Management Letter

City of Melrose

Melrose, 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

April 7, 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, 2016. 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 December 2, 2016. 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.

A *deficiency in internal control* exists when the design or operation of a control does not allow management or employees, in the normal course of performing their assigned functions, to prevent, or detect and correct, misstatements on a timely basis. A *material weakness* is a deficiency, or a combination of deficiencies, in internal control, such that there is a reasonable possibility that a material misstatement of the entity's financial statements will not be prevented, or detected and corrected on a timely basis. A *significant deficiency* is a deficiency, or a combination of deficiencies, in internal control that is less severe than a material weakness, yet important enough to merit attention by those charged with governance.

Our consideration of internal control was for the limited purpose described in the first paragraph of this section and was not designed to identify all deficiencies in internal control that might be material weaknesses or significant deficiencies. Given these limitations, during our audit we did not identify any deficiencies in internal control that we consider to be material weaknesses. However, material weaknesses may exist that have not been identified.

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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, 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 no instances of noncompliance or other matters that are required to be reported under *Government Auditing Standards* or statutes set forth by the State of Minnesota.

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). 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 7, 2017**.**

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.

Invoice Approval

During our audit, we noted multiple instances where the City's system of internal controls failed to properly approve invoices. The staff responsible for approving invoices was applying approval to a majority, but not all invoices. While this condition did not rise to a significant deficiency or material weakness we do want to point it out as an opportunity for improvement in internal control. This control weakness indicates that it would be possible for a misstatement to occur and fail to be detected by the City's system of internal control. We recommend current policies and procedures be revised or followed on a consistent basis to ensure all invoices are approved in the future. Staff is aware of the weakness and has implemented procedures to correct in 2017.

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), 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, 2016.

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 decreased $20,860 from 2015. The fund balance of $1,644,195 is 68 percent of the 2017 expenditures and transfers out.

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.

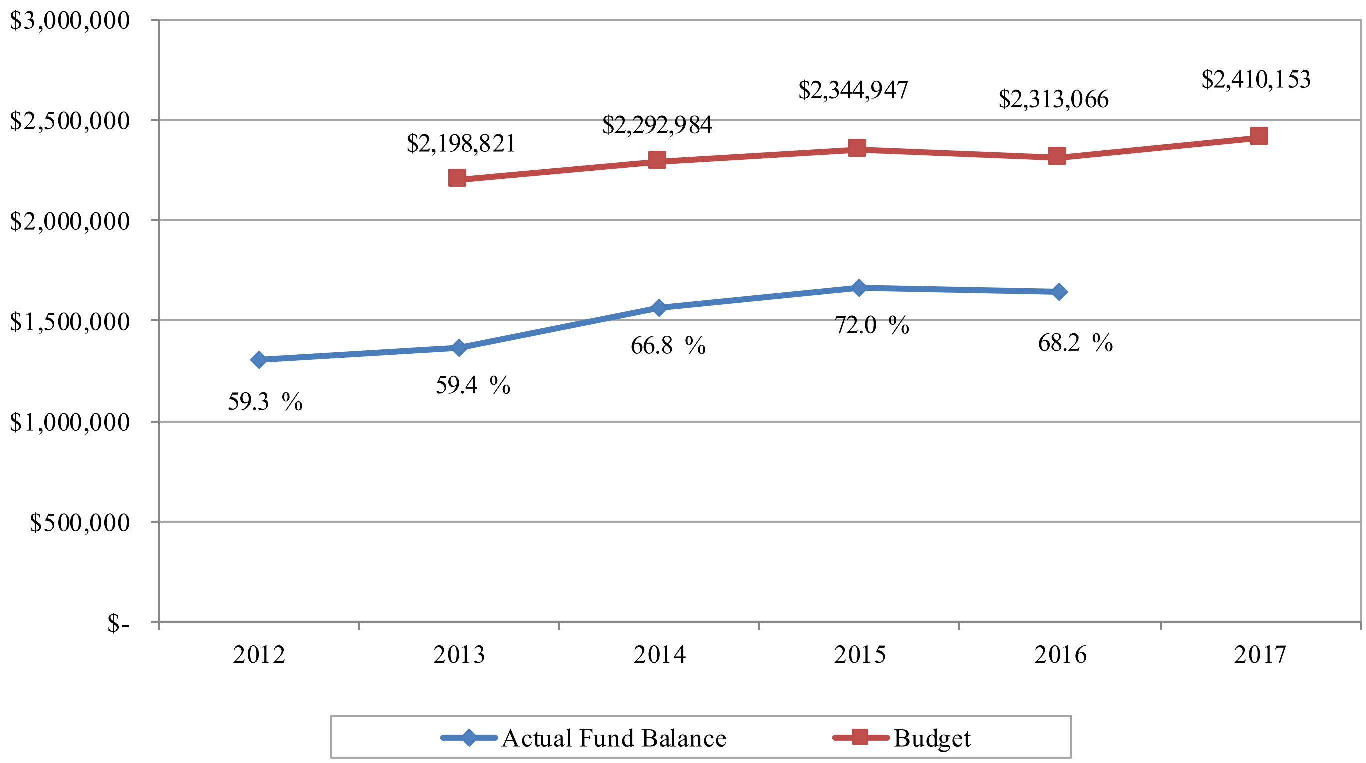
The purposes and benefits of a fund balance are as follows:

- 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
2012	$ 1,304,882	2013	$ 2,198,821	59.3 %
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

Fund Balance as a Percent of Next Year's Budget



A summary of the 2016 operations are as follows:

	Final Budget Amounts	Actual Amounts	Variance with Final Budget
Revenues	$ 2,346,559	$ 2,484,642	$ 138,083
Expenditures	1,755,912	1,665,748	90,164
Excess of revenues over expenditures	590,647	818,894	228,247
Other financing uses			
Sale of capital assets	2,000	1,705	(295)
Transfers out	(557,154)	(841,459)	(284,305)
Total other financing sources (uses)	(555,154)	(839,754)	(284,600)
Net change in fund balances	35,493	(20,860)	(56,353)
Fund balances, January 1	1,665,055	1,665,055	-
Fund balances, December 31	$ 1,700,548	$ 1,644,195	$ (56,353)

