Management Letter

City of East Bethel

East Bethel, Minnesota

For the Year Ended
December 31, 2014

ABDO EICK & MEYERS LLP
Certified Public Accountants & Consultants

People + Process. Going Beyond the Numbers

ABDO EICK & MEYERS LLP
Certified Public Accountants & Consultants

March 19, 2015

Management, Honorable Mayor and City Council
City of East Bethel, Minnesota

We have audited the accompanying financial statements of the governmental activities, the business-type activities, each major fund and the aggregate remaining fund information of the City of East Bethel, Minnesota (the City), for the year ended December 31, 2014. Professional standards require that we provide you with information about our responsibilities under generally accepted auditing standards, *Government Auditing Standards,* as well as certain information related to the planned scope and timing of our audit. We have communicated such information in our letter to you dated November 20, 2014. Professional standards also require that we communicate to you the following information related to our audit.

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

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

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

Significant Audit Findings

In planning and performing our audit of the financial statements, we considered the City's internal control 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 from 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. The results of our tests disclosed no instances of noncompliance or other matters that are required to be reported under *Government Auditing Standards* or statues set forth by the State of Minnesota.

Planned Scope and Timing of the Audit

We performed the audit according to the planned scope and timing previously communicated to you.

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 was not changed during the year ended December 31, 2014. We noted no transactions entered into by the City during the year for which there is a lack of authoritative guidance or consensus. All significant transactions have been recognized in the financial statements in the proper period.

Accounting estimates are an integral part of the financial statements prepared by management and are based on management's knowledge and experience about past and current events and assumptions about future events. Certain accounting estimates are particularly sensitive because of their significance to the financial statements and because of the possibility that future events affecting them may differ significantly from those expected. The most sensitive estimates affecting the financial statements were depreciation on capital assets and allocation of payroll and compensated absences.

- Management's estimate of depreciation is based on estimated useful lives of the assets. Depreciation is calculated using the straight-line method.

- Allocations of gross wages and payroll benefits are approved by City Council within the City's budget and are derived from each employee's estimated time to be spent servicing the respective functions of the City. These allocations are also used in allocating accrued compensated absences payable.

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

Difficulties Encountered in Performing the Audit

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

Corrected and Uncorrected Misstatements

Professional standards require us to accumulate all known and likely misstatements identified during the audit, other than those that are trivial, and communicate them to the appropriate level of management. Management has corrected all such misstatements.
In addition, none of the misstatements detected as a result of audit procedures and corrected by management were material, either individually or in the aggregate, to each opinion unit's financial statements taken as a whole.

Disagreements with Management

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

Management Representations

We have requested certain representations from management that are included in the management representation letter dated March 19, 2015.

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 governmental unit'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 Matters

With respect to the supplementary information accompanying the financial statements, 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.

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.

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, 2014.

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 $687,612 from 2013. The fund balance of $2,295,102 is 47.3 percent of the 2015 budgeted expenditures and transfers out. We recommend that the fund balance be maintained at a level sufficient to fund operations until the major revenue sources are received in June. The City's fund balance policy for the General fund identifies that a minimum unassigned fund balance of 40 percent of the following year's budgeted expenditures be maintained for cash-flow timing needs. The City's ending fund balance is above this target level from the policy as shown in the chart on the following page.

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

- Expenditures are incurred somewhat evenly throughout the year. However, property tax and State aid revenues are not received until the second half of the year. An adequate fund balance will provide the cash flow required to finance the governmental fund expenditures.

- The City is vulnerable to legislative actions at the State and Federal level. The State continually adjusts the local government aid formulas. An adequate fund balance will provide a temporary buffer against aid adjustments.

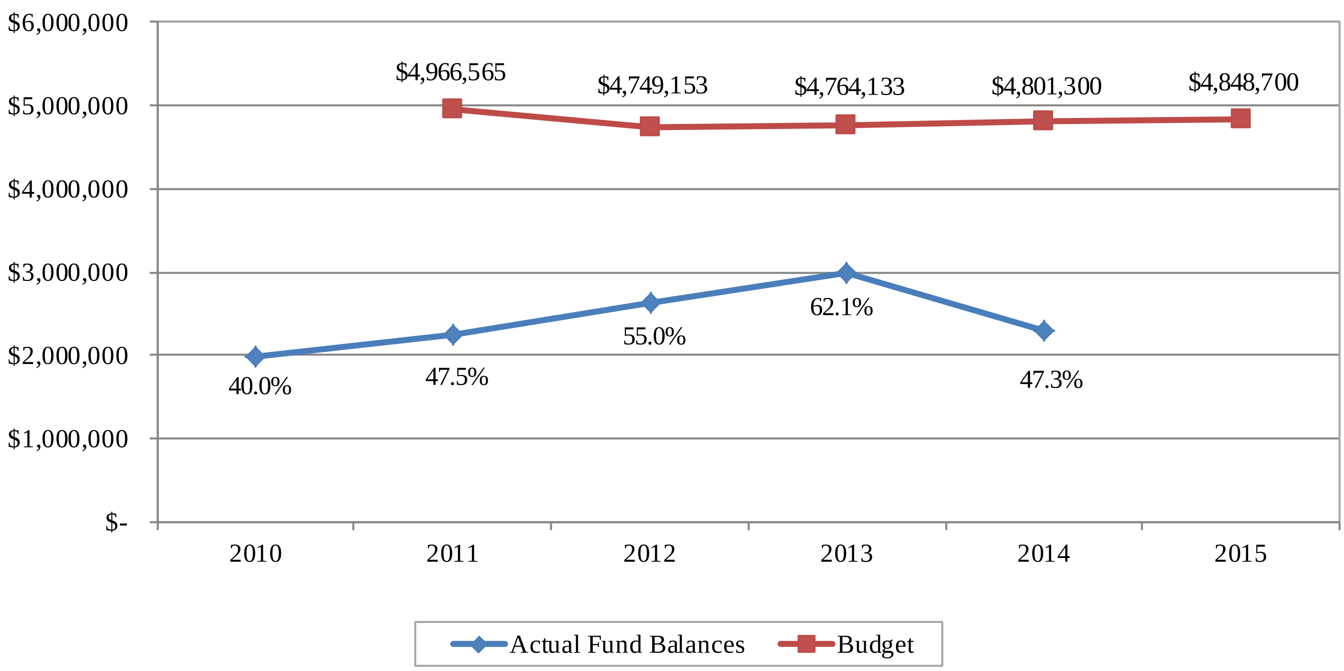
- Expenditures not anticipated at the time the annual budget was adopted may need immediate City Council action. These would include capital outlay, replacement, lawsuits and other items. An adequate fund balance will provide the financing needed for such expenditures.

