

Management Letter

City of Melrose

Melrose, Minnesota

For the Year Ended
December 31, 2017

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

We have audited the financial statements of the governmental activities, the business-type activities, discretely presented component unit, each major fund and the aggregate remaining fund information of the City of Melrose, Minnesota (the City), for the year ended December 31, 2017. Professional standards require that we provide you with information about our responsibilities under generally accepted auditing standards and *Government Auditing Standards* as well as certain information related to the planned scope and timing of our audit. We have communicated such information in our letter dated October 31, 2017. Professional standards require that we provide you with the following information related to our audit.

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

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

Our responsibility is to plan and perform the audit to obtain reasonable, but not absolute, assurance that the financial statements are free of material misstatement. As part of our audit, we considered the internal control over financial reporting 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 over financial reporting was for the limited purpose described in the preceding paragraph and was not designed to identify all deficiencies in internal control over financial reporting that might be significant deficiencies or material weaknesses and therefore, there can be no assurance that all deficiencies, significant deficiencies, or material weaknesses have been identified. However, as described in the accompanying Schedule of Findings and Responses, we identified certain deficiencies in internal control over financial reporting that we consider to be a material weakness and other deficiencies that we consider to be significant deficiencies

A *deficiency in internal control* exists when the design or operation of a control does not allow management or employees, in the normal course of performing their assigned functions, to prevent, or detect and correct, misstatements on a timely basis. A *material weakness* is a deficiency, or 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 deficiency described in the accompanying Schedule of Findings and Responses as finding 2017-001 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 did not identify any instances we consider to be significant deficiencies.

2017-0001 Material Audit Adjustment

- Condition:* During our audit, a material adjustment was needed to correct the year-end accounts payable balance by recognizing expenses related to building inspections for new construction in the current audit period.
- Criteria:* Internal control over accounts payable should consider the completeness of the listing.
- Cause:* This item was inadvertently overlooked when preparing the final listing.
- Effect:* As a result, accounts payable and expenditures are understated by \$50,000.
- Recommendation:* We recommend management review the related journal entries, obtain an understanding of why the entries were necessary and modify current procedure to ensure that future corrections are not needed.

Management Response:

City staff reviewed all payments after year end to prepare the accounts payable listing. The final building permit fee payment had not yet been made so it was inadvertently missed on the listing. Staff will enhance procedures to avoid future payables from being improperly excluded.

Compliance and Other Matters

As part of obtaining reasonable assurance about whether the City’s financial statements are free of material misstatement, we performed tests of its compliance with certain provisions of laws, regulations, contracts, and grant agreements, noncompliance with which could have a direct and material effect on the determination of financial statement amounts. However, providing an opinion on compliance with those provisions was not an objective of our audit, and accordingly, we do not express such an opinion. While our audit provides a reasonable basis for our opinion, it does not provide a legal determination on the City’s compliance with those requirements. As a result of our testing we noted one instance of noncompliance or other matters that are required to be reported under *Government Auditing Standards* or statutes set forth by the State of Minnesota.

Qualitative Aspects of Accounting Practices

Management is responsible for the selection and use of appropriate accounting policies. The significant accounting policies used by the City are described in Note 1 to the financial statements. No new accounting policies were adopted and the application of existing policies were not changed during the year ended December 31, 2017. We noted no transactions entered into by the City during the year for which there is a lack of authoritative guidance or consensus. All significant transactions have been recognized in the financial statements in the proper period.

Accounting estimates are an integral part of the financial statements prepared by management and are based on management’s knowledge and experience about past and current events and assumptions about future events. Certain accounting estimates are particularly sensitive because of their significance to the financial statements and because of the possibility that future events affecting them may differ significantly from those expected. The most sensitive estimates affecting the financial statements include depreciation on capital assets, allocation of wage expenses, liability for the City’s pension, and the liability for the City’s other postemployment benefits (OPEB).

- Management’s estimate of depreciation is based on estimated useful lives of the assets. Depreciation is calculated using the straight-line method.
- Allocations of gross wages and payroll benefits are approved by the City Council within the City’s budget and are derived from each employee’s estimated time to be spent servicing the respective function of the City. These allocations are also used in allocating accrued compensated absences payable.
- Management’s estimate of its 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 liabilities and assets are 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.

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

Difficulties Encountered in Performing the Audit

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

Corrected and Uncorrected Misstatements

Professional standards require us to accumulate all known and likely misstatements identified during the audit, other than those that are trivial, and communicate them to the appropriate level of management. No misstatements were noted.

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 representations letter dated April 6, 2018.

Management Consultations with Other Independent Accountants

In some cases, management may decide to consult with other accountants about auditing and accounting matters, similar to obtaining a "second opinion" on certain situations. If a consultation involves application of an accounting principle to the City's financial statements or 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 Shares of the Net Pension Liability, the Schedules of Employer's Contributions, the Schedule of Changes in Net Pension Liability (Asset) and Related Ratios and Schedule of Funding Progress), which is information that supplements the basic financial statements. Our procedures consisted of inquiries of management regarding the methods of preparing the information and comparing the information for consistency with management's responses to our inquiries, the basic financial statements, and other knowledge we obtained during our audit of the basic financial statements. We did not audit the RSI and do not express an opinion or provide any assurance on the RSI.

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

We were not engaged to report on the introductory section or the statistical section, 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.

Financial Position and Results of Operations

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

General Fund

The General fund is used to account for resources traditionally associated with government, which are not required legally or by sound principal management to be accounted for in another fund. The General fund balance increased \$236,045 from 2016. The fund balance of \$1,880,236 is 78 percent of the 2018 expenditures and transfers out.

A summary of the 2017 operations are as follows:

	Final Budget Amounts	Actual Amounts	Variance with Final Budget
Revenues	\$ 2,412,782	\$ 2,662,077	\$ 249,295
Expenditures	<u>1,826,865</u>	<u>1,831,758</u>	<u>(4,893)</u>
Excess of Revenues Over Expenditures	585,917	830,319	244,402
Other Financing Uses Transfers out	<u>(583,288)</u>	<u>(594,274)</u>	<u>(10,986)</u>
Net Change in Fund Balances	2,629	236,045	233,416
Fund Balances, January 1	<u>1,644,191</u>	<u>1,644,191</u>	<u>-</u>
Fund Balances, December 31	<u>\$ 1,646,820</u>	<u>\$ 1,880,236</u>	<u>\$ 233,416</u>

- The most significant revenue variances were in licenses and permits and charges for service which were over budget by \$170,538 and \$57,117, respectively. The positive budget variance for licenses and permits was mainly due increased commercial and residential building activity.
- The most significant expenditure variances were in the general and public safety functions. The general government was under budget by \$46,436, while public safety was over budget by \$129,141. The variance in the public safety budget can be attributed to higher than expected building inspection fees corresponding to the above increase in building activity.

We recommend the fund balance be maintained at a level sufficient to fund operations until the major revenue sources are received in June. The City has formally adopted a fund balance policy for the General fund to maintain a minimum unrestricted fund balance of 35-50 percent of the next year's budgeted expenditures. The City's ending fund balance is above this target level.