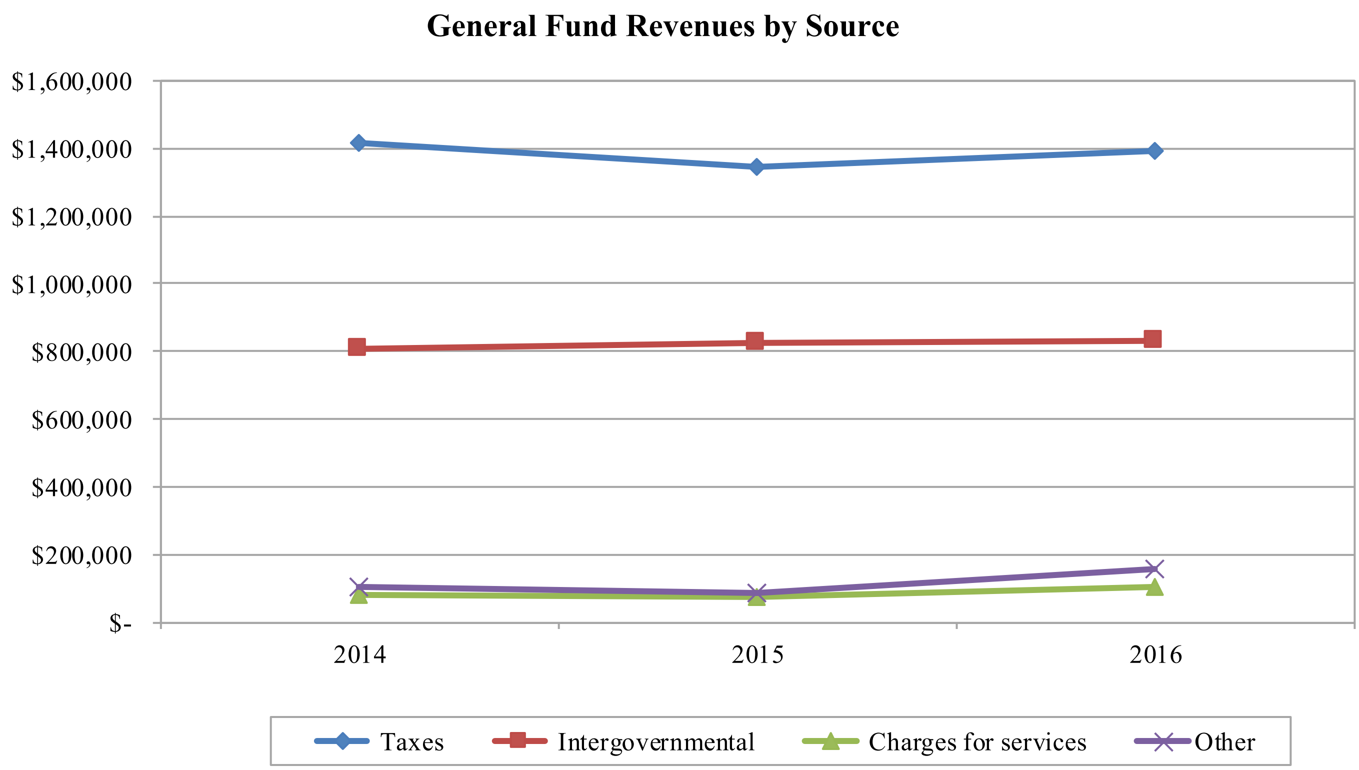
- The most significant revenue variances were in licenses and permits and charges for service which were over budget by $57,014 and 38,554, respectively. The positive budget variance for licenses and permits was mainly due to more building permits issued in 2016 compared to prior year and budget.

- The most significant expenditure variances were in the general government and streets and highways functions which were under budget by $25,878 and $64,976, respectively. The variance in general government is the result of the city administrator and finance administration department being under budget by $14,833 and $6,553, respectively . The variance in streets and highways can be attributed to less than anticipated expenses related to snow removal.

A comparison between 2014, 2015, and 2016 General fund revenues is presented below:

Revenue Source	2014	2015	2016	Percent of Total	Per Capita
Taxes	$ 1,413,164	$ 1,345,684	$ 1,394,850	56.1 %	$ 379
Licenses and permits	49,535	46,688	104,014	4.2	28
Intergovernmental	804,784	822,815	829,584	33.4	226
Charges for services	77,139	76,207	106,209	4.3	29
Fines and forfeitures	15,131	18,703	18,704	0.8	5
Interest on investments	18,543	11,676	20,151	0.8	5
Miscellaneous	19,752	8,615	11,130	0.4	3
Total revenues	$ 2,398,048	$ 2,330,388	$ 2,484,642	100.0 %	$ 675

A graphical presentation of 2014, 2015, and 2016 revenues follows:

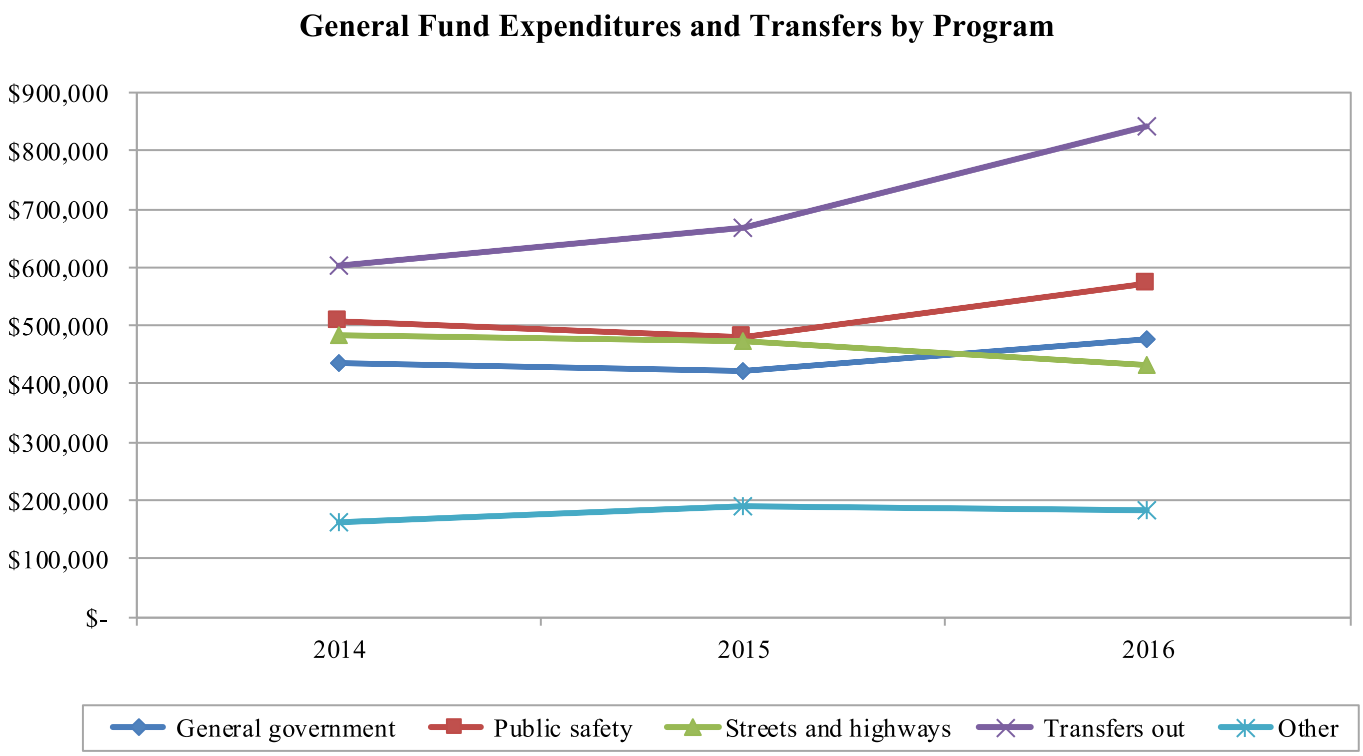


A comparison between 2014, 2015, and 2016 General fund expenditures and transfers is presented below:

Program	2014	2015	2016	Percent of Total	Per Capita	Peer Group Per Capita
Current						
General government	$ 436,645	$ 421,571	$ 476,978	19.0 %	$ 130	$ 133
Public safety	507,440	478,903	573,851	22.9	156	236
Streets and highways	483,943	472,735	433,098	17.3	118	112
Sanitation	3,679	4,083	3,528	0.1	1	-
Culture and recreation	65,961	86,914	84,426	3.4	23	59
Economic development	91,639	99,408	92,477	3.7	25	8
Total current	1,589,307	1,563,614	1,664,358	66.4	453	548
Debt service	250	1,093	1,390	0.1	-	-
Transfers out	602,166	668,333	841,459	33.5	229	-
Total expenditures and transfers	$ 2,191,723	$ 2,233,040	$ 2,507,207	100.0 %	$ 682	$ 548

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 2014, 2015, and 2016 expenditures and transfers totals by program follows:



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, 2016	Fund Balances December 31, 2015	Increase (Decrease)
Nonmajor			
Senior Activity Center	$ 1,883	$ 1,920	$ (37)
Tri-Cap Bus	3,020	5,893	(2,873)
Yellow Bike Program	1,470	1,470	-
Fire Department	244,922	408,126	(163,204)
Total	$ 251,295	$ 417,409	$ (166,114)

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, 2016	Fund Balances December 31, 2015	Increase (Decrease)
Major			
Capital improvements	$ 5,089,339	$ 4,467,634	$ 621,705
Nonmajor			
5th Ave. Bridge Improvements	365,781	359,714	6,067
Tax increment projects	67,094	39,327	27,767
Total nonmajor	432,875	399,041	33,834
Total	$ 5,522,214	$ 4,866,675	$ 655,539

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 $621,705 during the year mainly due to transfers in exceeding current year capital expenses.

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

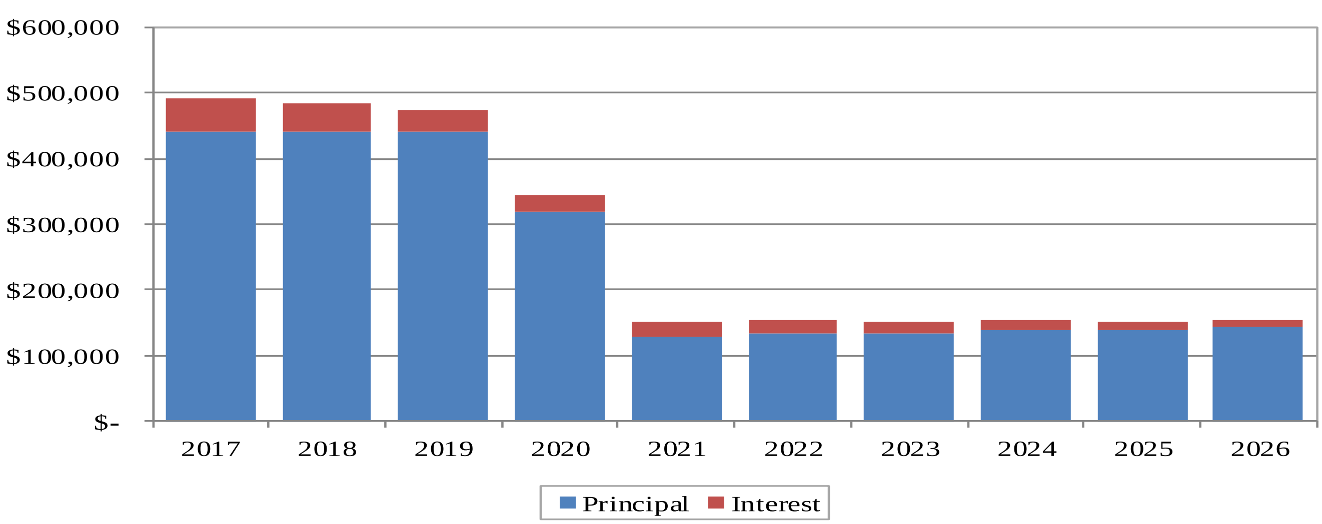
- Investment earnings

- 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	$ 217,806	$ 242,806	$ 1,135,000	02/01/20
G.O. Capital Improvement Plan Bonds, Series 2013A	136,602	136,602	1,625,000	02/01/28
Total	$ 354,408	$ 379,408	$ 2,760,000	
Total future scheduled interest payments			$ 251,031	