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

A table summarizing the General fund balance in relation to budgeted expenditures and transfers out follows:

Year	Fund Balance December 31	Budget Year	General Fund Budget	Percent of Fund Balance to Budget
2010	$ 1,984,749	2011	$ 4,966,565	40.0 %
2011	2,254,404	2012	4,749,153	47.5
2012	2,621,894	2013	4,764,133	55.0
2013	2,982,714	2014	4,801,300	62.1
2014	2,295,102	2015	4,848,700	47.3

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



We have compiled a peer group average derived from information we request from the Office of the State Auditor for Cities of the 3rd class which have populations of 10,000-20,000. In 2013 and 2014, the average General fund balance as a percentage of expenditures was 62 percent and 47, percent, respectively.

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The 2014 General fund operations are summarized as follows:

	Final Budgeted Amounts	Actual Amounts	Variance with Final Budget
Revenues	$ 4,781,300	$ 4,925,321	$ 144,021
Expenditures	4,256,300	4,100,029	156,271
Excess of revenues over expenditures	525,000	825,292	300,292
Other financing sources (uses)			
Transfer in	-	48,526	48,526
Transfers out	(545,000)	(1,561,430)	(1,016,430)
Total other financing sources (uses)	(545,000)	(1,512,904)	(967,904)
Net change in fund balances	(20,000)	(687,612)	(667,612)
Fund balances, January 1	2,982,714	2,982,714	-
Fund balances, December 31	$ 2,962,714	$ 2,295,102	$ (667,612)

The City's budget was not amended in 2014 and called for a decrease in fund balance of $20,000. Some of the line items with significant variances from the final budget are highlighted below:

During the year, revenues were more than budget by $144,021 , and expenditures were less than budgetary estimates by $156,271. The transfer out budget was $1,016,430 over budget for the year. The net result was a $687,612 decrease in the General fund. Some of the significant variances can be briefly summarized as follows:

- The most significant revenue variance was in licenses and permits, which exceeded budget by $73,883. This was due to more than anticipated development.
- All expenditure departments were under budget.
- Transfers out were over budget due to approved transfers for debt service payments and to close funds.

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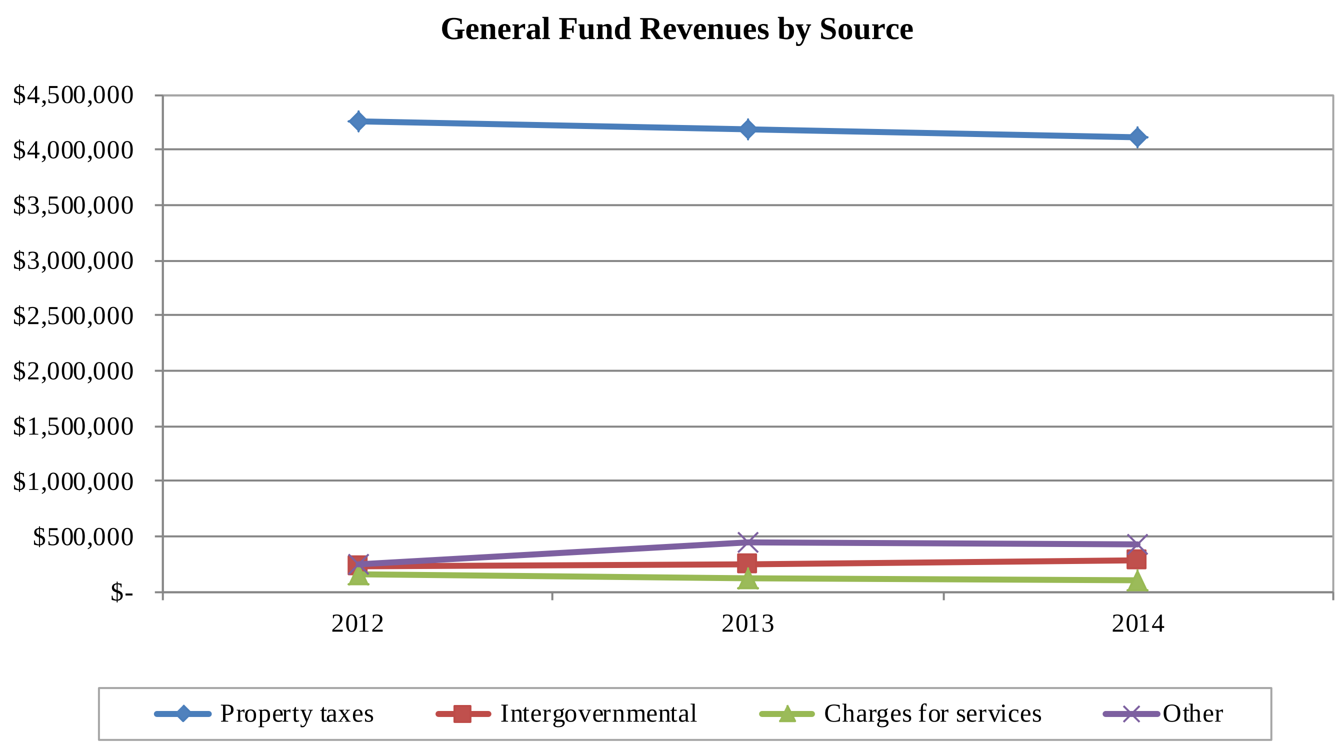
A comparison of General fund among 2012, 2013 and 2014 revenues are presented below:

Source	2012	2013	2014	Percent of Total	Per Capita
Property taxes	$ 4,225,660	$ 4,131,421	$ 4,048,832	81.4 %	$ 349
Franchise taxes	40,227	49,490	56,160	1.1	5
Licenses and permits	144,895	340,095	297,783	6.0	26
Intergovernmental	230,565	257,400	286,389	5.8	25
Charges for services	153,840	128,543	109,988	2.2	9
Fines and forfeitures	52,870	53,574	50,514	1.0	4
Investment income	2,100	1,166	1,164	-	-
Miscellaneous	49,385	55,360	74,491	1.5	6
Transfers in	-	-	48,526	1.0	4
Total revenues and transfers	$ 4,899,542	$ 5,017,049	$ 4,973,847	100.0 %	$ 428

A graphical presentation of 2012, 2013 and 2014 revenues and transfers in follows:



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

- Revenues have stayed fairly consist over the past three years. As you can see from the chart, the City's main source of revenue is from property taxes.