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

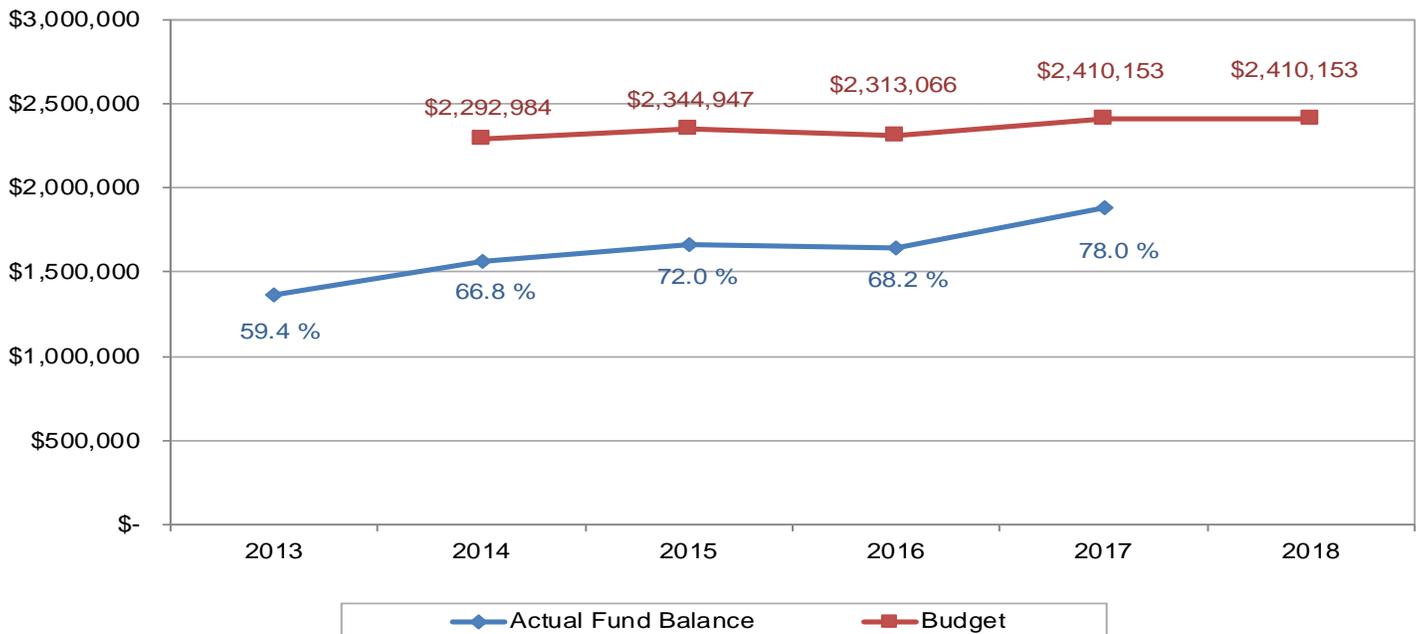
- Expenditures are incurred somewhat evenly throughout the year. However, property tax and state aid revenues are not received until the second half of the year. An adequate fund balance will provide the cash flow required to finance the governmental fund expenditures.
- Expenditures not anticipated at the time the annual budget was adopted may need immediate City Council action. These would include capital outlay, replacement, lawsuits and other items. An adequate fund balance will provide the financing needed for such expenditures.

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

A table summarizing the General fund balance in relation to the following years' budget follows:

Year	Fund Balance December 31	Budget Year	General Fund Budget	Percent of Fund Balance to Budget
2013	\$ 1,361,134	2014	\$ 2,292,984	59.4 %
2014	1,567,459	2015	2,344,947	66.8
2015	1,665,055	2016	2,313,066	72.0
2016	1,644,195	2017	2,410,153	68.2
2017	1,880,236	2018	2,410,153	78.0

Fund Balance as a Percent of Next Year's Budget

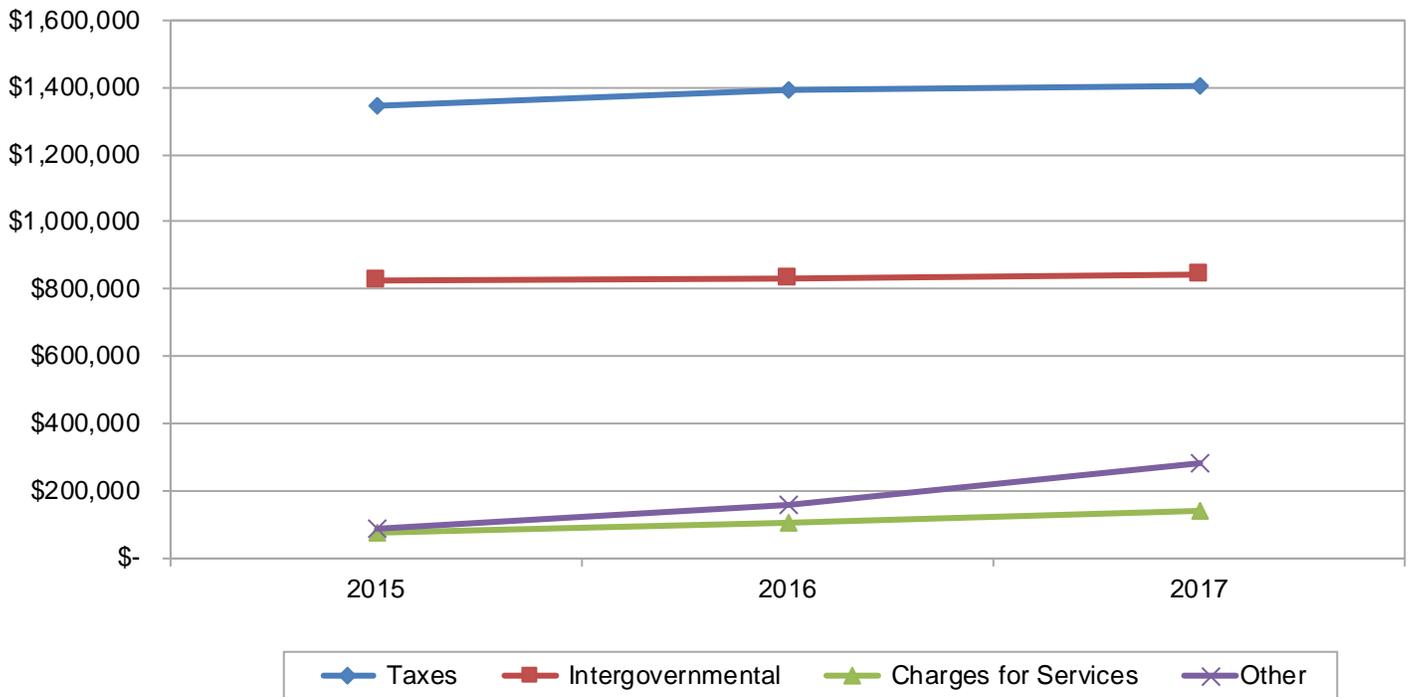


A comparison between 2015, 2016 and 2017 General fund revenues is presented below:

Revenue Source	2015	2016	2017	Percent of Total	Per Capita
Taxes	\$ 1,345,684	\$ 1,394,850	\$ 1,401,669	52.7 %	\$ 381
Licenses and Permits	46,688	104,014	240,388	9.0	65
Intergovernmental	822,815	829,584	842,145	31.6	229
Charges for Services	76,207	106,209	137,167	5.2	37
Fines and Forfeitures	18,703	18,704	14,910	0.6	4
Interest on Investments	11,676	20,151	13,989	0.5	4
Miscellaneous	8,615	11,130	11,809	0.4	3
Total Revenues	\$ 2,330,388	\$ 2,484,642	\$ 2,662,077	100.0 %	\$ 723