Debt Service Scheduled Principal and Interest for the Next 10 Years



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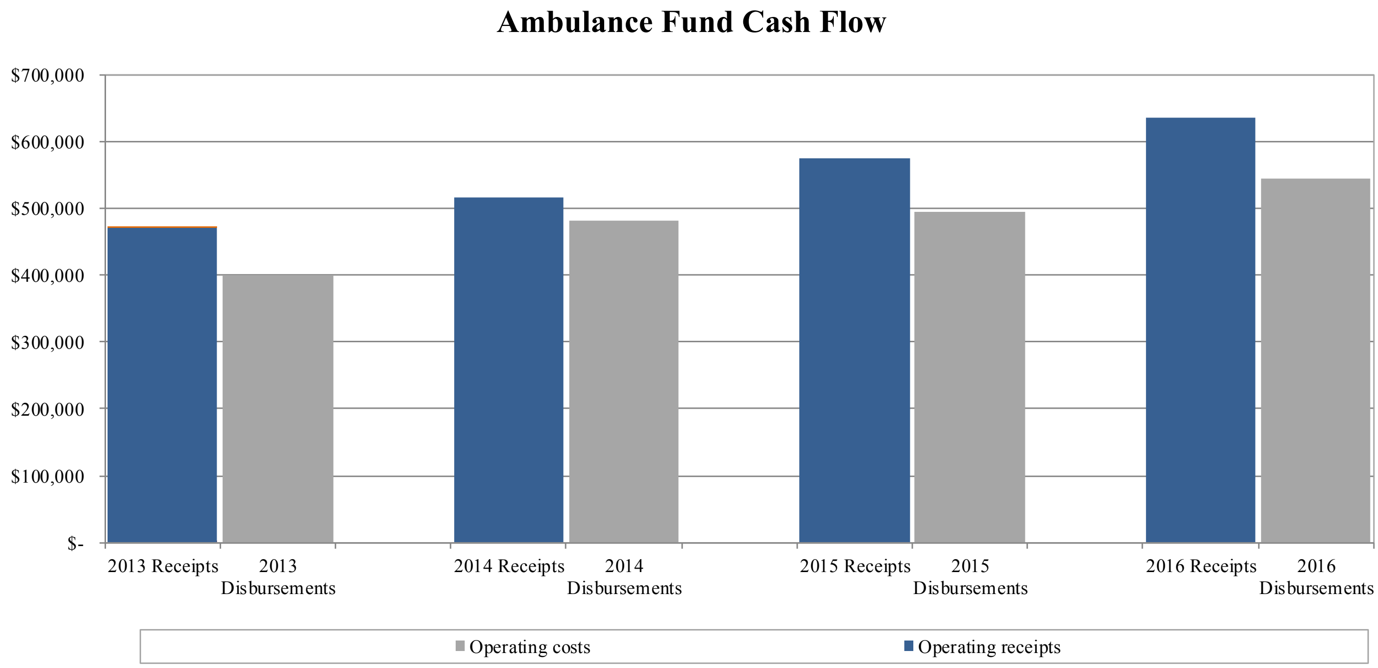
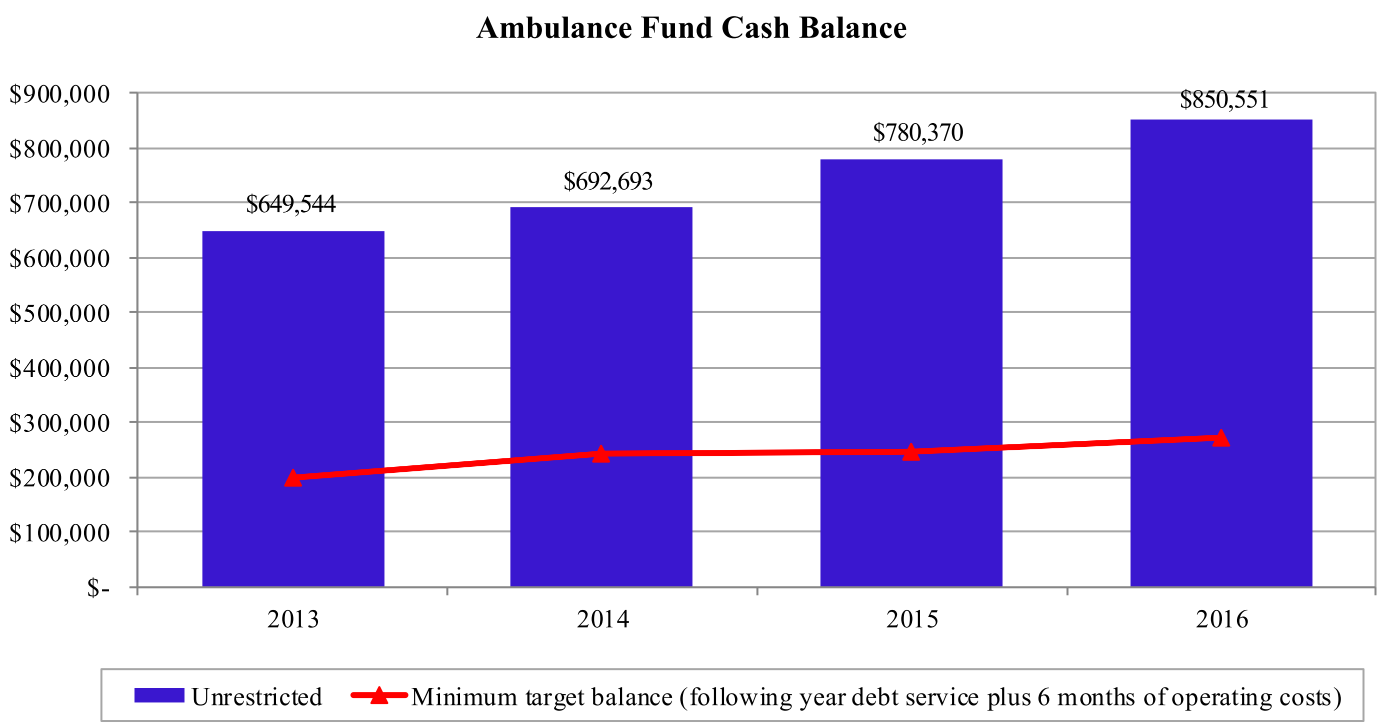
Enterprise Funds

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. 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:





Some of the items with significant changes are highlighted below:

The cash balance increased from the prior year as a result of operations and it is at a level sufficient to provide for working capital and other needs. The change in net position was positive and the fund has healthy reserves relative to operations.