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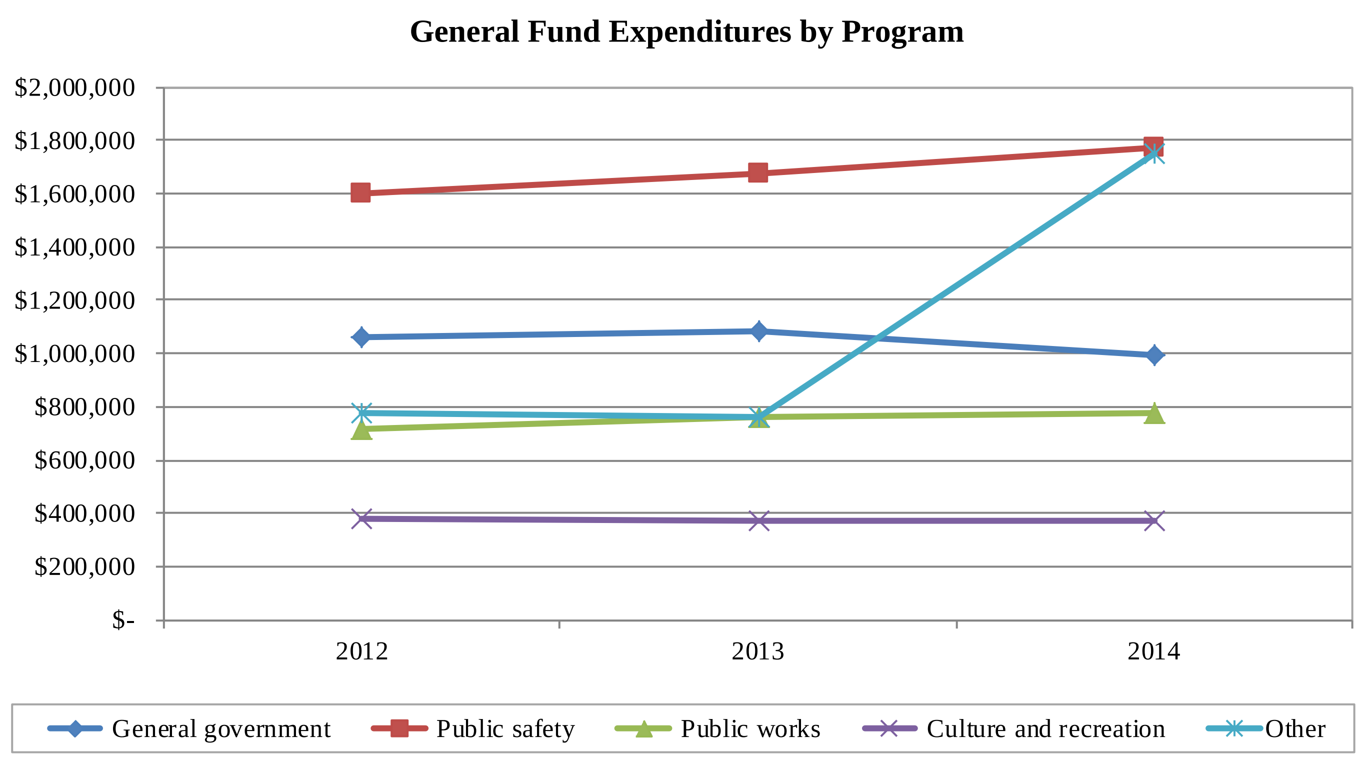
A comparison of General fund expenditures among 2012, 2013 and 2014 are presented below:

Program	2012	2013	2014	Percent of Total	Per Capita	Peer Group
Current						
General government	$ 1,063,948	$ 1,085,090	$ 992,582	17.5 %	$ 86	$ 113
Public safety	1,598,718	1,678,192	1,769,896	31.3	153	221
Public works	719,920	762,351	777,733	13.7	67	108
Culture and recreation	376,067	367,895	369,140	6.5	32	63
Miscellaneous	176,468	211,112	190,678	3.4	16	12
Total current	3,935,121	4,104,640	4,100,029	72.4	354	517
Capital outlay	16,931	1,589	-	-	-	16
Transfers out	580,000	550,000	1,561,430	27.6	135	-
Total expenditures	$ 4,532,052	$ 4,656,229	$ 5,661,459	100.0 %	$ 489	$ 533

The above chart compares the amount the City spends per capita in comparison to a peer group. The peer group average is compiled from 2013 information we have requested from the Office of the State Auditor and the complied data for Cities of the third class which populations between 10,000 and 20,000.

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



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

- The public safety line item has increase over the past three years due to higher expenditures related to fire and police protection, along with increased expenditures in building inspections due to the increase in building permits.
- Transfers increased due to approved transfers for debt service payments and to close funds.

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Special Revenue Funds

A summary of the special revenue fund balances is shown below:

Fund	Fund Balances December 31, 2014	Fund Balances December 31, 2013	Increase (Decrease)
Nonmajor			
Recycling	$ 57,320	$ 51,707	$ 5,613
Miscellaneous Grants/Donations	3,537	7,464	(3,927)
HRA	771,260	785,564	(14,304)
EDA	78,205	1,765	76,440
Total	$ 910,322	$ 846,500	$ 63,822

In 2013, the EDA fund transferred the funds to the equipment replacement fund for a share capital purchases. With no capital purchases in 2014, the fund saw an increase due to less than anticipated expenditures.