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

General Fund Revenues by Source



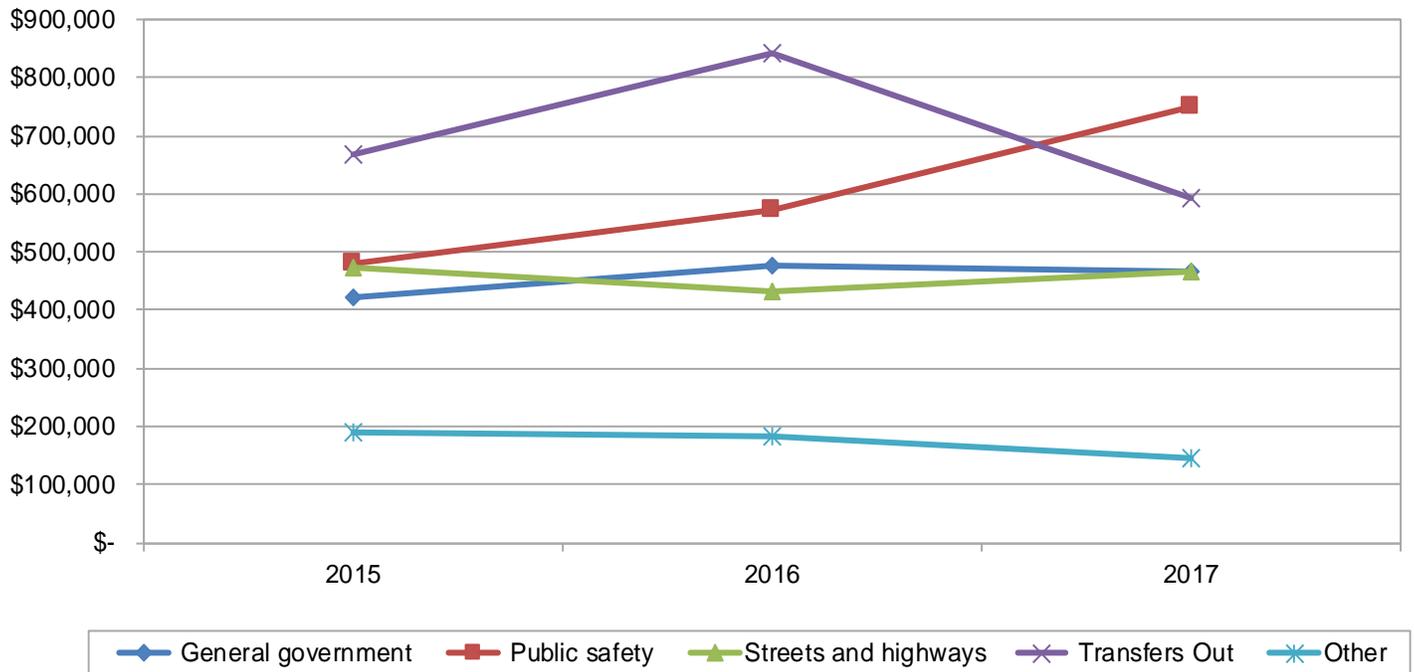
A comparison between 2015, 2016 and 2017 General fund expenditures and transfers is presented below:

Program	2015	2016	2017	Percent of Total	Per Capita	Peer Group Per Capita
Current						
General government	\$ 421,571	\$ 476,978	\$ 465,188	19.2 %	\$ 127	\$ 148
Public safety	478,903	573,851	748,340	30.9	204	233
Streets and highways	472,735	433,098	465,075	19.2	126	118
Sanitation	4,083	3,528	3,947	0.2	1	-
Culture and recreation	86,914	84,426	59,181	2.4	16	62
Economic development	99,408	92,477	82,608	3.4	22	6
Total Current	1,563,614	1,664,358	1,824,339	75.3	\$ 496	\$ 567
Debt Service	1,093	1,390	924	-		
Transfers Out	668,333	841,459	594,274	24.7		
Total Expenditures and Transfers	\$ 2,233,040	\$ 2,507,207	\$ 2,419,537	100.0 %		

The above chart compares the amount the City spends per capita, in comparison to a peer group. The peer group average is compiled from information we have requested from the Office of the State Auditor of 4th class cities with populations between 2,500 and 10,000.

A graphical presentation of 2015, 2016 and 2017 expenditures and transfers totals by program follows:

General Fund Expenditures and Transfers by Program



Special Revenue Funds

The nonmajor special revenue funds account for revenue sources that are restricted or committed to expenditure for specified purposes. The funds in this account group include:

Fund	Fund Balances December 31,		Increase (Decrease)
	2017	2016	
Nonmajor			
Senior Activity Center	\$ 2,148	\$ 1,883	\$ 265
Tri-Cap Bus	4,414	3,020	1,394
Yellow Bike Program	1,293	1,470	(177)
Melrose Area Relief Fund	13,837	-	13,837
Fire Department	304,219	244,922	59,297
Total	\$ 325,911	\$ 251,295	\$ 74,616

Capital Projects Funds

The capital projects funds account for the financial resources that are restricted, committed, or assigned to expenditure for capital outlays, including the acquisition or construction of capital facilities and other capital assets not being financed by proprietary funds. The funds in this group include:

Fund	Fund Balances December 31,		Increase (Decrease)
	2017	2016	
Major			
Capital improvements	\$ 5,499,246	\$ 5,089,339	\$ 409,907
Nonmajor			
5th Ave. Bridge Improvements	359,597	365,781	(6,184)
Tax increment projects	41,435	67,094	(25,659)
Total Nonmajor	401,032	432,875	(31,843)
Total	\$ 5,900,278	\$ 5,522,214	\$ 378,064

The Capital Improvements fund was established to allow the City to finance its capital improvement projects internally rather than issuing bonds and incurring the related issuance costs. The City has also planned well for its use through a thorough fund balance policy. The fund balance increased \$409,907 during the year mainly due to transfers in exceeding current year capital expenditures.

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 streets and municipal buildings. Property taxes may also be used to fund special assessment bonds which are not fully assessed.
- 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.

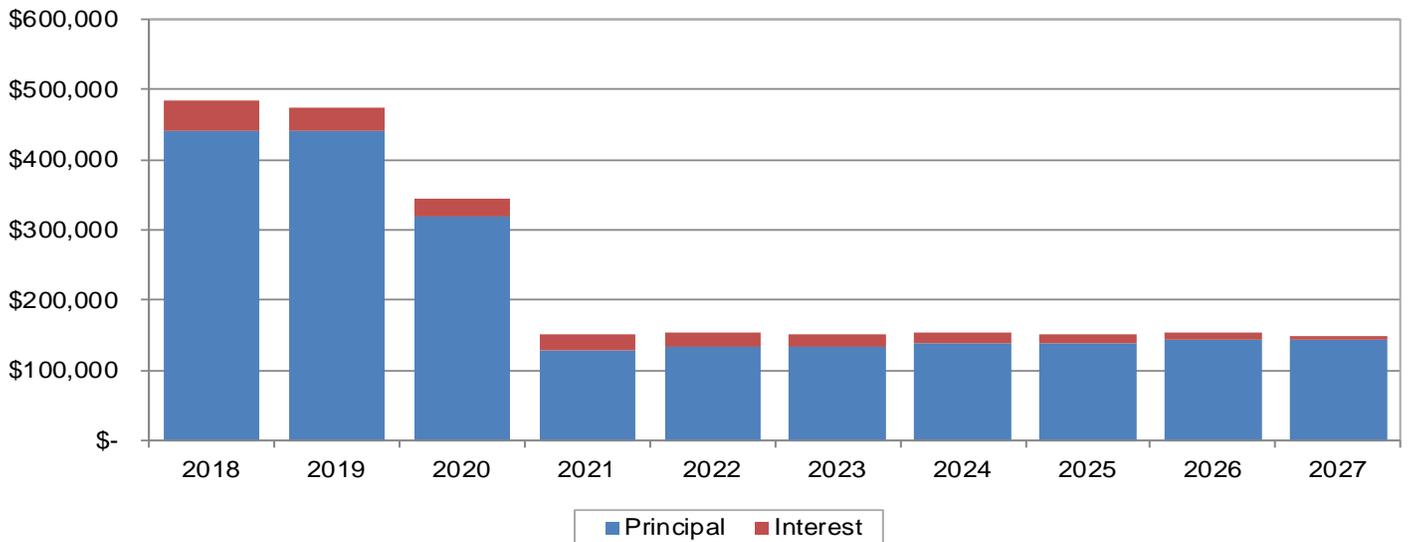
In addition to the above pledged assets, other funding sources may be received by Debt Service funds as follows:

- Residual project proceeds from the related capital projects fund
- Investment earnings
- Transfers from other funds

The following is a recap of the various Debt Service fund assets and the related bond principal outstanding:

Debt Description	Cash Balance	Total Assets	Bonds Outstanding	Year of Maturity
G.O. Improvement Refunding Bonds, Series 2011A	\$ 224,181	\$ 242,514	\$ 820,000	02/01/20
G.O. Capital Improvement Plan Bonds, Series 2013A	141,535	141,535	1,500,000	02/01/28
Total	\$ 365,716	\$ 384,049	\$ 2,320,000	
Total Future Scheduled Interest Payments			\$ 198,729	

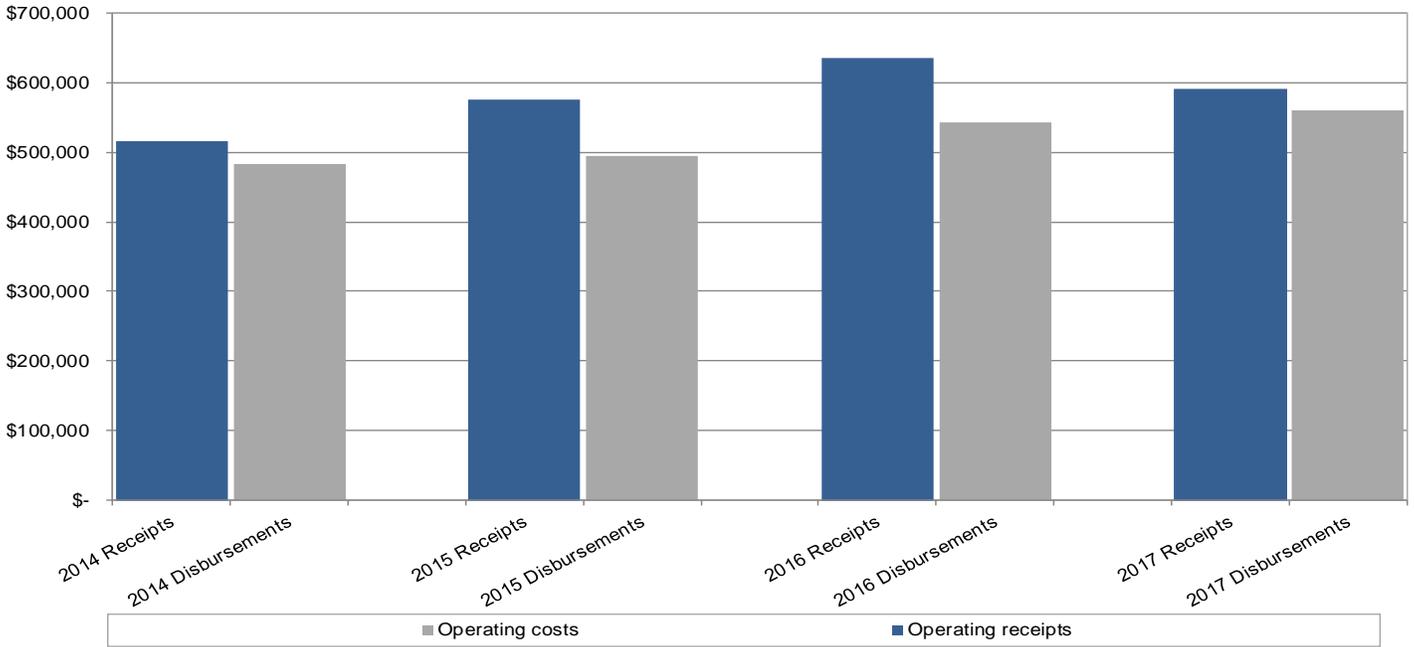
Debt Service Scheduled Principal and Interest for the Next 10 Years