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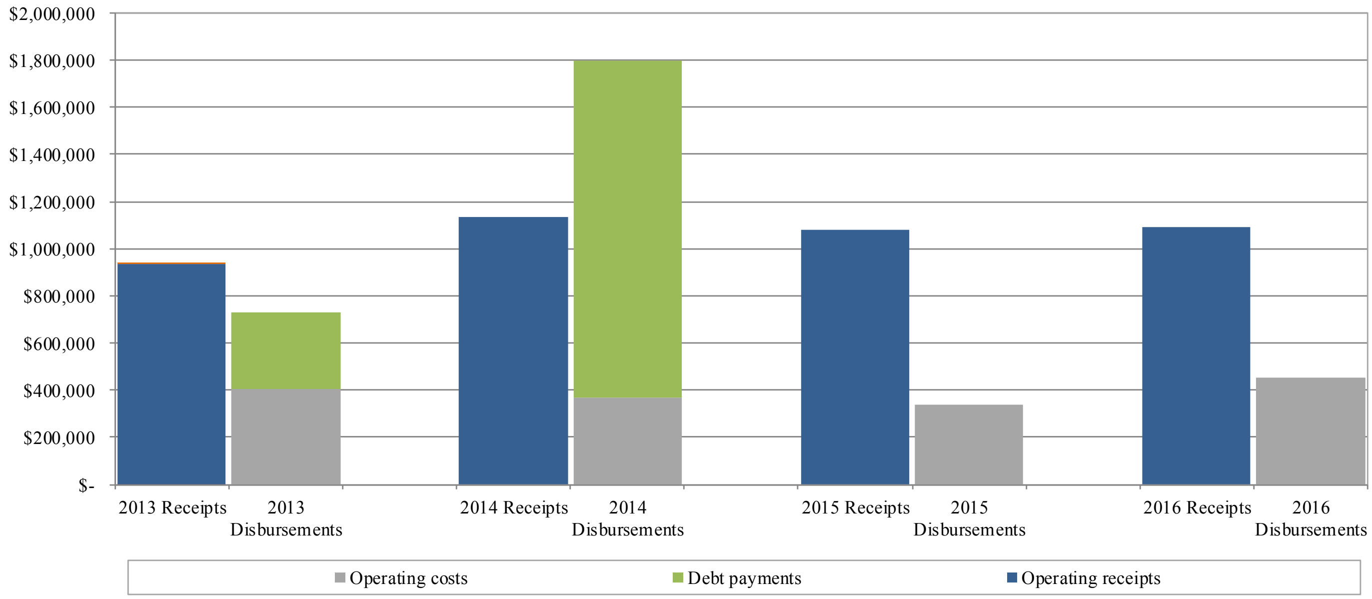
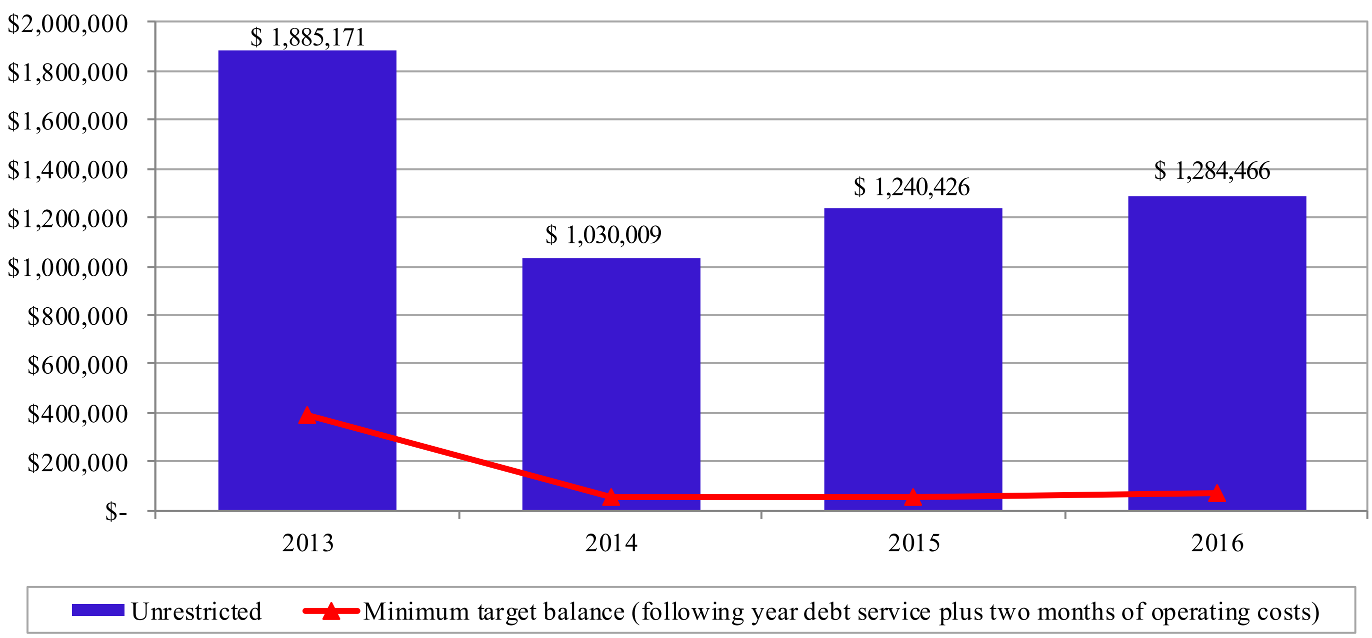
Water Fund Cash Flow