Capital Projects Funds

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

Capital Projects Fund	Fund Balances December 31, 2014	Fund Balances December 31, 2013	Increase (Decrease)
Major			
Water Infrastructure	$ 324,474	$ 1,848,107	$ (1,523,633)
Nonmajor			
Park Acquisition	26,082	26,064	18
Park Trails	-	144,088	(144,088)
Minard Street	33,734	27,712	6,022
Improvements of 2003	21,078	7,822	13,256
Municipal State Aid Street Improvement	3,974	(400,023)	403,997
Street Capital	786,852	713,818	73,034
Park Capital	86,980	36,930	50,050
Utility Improvement	29,360	25,248	4,112
Building	182,247	132,132	50,115
Lunde/Jewell Street	-	44,463	(44,463)
TIF No. 1.1	(2,922)	(3,710)	788
Total nonmajor	1,167,385	754,544	412,841
Total	$ 1,491,859	$ 2,602,651	$ (1,110,792)

The Water Infrastructure fund decreased due to costs associated with the utility infrastructure project. The Park Trail's funds and Lunde/Jewell Street were closed during the year and closed into funds as approved. The Municipal State Aid Street Improvement fund increased due to the City receiving MSA monies for street projects.

Debt Service Funds

Debt Service funds are a type of governmental fund to account for the accumulation of resources for the payment of interest and principal on debt (other than enterprise fund debt). Debt Service funds may have one or a combination of the following revenue sources pledged to retire debt as follows:

- Property taxes - Primarily for general City benefit projects such as parks and municipal buildings. Property taxes may also be used to fund special assessment bonds which are not fully assessed.
- Tax increments - Pledged exclusively for tax increment/economic development districts.
- Capitalized interest portion of bond proceeds - After the sale of bonds, the project may not produce revenue (tax increments or special assessments) for a period of one to two years. Bonds are issued with this timing difference considered in the form of capitalized interest.
- Special assessments - Charges to benefited properties for various improvements.

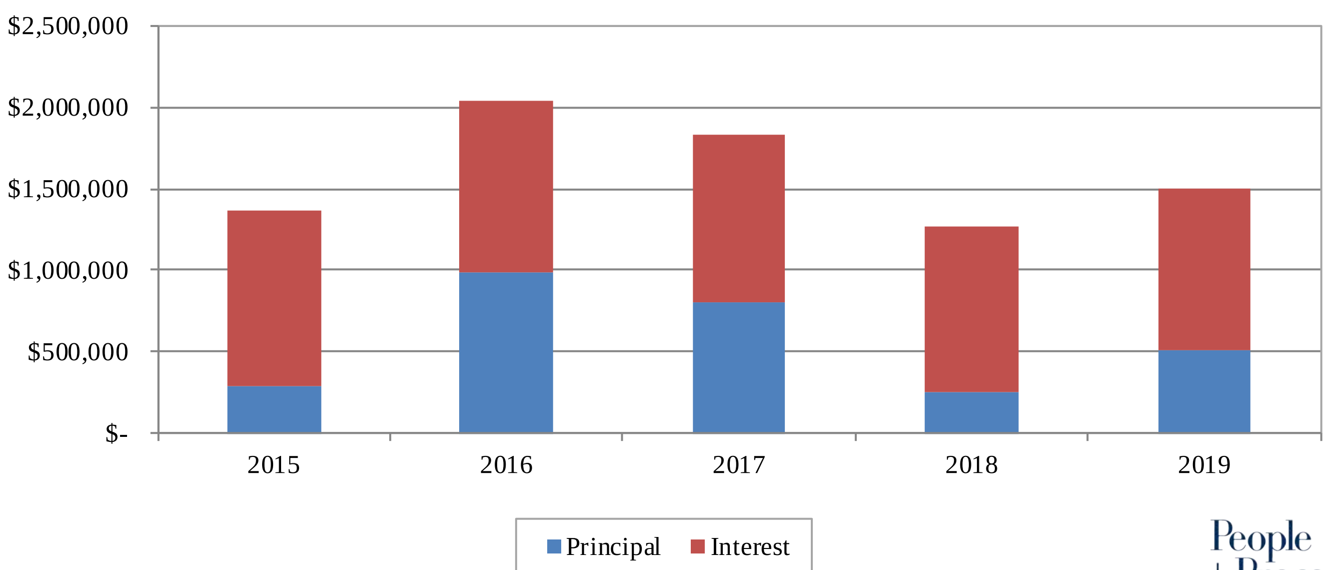
In addition to the above pledged assets, other funding sources may be received by Debt Service funds as follows:

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

The following is a summary of the cash, total assets and bonds outstanding for each issue of the City:

Debt Service Fund	Cash and Investments	Total Assets	Bonds Outstanding	Final Maturity Date
2013A Public Safety Bonds	$ 85,096	$ 86,794	$ 1,250,000	02/01/26
2008A Sewer Revenue Bond	(2,465)	140,125	1,135,000	02/01/29
2010C Improvement Bond	1,344,334	1,344,334	1,260,000	02/01/17
2005B Street Improvement Debt	93,697	119,739	115,000	02/01/16
2010 Water Revenue Note	5,536	5,536	56,590	08/20/29
2010A Revenue Bond	6,267	170,375	11,465,000	02/01/40
2014A Water Revenue Note	16,061	20,378	5,485,000	02/01/40
Total Debt Service Funds	$ 1,548,526	$ 1,887,281	$ 20,766,590	