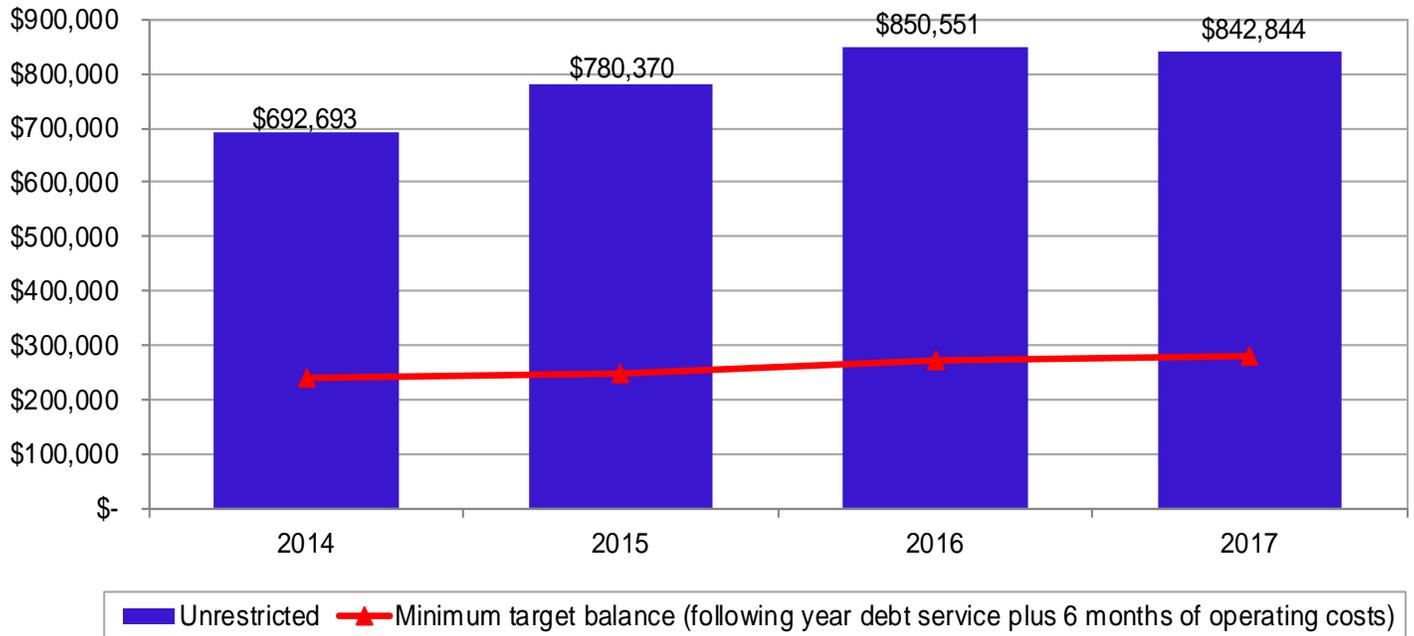
Enterprise Funds

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

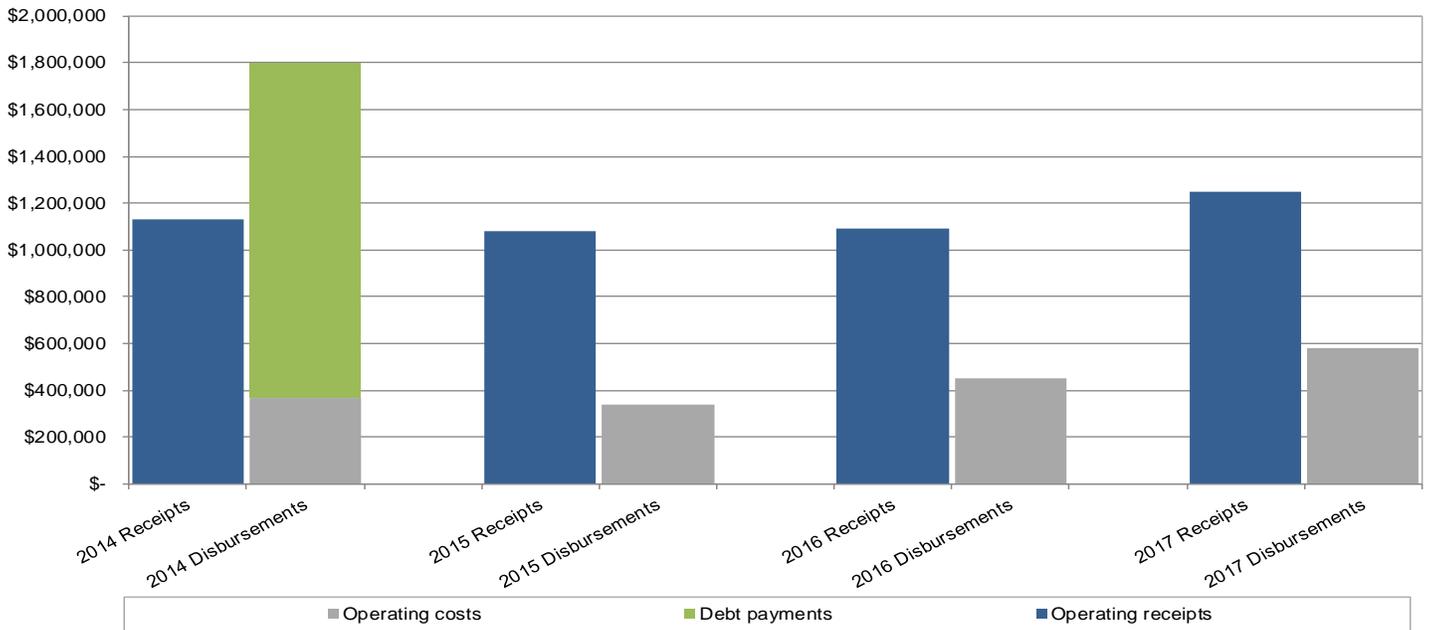
Ambulance Fund Cash Flows



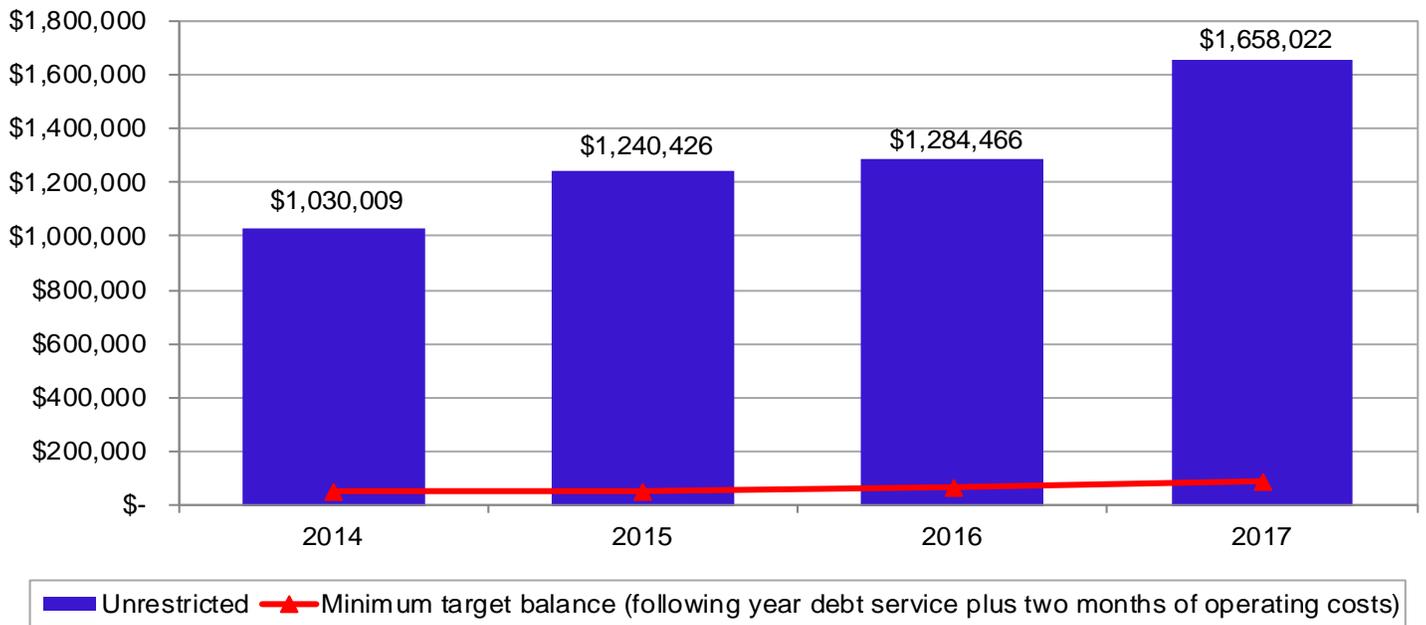
Ambulance Fund Cash Balances



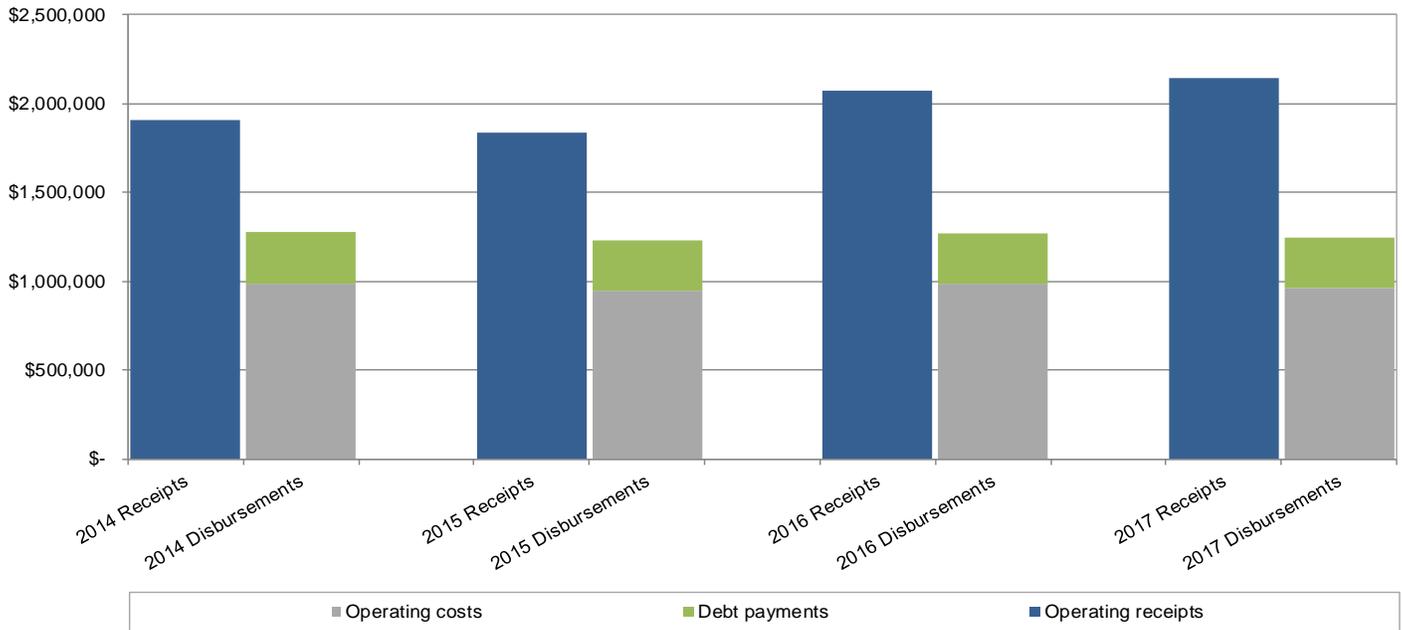
Water Fund Cash Flows



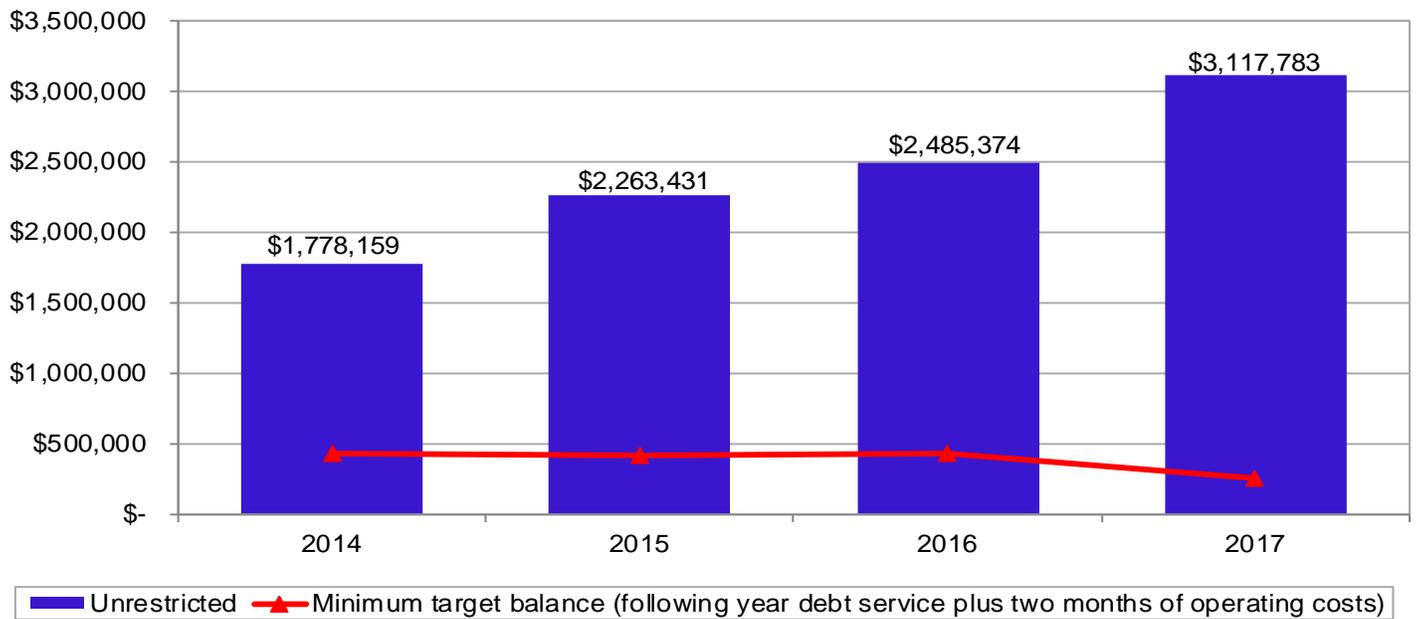
Water Fund Cash Balances



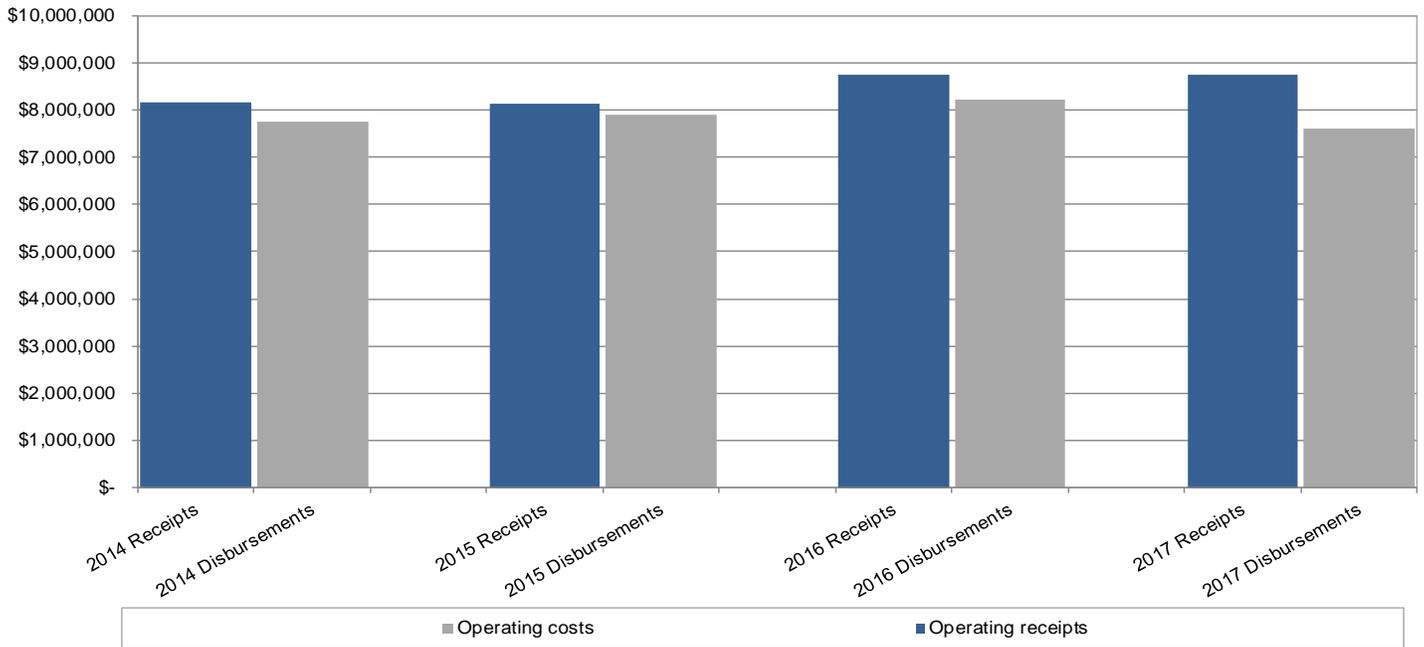
Wastewater Fund Cash Flows



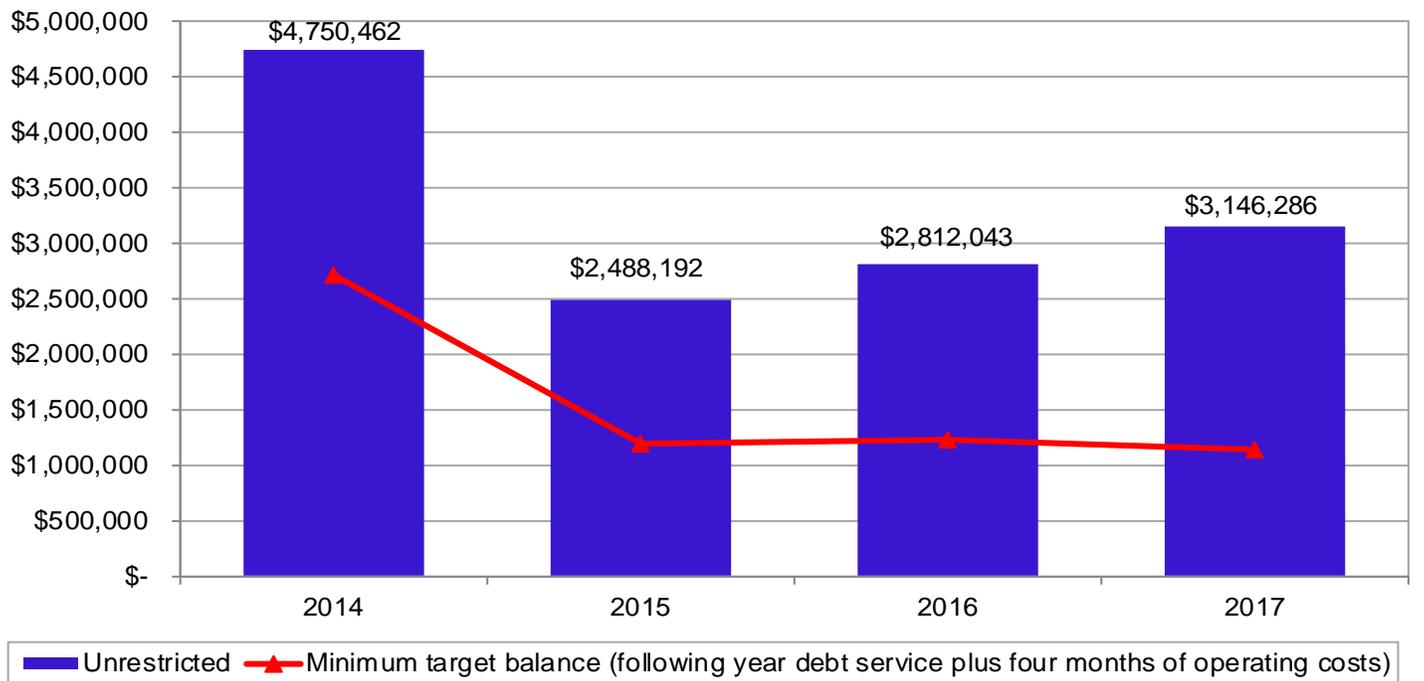
Wastewater Fund Cash Balances



Electric Fund Cash Flows



Electric Fund Cash Balances



Ratio Analysis

The following captures a few ratios from the City's financial statements that give some additional information for trend and peer group analysis. The peer group average is derived from information available on the website of the Office of the State Auditor for Cities of the 4th class (2,500-10,000). The majority of these ratios facilitate the use of economic resources focus and accrual basis of accounting at the government-wide level. A combination of liquidity (ability to pay its most immediate obligations), solvency (ability to pay its long-term obligations), funding (comparison of financial amounts and economic indicators to measure changes in financial capacity over time) and common-size (comparison of financial data with other cities) ratios are shown below.

Ratio	Calculation	Source	2014	2015	2016	2017
Debt to Assets	Total liabilities/total assets	Government-wide	15% 32%	11% 34%	12% 34%	9% N/A
Debt Service Coverage	Net cash provided by operation enterprise fund debt payments	Enterprise funds	221% 114%	98% 119%	314% 105%	415% N/A
Debt Per Capita	Bonded debt/population	Government-wide	\$ 1,814 \$ 2,506	\$ 1,253 \$ 2,517	\$ 1,051 \$ 2,068	\$ 658 N/A
Taxes Per Capita	Tax revenues/population	Government-wide	\$ 489 \$ 484	\$ 510 \$ 510	\$ 529 \$ 510	\$ 558 N/A