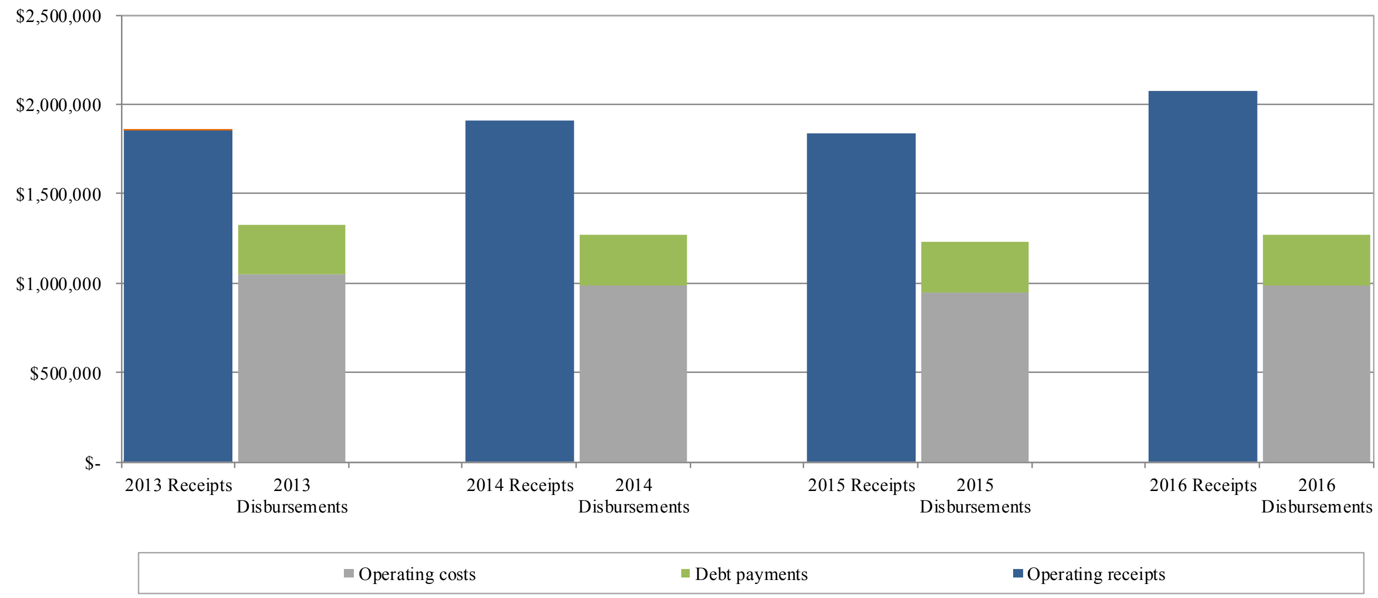
Water Fund Cash Balance



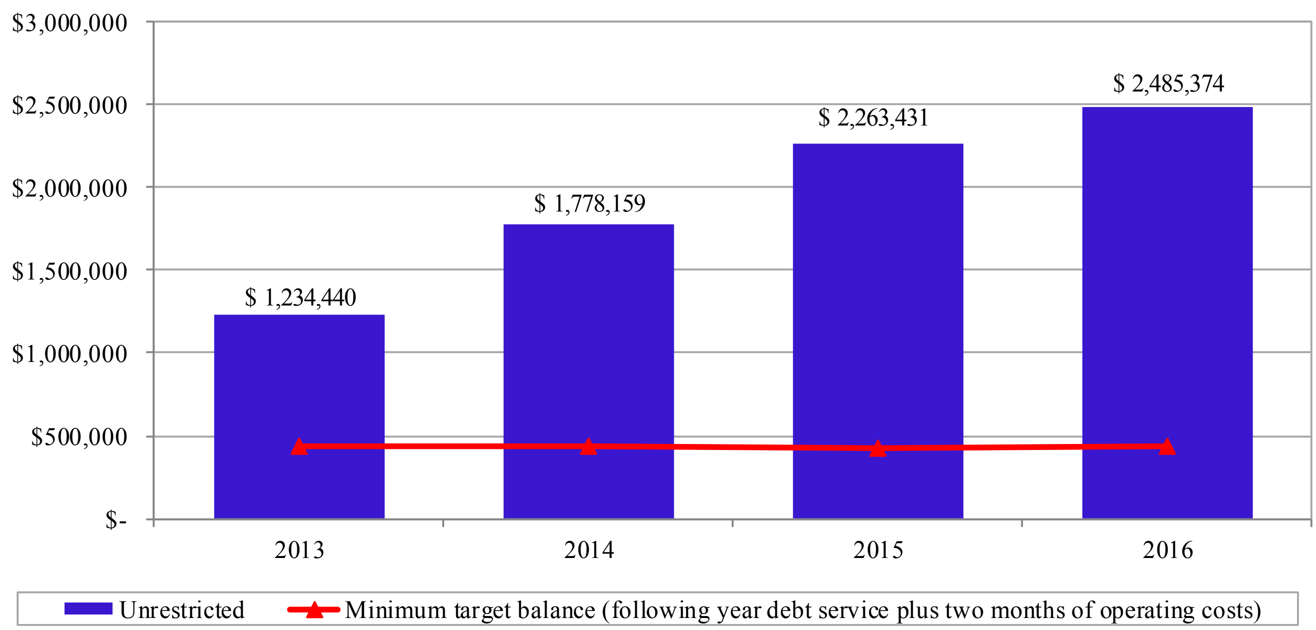
Some of the items with significant changes are highlighted below:

The operating income has been adequate to support cash flow needs in the past and is expected to remain sufficient but it is always important to review cash flow each year to determine if rates are adequate to cover operations and debt service.