Debt Service Scheduled Principal and Interest for the Next 5 Years



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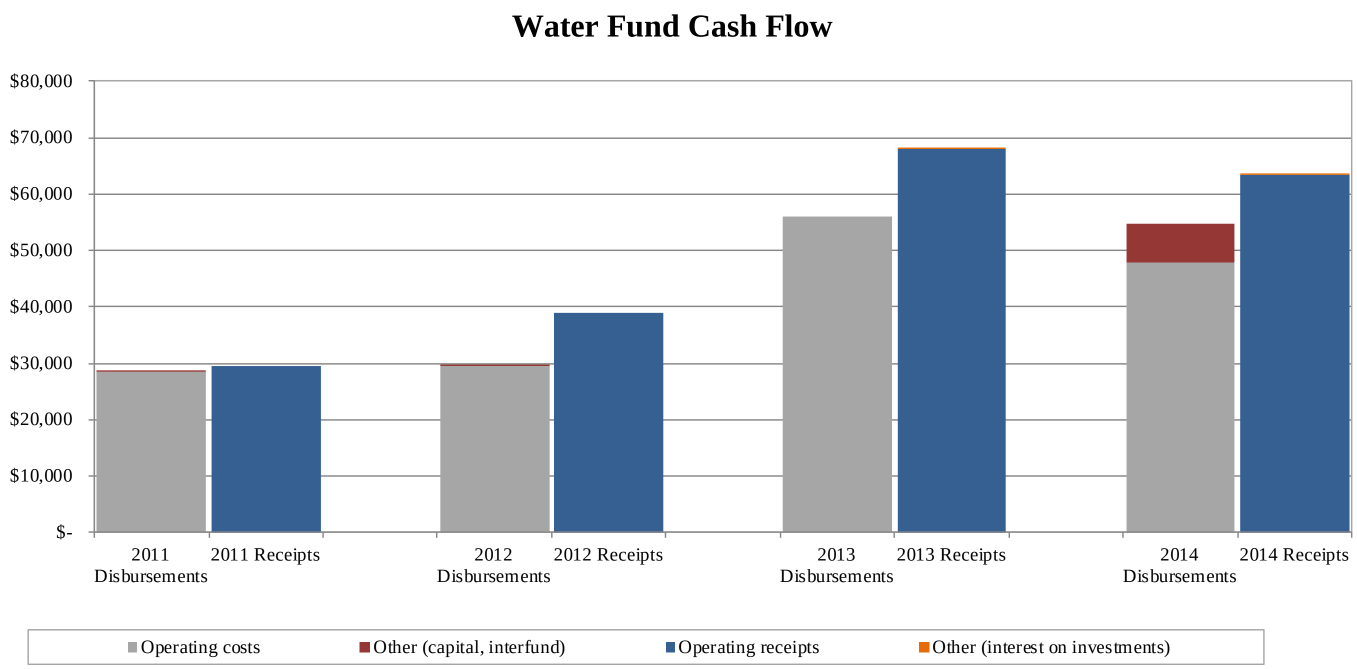
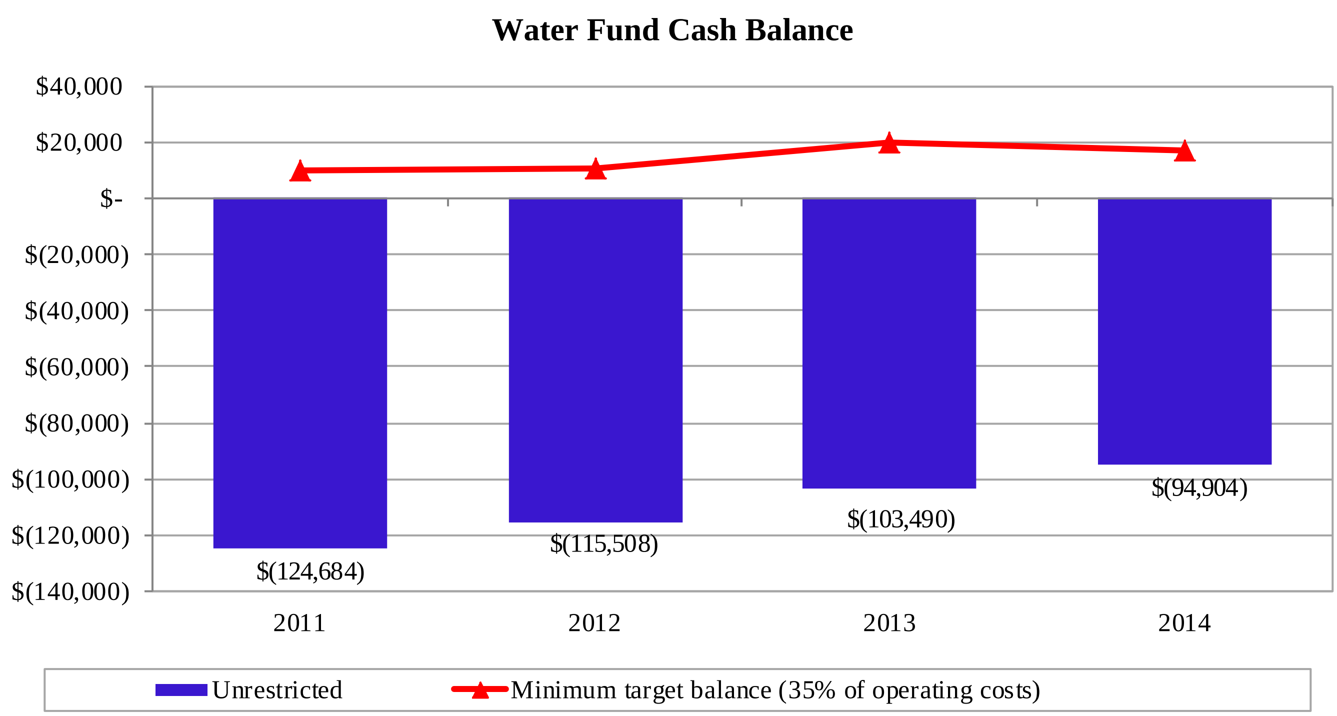
Enterprise Funds

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 in the above charts are highlighted below:

- Operating receipts (blue) were sufficient to cover operating costs (gray) the past four years, which has led to an increase in cash balance of almost $30,000.
- With the deficit cash balance, the fund has been borrowing from other funds to operate.

We recommend that the rates be reviewed annually to ensure that they are sufficient to cover operating costs and future capital needs.

