratio)

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

Taxes per Capita (Funding Ratio)

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

Current Expenditures per Capita (Funding Ratio)

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

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

Capital Assets Percentage (Common-size Ratio)

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

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Future Accounting Standard Changes

The following Governmental Accounting Standards Board (GASB) Statements have been issued and may have an impact on future City financial statements: **(1)**

GASB Statement No. 74 - *Financial Reporting for Postemployment Benefit Plans Other than Pension Plans*

Summary

The objective of this Statement is to improve the usefulness of information about postemployment benefits other than pensions (other postemployment benefits or OPEB) included in the general purpose external financial reports of state and local governmental OPEB plans for making decisions and assessing accountability. 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 Statements No. 43, Financial Reporting for Postemployment Benefit Plans Other Than Pension Plans, as amended, and No. 57, OPEB Measurements by Agent Employers and Agent Multiple-Employer Plans. It also includes requirements for defined contribution OPEB plans that replace the requirements for those OPEB plans in Statement No. 25, Financial Reporting for Defined Benefit Pension Plans and Note Disclosures for Defined Contribution Plans, as amended, Statement 43, and Statement No. 50, Pension Disclosures.

Statement No. 75, Accounting and Financial Reporting for Postemployment Benefits Other than Pensions, establishes new accounting and financial reporting requirements for governments whose employees are provided with OPEB, as well as for certain nonemployer governments that have a legal obligation to provide financial support for OPEB provided to the employees of other entities.

The scope of this Statement includes OPEB plans-defined benefit and defined contribution-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, and the OPEB plan administrator. If the plan is a defined benefit OPEB plan, plan assets also are legally protected from creditors of the plan members.

This Statement also includes requirements to address financial reporting for assets accumulated for purposes of providing defined benefit OPEB through OPEB plans that are not administered through trusts that meet the specified criteria.

Effective Date and Transition

This Statement is effective for financial statements for fiscal years beginning after June 15, 2016. Earlier application is encouraged.

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How the Changes in This Statement Will Improve Financial Reporting

The requirements of this Statement will improve financial reporting primarily through enhanced note disclosures and schedules of required supplementary information that will be presented by OPEB plans that are administered through trusts that meet the specified criteria. The new information will enhance the decision-usefulness of the financial reports of those OPEB plans, their value for assessing accountability, and their transparency by providing information about measures of net OPEB liabilities and explanations of how and why those liabilities changed from year to year. The net OPEB liability information, including ratios, will offer an up-to-date indication of the extent to which the total OPEB liability is covered by the fiduciary net position of the OPEB plan. The comparability of the reported information for similar types of OPEB plans will be improved by the changes related to the attribution method used to determine the total OPEB liability. The contribution schedule will provide measures to evaluate decisions related to the assessment of contribution rates in comparison with actuarially determined rates, if such rates are determined. In addition, new information about rates of return on OPEB plan investments will inform financial report users about the effects of market conditions on the OPEB plan's assets over time and provide information for users to assess the relative success of the OPEB plan's investment strategy and the relative contribution that investment earnings provide to the OPEB plan's ability to pay benefits to plan members when they come due.

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.

Future Accounting Standard Changes - Continued

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.
- 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. 80 - *Blending Requirements for Certain Component Units - an Amendment of GASB Statement No. 14*

Summary

The objective of the Statement is to improve financial reporting by clarifying the financial statement presentation requirements for certain component units. This Statement amends the blending requirements established in paragraph 53 of Statement No. 14, *The Financial Reporting Entity, as amended*.

This Statement amends the blending requirements for the financial statement presentation of component units of all state and local governments. The additional criterion requires blending of a component unit incorporated as a not-for-profit corporation in which the primary government is the sole corporate member. The additional criterion does not apply to component units included in the financial reporting entity pursuant to the provisions of Statement No. 39, *Determining Whether Certain Organizations Are Component Units*.

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Future Accounting Standard Changes - Continued

Effective Date

The requirements of this Statement are effective for reporting periods beginning after June 15, 2016. Earlier application is encouraged.

How the Changes in This Statement Will Improve Financial Reporting

The requirements of this Statement enhance the comparability of financial statements among governments. Greater comparability improves the decision-usefulness of information reported in financial statements and enhances its value for assessing government accountability.