Wastewater Fund Cash Flow



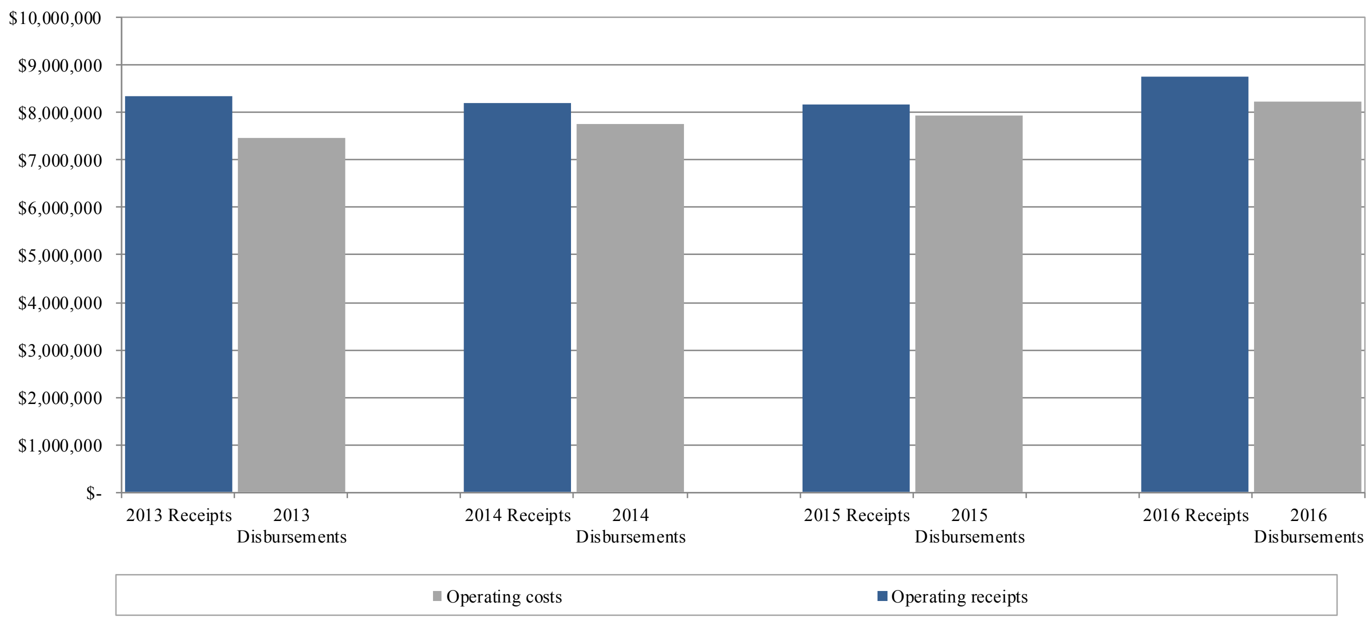
Wastewater Fund Cash Balance



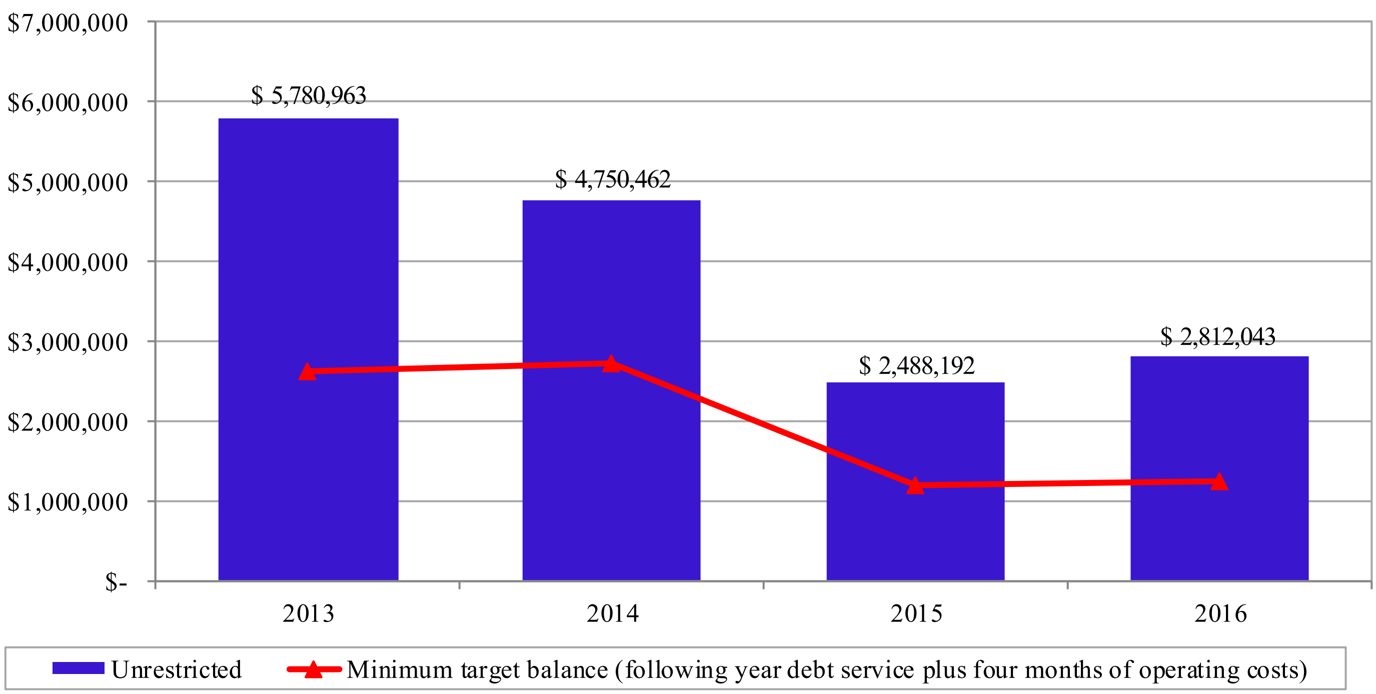
Some of the items with significant changes are highlighted below:

The operating income has been adequate to support cash flow needs in the past and is expected to remain sufficient but it is always important to review cash flow each year to determine if rates are adequate to cover operations and debt service.

Electric Fund Cash Flow



Electric Fund Cash Balance



Some of the items with significant changes are highlighted below:

The operating income has been adequate to support cash flow needs in the past and is expected to remain sufficient but it is always important to review cash flow each year to determine if rates are adequate to cover operations.