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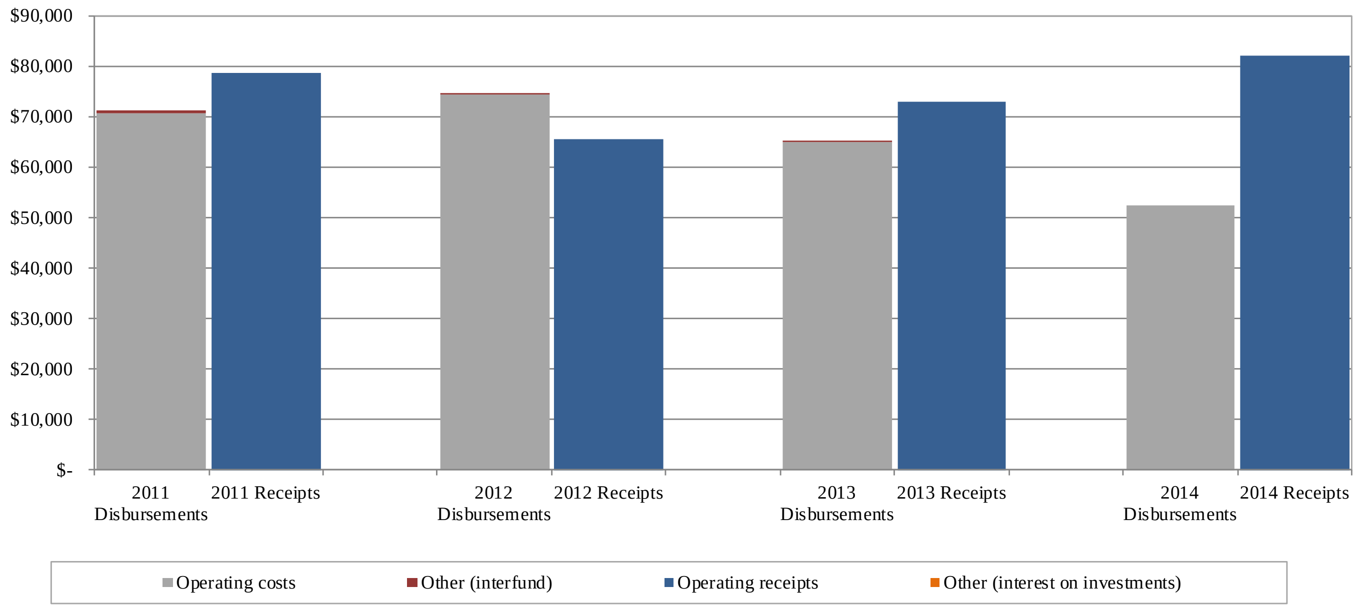
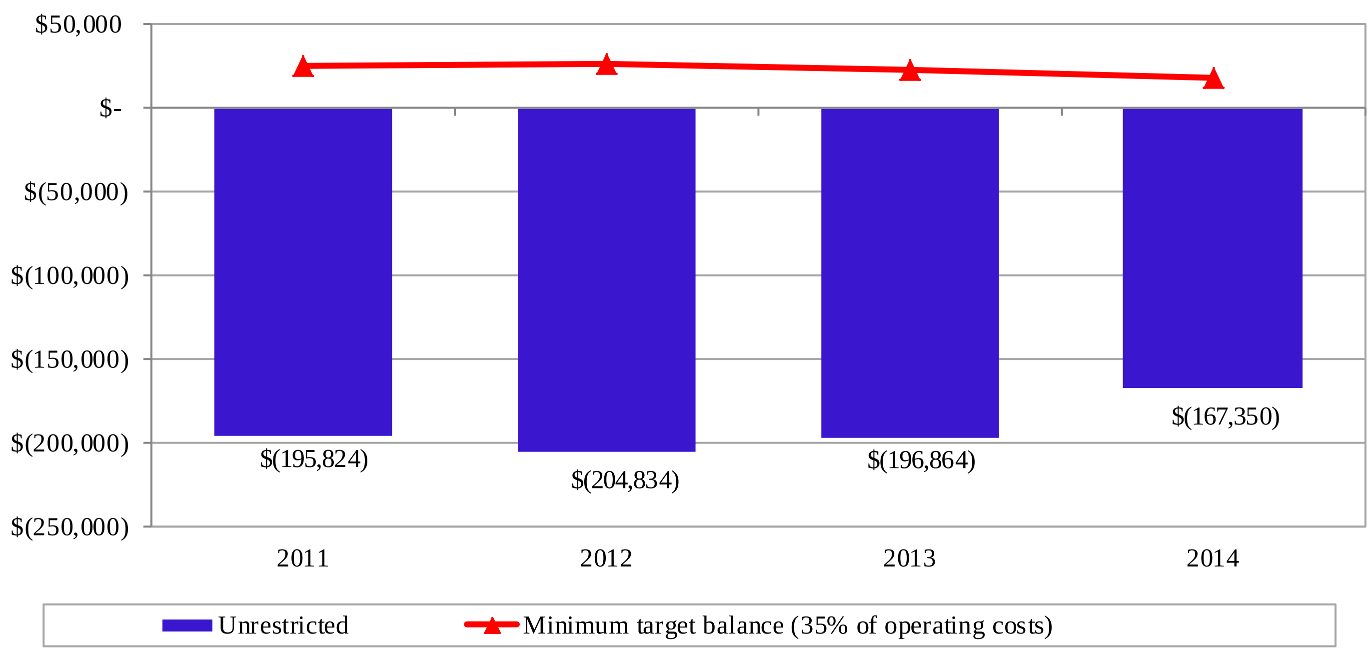
Sewer Fund Cash Flow



Sewer Fund Cash Balance



Some of the items with significant changes in the above charts are highlighted below

- Operating receipts (blue) were sufficient to cover operating costs (gray) the two of the past four years. However, the cash balance has increased roughly $28,000 from 2011.

- With the deficit cash balance, the fund has been borrowing from other funds to operate.

We recommend that the rates be reviewed annually to ensure that they are sufficient to cover operating costs and future capital needs.