Current Expenditures Per Capita	Governmental fund current expenditures/population	Governmental funds	\$ 499 \$ 674	\$ 504 \$ 688	\$ 498 \$ 725	\$ 585 N/A
Capital Expenditures Per Capita	Governmental fund capital outlay/population	Governmental funds	\$ 200 \$ 320	\$ 82 \$ 354	\$ 114 \$ 338	\$ 125 N/A
Capital Assets % Left to Depreciate - Governmental	Net capital assets/ gross capital assets	Government-wide	68% 63%	65% 63%	63% 61%	59% N/A
Capital Assets % Left to Depreciate - Business-type	Net capital assets/ gross capital assets	Government-wide	51% 61%	49% 61%	52% 60%	50% N/A

Represents the City of Melrose
Represents Peer Group Average

Debt-to-Assets Leverage Ratio (Solvency Ratio)

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

Debt Service Coverage Ratio (Solvency Ratio)

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

Bonded Debt per Capita (Funding Ratio)

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

Taxes per Capita (Funding Ratio)

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

Current Expenditures per Capita (Funding Ratio)

This dollar amount is arrived at by dividing the total current governmental expenditures by the population of the City and represents the amount of governmental 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.

City of Melrose, Minnesota
Melrose Electric Utilities
Electric Utility Operating Statistics (Unaudited)
For the Years Ended December 31, 2017, 2016, 2015, 2014, 2013, and 2012

	2012 Peer Group	2012	2013	2014	2015	2016	2017
Financial Ratios							
Revenue per KWH							
Residential Customers	\$ 0.109	\$ 0.082	\$0.0810	\$0.0840	\$0.0850	\$0.0900	\$0.0940
Commercial Customers	\$ 0.104	\$ 0.079	\$0.0800	\$0.0800	\$0.0780	\$0.0820	\$0.0850
Industrial Customers	\$ 0.081	\$ 0.063	\$0.0630	\$0.0640	\$0.0610	\$0.0630	\$0.0660