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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 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	2013	2014	2015	2016
Debt to assets	Total liabilities/total assets	Government-wide	15%	11%	12%	13%
			32%	*32%*	*34%*	*N/A*
Debt service coverage	Net cash provided by operations/ enterprise fund debt payments	Enterprise funds	221%	98%	314%	389%
			117%	*114%*	*119%*	*N/A*
Debt per capita	Bonded debt/population	Government-wide	$ 1,814	$ 1,253	$ 1,051	$ 857
			$ 2,656	*$ 2,506*	*$ 2,517*	*N/A*
Taxes per capita	Tax revenues/population	Government-wide	$ 489	$ 510	$ 529	$ 548
			$ 487	*$ 484*	*$ 510*	*N/A*
Current expenditures per capita	Governmental fund current expenditures/population	Governmental funds	$ 499	$ 504	$ 498	$ 525
			$ 634	*$ 674*	*$ 688*	*N/A*
Capital expenditures per capita	Governmental fund capital outlay/population	Governmental funds	$ 200	$ 82	$ 114	$ 129
			$ 294	*$ 320*	*$ 354*	*N/A*
Capital assets % left to depreciate - Governmental	Net capital assets/ gross capital assets	Government-wide	68%	65%	63%	61%
			64%	*63%*	*63%*	*N/A*
Capital assets % left to depreciate - Business-type	Net capital assets/ gross capital assets	Government-wide	51%	49%	52%	52%
			63%	*61%*	*61%*	*N/A*

Represents the City of Melrose
Represents Peer Group Average

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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 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, 2016, 2015, 2014, 2013, AND 2012

	2012 Peer Group	2012	2013	2014	2015	2016
Financial Ratios						
Revenue per KWH						
Residential Customers	$ 0.109	$ 0.082	$ 0.0810	$ 0.0840	$ 0.0850	$ 0.0900
Commercial Customers	$ 0.104	$ 0.079	$ 0.0800	$ 0.0800	$ 0.0780	$ 0.0820
Industrial Customers	$ 0.081	$ 0.063	$ 0.0630	$ 0.0640	$ 0.0610	$ 0.0630
Times Interest Earned	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
Uncollectible Accounts per Revenue Dollar	$ 0.0008	$ 0.0001	$ 0.0002	$ 0.0010	$ 0.0002	$ 0.0002
Operating Ratios						
Total O&M Expense per KWH Sold	$ 0.083	$ 0.070	$ 0.690	$ 0.070	$ 0.073	$ 0.075
Total Distribution and O&M Expense (Excluding Power Supply Exp.) per retail customer	N/A	$ 375	$ 302	$ 403	369	614
Purchased Power per KWH	$ 0.055	$ 0.058	$ 0.056	$ 0.058	$ 0.061	$ 0.060
Distribution O&M Expense per Retail Customer	$ 306	$ 212	$ 150	$ 235	$ 177	$ 376
Distribution O&M Expense per Circuit Mile	$ 14,112	$ 7,319 *	$ 5,175	$ 8,129	$ 4,859	$ 8,174
Customer Accounting, Service, and Sales, Administrative and General Expense per Retail Customer	$ 229	$ 229	$ 224	$ 209	$ 257	$ 356
Other Ratios						
Labor Expense per Worker- Hour	$ 33.26	$ 27.85	$ 27.90	$ 29.35	$ 30.90	$ 32.74
Energy Loss Percentage	N/A	-4.60%	1.70%	2.90%	220.00%	0.00%
System Load Factor	N/A	75.60%	75.60%	77.00%	78.13%	71.97%

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.

CITY OF MELROSE, MINNESOTA
MELROSE ELECTRIC UTILITIES
ELECTRIC UTILITY LINE LOSS (UNAUDITED)
FOR THE YEARS ENDED DECEMBER 31, 2016, 2015, AND 2014

Source of Energy, Disposition of Energy and Percentage Relations	2014 KWH	2014 Percent	2015 KWH	2015 Percent	2016 KWH	2016 Percent
Purchased energy	$ 118,514,393	100.2 %	$ 115,176,246	100.1 %	$ 116,614,486	100.2 %
Energy consumed by station	(185,193)	(0.2)	(156,448)	(0.1)	(247,520)	(0.2)
Total net energy outgoing feeders	118,329,200	100.0	115,019,798	100.0	116,366,966	100.0
Net distributed energy	(114,943,051)	(97.1)	(112,908,537)	(98.2)	(113,798,342)	(97.8)
Energy lost in distribution system	$ 3,386,149	2.9 %	$ 2,111,261	1.8 %	$ 2,568,624	2.2 %

* 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, 2015, 2014, AND 2013

SUMMARY OF OPERATIONS

	2014	2015	2016
OPERATING REVENUES			
Sales of water	$ 966,955	$ 953,102	$ 1,027,130
Miscellaneous	90,487	83,177	68,844
TOTAL OPERATING REVENUES	1,057,442	1,036,279	1,095,974
OPERATING EXPENSES			
Operating expenses less depreciation	372,610	345,725	471,843
Depreciation	284,638	282,673	274,911
TOTAL OPERATING EXPENSES	657,248	628,398	746,754
TOTAL OPERATING INCOME	$ 400,194	$ 407,881	$ 349,220
PERCENT OF CHANGE			
Sales of water	6.97%	-1.43%	7.77%

UNAUDITED STATISTICS
MISCELLANEOUS

	2014	2015	2016
WATER PUMPED (gallons)	599,956,000	574,233,000	626,767,000
WATER SOLD (gallons)	587,059,401	564,343,075	604,976,292
Percent of line loss	2.15%	1.72%	3.48%
Revenues per 1,000 gallons pumped	$ 1.76	$ 1.80	$ 1.75
Revenues per 1,000 gallons sold	$ 1.80	$ 1.84	$ 1.81
Labor cost per customer	$ 92.29	$ 98.10	$ 85.24
O&M per customer	$ 231.28	$ 325	$ 258
Number of customers	1,147	1,153	1,138

Future Accounting Standard Changes

The following Governmental Accounting Standards Board (GASB) Statements have been issued and may have an impact on future the 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.

Future Accounting Standard Changes - Continued

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.

People + Process. Going Beyond the Numbers

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*.

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.

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.

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.

* * * * *

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

ABDO, EICK & MEYERS, LLP
Minneapolis, Minnesota
April 7, 2017

People + Process. Going Beyond the Numbers