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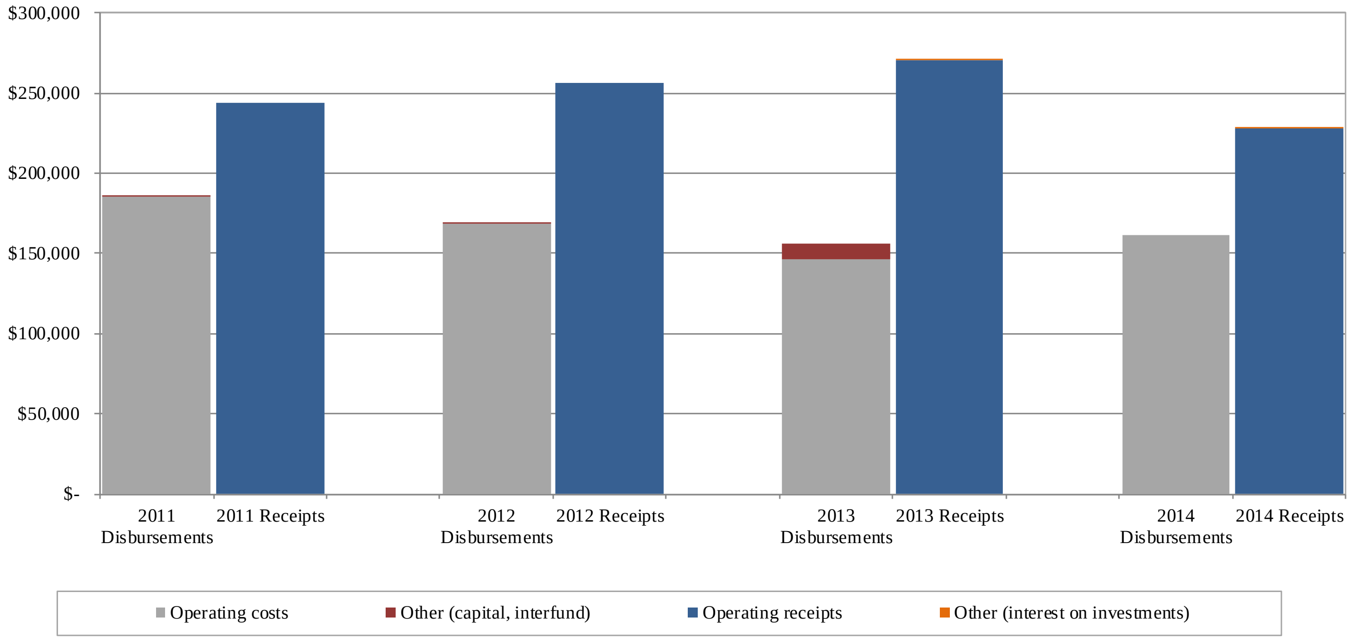
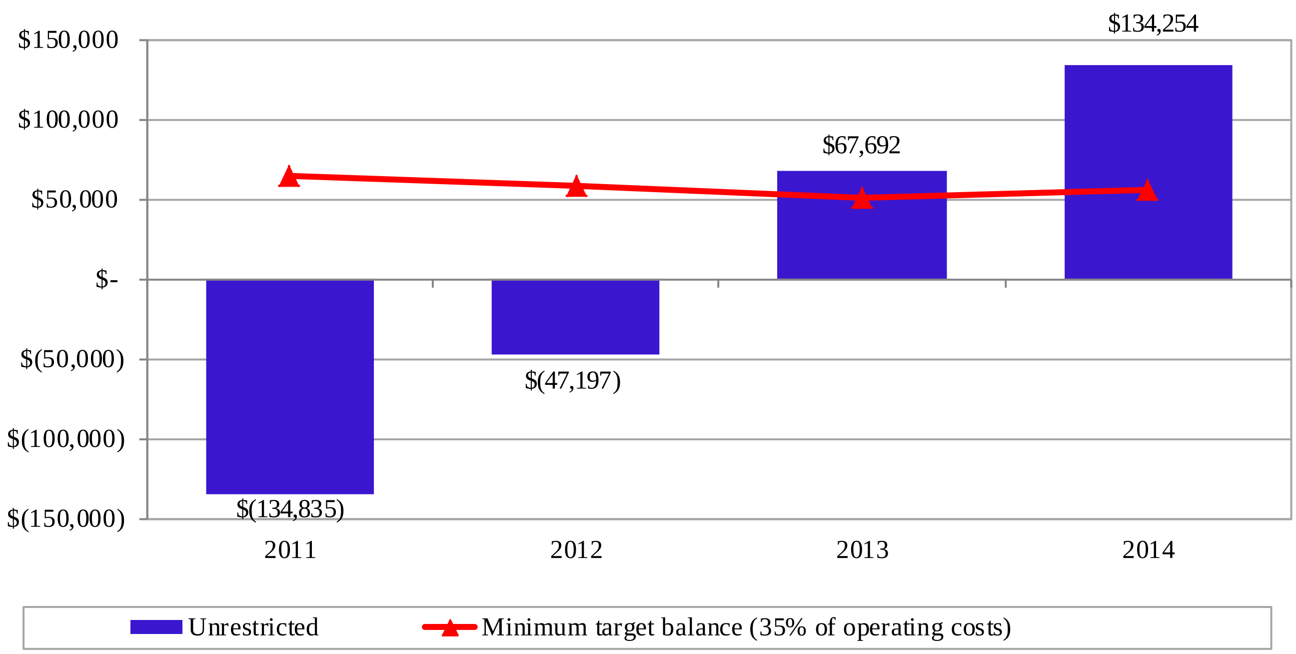
Ice Arena Cash Flow



Ice Arena Cash Balance



Some of the items with significant changes in the above charts are highlighted below:

- Operating receipts (blue) were sufficient to cover operating costs (gray) the past four years, which has led to double the cash balance the fund had in 2011.

Ratio Analysis

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

Ratio	Calculation	Source	2011	2012	2013	2014
Debt to assets	Total liabilities/total assets	Government-wide	41%	42%	41%	40%
			32%	*33%*	*32%*	*N/A*
Debt per capita	Bonded debt/population	Government-wide	$ 1,943	$ 1,917	$ 1,862	$ 1,807
			$ 2,253	*$ 2,641*	*$ 2,637*	*N/A*
Taxes per capita	Tax revenues/population	Government-wide	$ 415	$ 395	$ 394	$ 457
			$ 442	*$ 465*	*$ 485*	*N/A*
Current expenditures per capita	Governmental fund current expenditures/population	Governmental funds	$ 426	$ 379	$ 368	$ 370
			$ 636	*$ 601*	*$ 633*	*N/A*
Capital expenditures per capita	Governmental fund capital outlay/population	Governmental funds	$ 418	$ 513	$ 471	$ 108
			$ 257	*$ 295*	*$ 267*	*N/A*
Capital assets % left to depreciate - Governmental	Net capital assets/ gross capital assets	Government-wide	57%	54%	59%	56%
			63%	*60%*	*59%*	*N/A*
Capital assets % left to depreciate - Business-type	Net capital assets/ gross capital assets	Government-wide	51%	72%	69%	66%
			68%	*62%*	*61%*	*N/A*

Represents the City of East Bethel
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).

Bonded Debt per Capita (Funding Ratio)

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

Taxes per Capita (Funding Ratio)

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

Current Expenditures per Capita (Funding Ratio)

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

Capital Expenditures per Capita (Funding Ratio)

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

Capital Assets Percentage (Common-size Ratio)

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

Future Accounting Standard Changes

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

GASB Statement No. 68 - *The Accounting and Financial Reporting of Pensions- an Amendment of GASB Statement No. 27*

The primary objective of this Statement is to improve accounting and financial reporting by state and local governments for pensions. It also improves information provided by state and local governmental employers about financial support for pensions 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 pensions with regard to providing decision-useful information, supporting assessments of accountability and interperiod equity, and creating additional transparency.