Times Interest Earned	N/A	N/A	N/A	N/A	N/A	N/A	N/A
Debt Service Coverage	N/A	N/A	N/A	N/A	N/A	N/A	N/A
Uncollectible Accounts per Revenue Dollar	\$0.0008	\$0.0001	\$0.0002	\$0.0010	\$0.0002	\$0.0002	\$0.0001
Operating Ratios							
Total O&M Expense per KWH Sold	\$ 0.083	\$ 0.070	\$ 0.690	\$ 0.070	\$ 0.074	\$ 0.075	\$ 0.072
Total Distribution and O&M Expense (Excluding Power Supply Exp.) per retail customer	N/A	\$ 375	\$ 302	\$ 403	486	614	681
Purchased Power per KWH	\$ 0.055	\$ 0.058	\$ 0.056	\$ 0.058	\$ 0.061	\$ 0.060	\$ 0.058
Distribution O&M Expense per Retail Customer	\$ 306	\$ 212	\$ 150	\$ 235	\$ 177	\$ 376	\$ 325
Distribution O&M Expense per Circuit Mile	\$14,112	\$ 7,319 *	\$ 5,175	\$ 8,129	\$ 4,859	\$ 8,174	\$ 7,071
Customer Accounting, Service, and Sales, Administrative and General Expense per Retail Customer	\$ 229	\$ 229	\$ 224	\$ 209	\$ 257	\$ 356	\$ 328
Other Ratios							
Labor Expense per Worker- Hour	\$ 33.26	\$ 27.85	\$ 27.90	\$ 29.35	\$ 30.90	\$ 32.74	\$ 33.13
Energy Loss Percentage	N/A	-4.60%	1.70%	2.90%	1.80%	2.20%	3.30%
System Load Factor	N/A	75.60%	75.60%	77.00%	78.13%	71.97%	76.17%

Represents the Melrose Electric Utility
APPA Peer Group Ratio

The peer group data was derived from a report issued by the American Public Power Association (APPA) titled, "Selected Financial and Operating Ratios of Public Power Systems, 2012". The report presented data of financial and operating ratios for 157 of the largest publicly owned electric utilities in the United States and averaged the ratios based on number of customers. The ratios presented are those for utilities with 2,000 to 5,000 customers. The ratios can be a useful tool in assessing electric utility performance. However, as it stated in the report, these ratios do not provide definitive information and the level of any indicator should not be taken as the "correct" performance.