GASB Statement No. 81 - *Irrevocable Split-Interest Agreements*

Summary

The objective of this Statement is to improve accounting and financial reporting for irrevocable split-interest agreements by providing recognition and measurement guidance for situations in which a government is a beneficiary of the agreement. Split-interest agreements are a type of giving agreement used by donors to provide resources to two or more beneficiaries, including governments. Split-interest agreements can be created through trusts—or other legally enforceable agreements with characteristics that are equivalent to split-interest agreements—in which a donor transfers resources to an intermediary to hold and administer for the benefit of a government and at least one other beneficiary. Examples of these types of agreements include charitable lead trusts, charitable remainder trusts, and life-interests in real estate.

This Statement requires that a government that receives resources pursuant to an irrevocable split-interest agreement recognize assets, liabilities, and deferred inflows of resources at the inception of the agreement. Furthermore, this Statement requires that a government recognize assets representing its beneficial interests in irrevocable split-interest agreements that are administered by a third party, if the government controls the present service capacity of the beneficial interests. This Statement requires that a government recognize revenue when the resources become applicable to the reporting period.

Effective Date

The requirements of this Statement are effective for financial statements for periods beginning after December 15, 2016, and should be applied retroactively. Earlier application is encouraged.

How the Changes in This Statement Will Improve Financial Reporting

This Statement enhances the comparability of financial statements by providing accounting and financial reporting guidance for irrevocable split-interest agreements in which a government is a beneficiary. This Statement also enhances the decision-usefulness of general purpose external financial reports, and their value for assessing accountability, by more clearly identifying the resources that are available for the government to carry out its mission.

GASB Statement No. 82 - *Pension Issues an Amendment of GASB Statements No. 67, No. 68, and No. 73*

Summary

The objective of this Statement is to address certain issues that have been raised with respect to Statements No. 67, Financial Reporting for Pension Plans, No. 68, Accounting and Financial Reporting for Pensions, and No. 73, Accounting and Financial Reporting for Pensions and Related Assets That Are Not within the Scope of GASB Statement 68, and Amendments to Certain Provisions of GASB Statements 67 and 68. Specifically, this Statement addresses issues regarding (1) the presentation of payroll-related measures in required supplementary information, (2) the selection of assumptions and the treatment of deviations from the guidance in an Actuarial Standard of Practice for financial reporting purposes, and (3) the classification of payments made by employers to satisfy employee (plan member) contribution requirements.

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Future Accounting Standard Changes - Continued

Presentation of Payroll-Related Measures in Required Supplementary Information

Prior to the issuance of this Statement, Statements 67 and 68 required presentation of covered-employee payroll, which is the payroll of employees that are provided with pensions through the pension plan, and ratios that use that measure, in schedules of required supplementary information. This Statement amends Statements 67 and 68 to instead require the presentation of covered payroll, defined as the payroll on which contributions to a pension plan are based, and ratios that use that measure.

Selection of Assumptions

This Statement clarifies that a deviation, as the term is used in Actuarial Standards of Practice issued by the Actuarial Standards Board, from the guidance in an Actuarial Standard of Practice is not considered to be in conformity with the requirements of Statement 67, Statement 68, or Statement 73 for the selection of assumptions used in determining the total pension liability and related measures.

Classification of Employer-Paid Member Contributions

This Statement clarifies that payments that are made by an employer to satisfy contribution requirements that are identified by the pension plan terms as plan member contribution requirements should be classified as plan member contributions for purposes of Statement 67 and as employee contributions for purposes of Statement 68. It also requires that an employer's expense and expenditures for those amounts be recognized in the period for which the contribution is assessed and classified in the same manner as the employer classifies similar compensation other than pensions (for example, as salaries and wages or as fringe benefits).

Effective Date

The requirements of this Statement are effective for reporting periods beginning after June 15, 2016, except for the requirements of this Statement for the selection of assumptions in a circumstance in which an employer's pension liability is measured as of a date other than the employer's most recent fiscal year-end. In that circumstance, the requirements for the selection of assumptions are effective for that employer in the first reporting period in which the measurement date of the pension liability is on or 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 financial reporting by enhancing consistency in the application of financial reporting requirements to certain pension issues.

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Future Accounting Standard Changes - Continued

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

Summary

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

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

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

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

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

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

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

Effective Date

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

Future Accounting Standard Changes - Continued

How the Changes in This Statement Will Improve Financial Reporting

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

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Restriction on Use

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

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

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

Abdo Eick & Meyers, LLP

ABDO, EICK & MEYERS, LLP
Mankato, Minnesota
June 27, 2017

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