* The City of Melrose has a unique situation with a large amount of rural territory which affects their circuit mile cost. Therefore, this could contribute to higher circuit mile costs compared to the peer group.

Source of Energy, Disposition of Energy and Percentage Relations	2015		2016		2017	
	KWH	Percent	KWH	Percent	KWH	Percent
Purchased Energy	\$ 115,176,246	100.1 %	\$ 116,614,486	100.2 %	\$ 116,614,486	100.3 %
Energy Consumed By Station	<u>(156,448)</u>	<u>(0.1)</u>	<u>(247,520)</u>	<u>(0.2)</u>	<u>(348,500)</u>	<u>(0.3)</u>
Total Net Energy Outgoing Feeders	115,019,798	100.0	116,366,966	100.0	116,265,986	100.0
Net Distributed Energy	<u>(112,908,537)</u>	<u>(98.2)</u>	<u>(113,798,342)</u>	<u>(97.8)</u>	<u>(112,387,148)</u>	<u>(96.7)</u>
Energy Lost in Distribution System	<u>\$ 2,111,261</u>	<u>1.8 %</u>	<u>\$ 2,568,624</u>	<u>2.2 %</u>	<u>\$ 3,878,838</u>	<u>3.3 %</u>

* As a result of the timing of meter readings of new and used meters, distributed energy exceeded purchased energy.

City of Melrose, Minnesota
Melrose Water Utilities
Summary of Operations and Unaudited Statistics
For the Years Ended December 31, 2017, 2016, and 2015

SUMMARY OF OPERATIONS

	<u>2015</u>	<u>2016</u>	<u>2017</u>
Operating Revenues			
Sales of water	\$ 953,102	\$ 1,027,130	\$ 1,020,605
Miscellaneous	83,177	68,844	75,749
Total Operating Revenues	<u>1,036,279</u>	<u>1,095,974</u>	<u>1,096,354</u>
Operating Expenses			
Operating expenses less depreciation	345,725	471,843	522,505
Depreciation	<u>282,673</u>	<u>274,911</u>	<u>270,362</u>
Total Operating Expenses	<u>628,398</u>	<u>746,754</u>	<u>792,867</u>
Total Operating Income	<u>\$ 407,881</u>	<u>\$ 349,220</u>	<u>\$ 303,487</u>
Percent of Change			
Sales of water	1.43%	7.77%	-0.64%

**UNAUDITED STATISTICS
MISCELLANEOUS**

	<u>2015</u>	<u>2016</u>	<u>2017</u>
Water Pumped (Gallons)	574,233,000	626,767,000	627,824,000
Water Sold (Gallons)	564,343,075	604,976,292	594,971,562
Percent of Line Loss	1.72%	3.48%	5.23%
Revenues Per 1,000 Gallons Pumped	\$ 1.80	\$ 1.75	\$ 1.75
Revenues Per 1,000 Gallons Sold	\$ 1.84	\$ 1.81	\$ 1.84
Labor Cost Per Customer	\$ 98.10	\$ 85.24	\$ 85.15
O&M Per Customer	\$ 367.31	\$ 258	\$ 452
Number of Customers	1,153	1,138	1,157

Future Accounting Standard Changes

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

GASB Statement No. 75 - *Accounting and Financial Reporting for Postemployment Benefit Plans Other than Pension*

Summary

The primary objective of this Statement is to improve accounting and financial reporting by state and local governments for postemployment benefits other than pensions (other postemployment benefits or OPEB). It also improves information provided by state and local governmental employers about financial support for OPEB that is provided by other entities. This Statement results from a comprehensive review of the effectiveness of existing standards of accounting and financial reporting for all postemployment benefits (pensions and OPEB) with regard to providing decision-useful information, supporting assessments of accountability and interperiod equity, and creating additional transparency.

This Statement replaces the requirements of Statements No. 45, Accounting and Financial Reporting by Employers for Postemployment Benefits Other than Pensions, as amended, and No. 57, OPEB Measurements by Agent Employers and Agent Multiple-Employer Plans, for OPEB. Statement No. 74, Financial Reporting for Postemployment Benefit Plans Other than Pension Plans, establishes new accounting and financial reporting requirements for OPEB plans.

The scope of this Statement addresses accounting and financial reporting for OPEB that is provided to the employees of state and local governmental employers. This Statement establishes standards for recognizing and measuring liabilities, deferred outflows of resources, deferred inflows of resources, and expense/expenditures. For defined benefit OPEB, this Statement identifies the methods and assumptions that are required to be used to project benefit payments, discount projected benefit payments to their actuarial present value, and attribute that present value to periods of employee service. Note disclosure and required supplementary information requirements about defined benefit OPEB also are addressed.

In addition, this Statement details the recognition and disclosure requirements for employers with payables to defined benefit OPEB plans that are administered through trusts that meet the specified criteria and for employers whose employees are provided with defined contribution OPEB. This Statement also addresses certain circumstances in which a nonemployer entity provides financial support for OPEB of employees of another entity.

In this Statement, distinctions are made regarding the particular requirements depending upon whether the OPEB plans through which the benefits are provided are administered through trusts that meet the following criteria:

- Contributions from employers and nonemployer contributing entities to the OPEB plan and earnings on those contributions are irrevocable.
- OPEB plan assets are dedicated to providing OPEB to plan members in accordance with the benefit terms.
- OPEB plan assets are legally protected from the creditors of employers, nonemployer contributing entities, the OPEB plan administrator, and the plan members.

Effective Date

This Statement is effective for fiscal years beginning after June 15, 2017. Earlier application is encouraged.

How the Changes in This Statement Will Improve Financial Reporting

The requirements of this Statement will improve the decision-usefulness of information in employer and governmental nonemployer contributing entity financial reports and will enhance its value for assessing accountability and interperiod equity by requiring recognition of the entire OPEB liability and a more comprehensive measure of OPEB expense. Decision-usefulness and accountability also will be enhanced through new note disclosures and required supplementary information, as follows:

- More robust disclosures of assumptions will allow for better informed assessments of the reasonableness of OPEB measurements.

Future Accounting Standard Changes (Continued)

- 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. 83 - *Certain Asset Retirement Obligations*

Summary

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

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

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

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

Future Accounting Standard Changes (Continued)

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

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

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

Effective Date

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

How the Changes in This Statement Will Improve Financial Reporting

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

GASB Statement No. 84 - *Fiduciary Activities*

Summary

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

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

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

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

Future Accounting Standard Changes (Continued)

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

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

Effective Date

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

How the Changes in This Statement Will Improve Financial Reporting

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

GASB Statement No. 85 - Omnibus 2017

Summary

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

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

Effective Date

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

Future Accounting Standard Changes (Continued)

How the Changes in This Statement Will Improve Financial Reporting

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

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

Summary

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

Effective Date

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

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

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

GASB Statement No. 87 - *Leases*

Summary

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

Effective Date and Transition

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

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

Future Accounting Standard Changes (Continued)

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

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

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

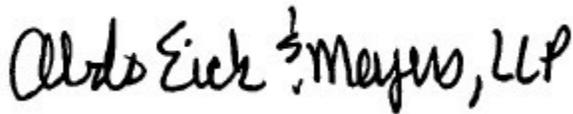
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Restriction on Use

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

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

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



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