This Statement replaces the requirements of Statement No. 27, Accounting for Pensions by State and Local Governmental Employers, as well as the requirements of Statement No. 50, Pension Disclosures, as they relate to pensions that are provided through pension plans administered as trusts or equivalent arrangements (hereafter jointly referred to as trusts) that meet certain criteria. The requirements of Statements 27 and 50 remain applicable for pensions that are not covered by the scope of this Statement.

This Statement is effective for fiscal years beginning after June 15, 2014. 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 net pension liability and a more comprehensive measure of pension expense. Decision-usefulness and accountability also will be enhanced through new note disclosures and required supplementary information.

GASB Statement No. 71 - *Pension Transition for Contributions Made Subsequent to the Measure Date - an Amendment of GASB Statement No. 68*

Summary

The objective of this Statement is to address an issue regarding application of the transition provisions of Statement No. 68, Accounting and Financial Reporting for Pensions. The issue relates to amounts associated with contributions, if any, made by a state or local government employer or nonemployer contributing entity to a defined benefit pension plan after the measurement date of the government's beginning net pension liability.

Statement No. 68 requires a state or local government employer (or nonemployer contributing entity in a special funding situation) to recognize a net pension liability measured as of a date (the measurement date) no earlier than the end of its prior fiscal year. If a state or local government employer or nonemployer contributing entity makes a contribution to a defined benefit pension plan between the measurement date of the reported net pension liability and the end of the government's reporting period, Statement No. 68 requires that the government recognize its contribution as a deferred outflow of resources. In addition, Statement No. 68 requires recognition of deferred outflows of resources and deferred inflows of resources for changes in the net pension liability of a state or local government employer or nonemployer contributing entity that arise from other types of events. At transition to Statement No. 68, if it is not practical for an employer or nonemployer contributing entity to determine the amounts of all deferred outflows of resources and deferred inflows of resources related to pensions, paragraph 137 of Statement No. 68 required that beginning balances for deferred outflows of resources and deferred inflows of resources not be reported.

Consequently, if it is not practical to determine the amounts of all deferred outflows of resources and deferred inflows of resources related to pensions, contributions made after the measurement date of the beginning net pension liability could not have been reported as deferred outflows of resources at transition. This could have resulted in a significant understatement of an employer or nonemployer contributing entity's beginning net position and expense in the initial period of implementation.

This Statement amends paragraph 137 of Statement No. 68 to require that, at transition, a government recognize a beginning deferred outflow of resources for its pension contributions, if any, made subsequent to the measurement date of the beginning net pension liability. Statement No. 68, as amended, continues to require that beginning balances for other deferred outflows of resources and deferred inflows of resources related to pensions be reported at transition only if it is practical to determine all such amounts.

The provisions of this Statement are required to be applied simultaneously with the provisions of Statement No. 68.

How the Changes in This Statement Will Improve Financial Reporting

The requirements of this Statement will eliminate the source of a potential significant understatement of restated beginning net position and expense in the first year of implementation of Statement No. 68 in the accrual-basis financial statements of employers and nonemployer contributing entities. This benefit will be achieved without the imposition of significant additional costs.

GASB Statement No. 72 - *Fair Value Measurement and Application*

Summary

This Statement addresses accounting and financial reporting issues related to fair value measurements. The definition of *fair value* is the price that would be received to sell an asset or paid to transfer a liability in an orderly transaction between market participants at the measurement date. This Statement provides guidance for determining a fair value measurement for financial reporting purposes. This Statement also provides guidance for applying fair value to certain investments and disclosures related to all fair value measurements.

<u>Fair Value Measurement</u>

Fair value is described as an exit price. Fair value measurements assume a transaction takes place in a government's principal market, or a government's most advantageous market in the absence of a principal market. The fair value also should be measured assuming that general market participants would act in their economic best interest. Fair value should not be adjusted for transaction costs.

To determine a fair value measurement, a government should consider the unit of account of the asset or liability. The unit of account refers to the level at which an asset or a liability is aggregated or disaggregated for measurement, recognition, or disclosure purposes as provided by the accounting standards. For example, the unit of account for investments held in a brokerage account is each individual security, whereas the unit of account for an investment in a mutual fund is each share in the mutual fund held by a government.

This Statement requires a government to use valuation techniques that are appropriate under the circumstances and for which sufficient data are available to measure fair value. The techniques should be consistent with one or more of the following approaches: the market approach, the cost approach, or the income approach. The market approach uses prices and other relevant information generated by market transactions involving identical or comparable assets, liabilities, or a group of assets and liabilities. The cost approach reflects the amount that would be required to replace the present service capacity of an asset. The income approach converts future amounts (such as cash flows or income and expenses) to a single current (discounted) amount. Valuation techniques should be applied consistently, though a change may be appropriate in certain circumstances. Valuation techniques maximize the use of relevant observable inputs and minimize the use of unobservable inputs.

This Statement establishes a hierarchy of inputs to valuation techniques used to measure fair value. That hierarchy has three levels. Level 1 inputs are quoted prices (unadjusted) in active markets for identical assets or liabilities. Level 2 inputs are inputs - other than quoted prices - included within Level 1 that are observable for the asset or liability, either directly or indirectly. Finally, Level 3 inputs are unobservable inputs, such as management's assumption of the default rate among underlying mortgages of a mortgage-backed security.

A fair value measurement takes into account the highest and best use for a nonfinancial asset. A fair value measurement of a liability assumes that the liability would be transferred to a market participant and not settled with the counterparty. In the absence of a quoted price for the transfer of an identical or similar liability and if another party holds an identical item as an asset, a government should be able to use the fair value of that asset to measure the fair value of the liability.

Future Accounting Standard Changes - Continued

This Statement requires additional analysis of fair value if the volume or level of activity for an asset or liability has significantly decreased. It also requires identification of transactions that are not orderly. Quoted prices provided by third parties are permitted, as long as a government determines that those quoted prices are developed in accordance with the provisions of this Statement.

Fair Value Application

This Statement generally requires investments to be measured at fair value. An *investment* is defined as a security or other asset that (a) a government holds primarily for the purpose of income or profit and (b) has a present service capacity based solely on its ability to generate cash or to be sold to generate cash. Investments not measured at fair value continue to include, for example, money market investments, 2a7-like external investment pools, investments in life insurance contracts, common stock meeting the criteria for applying the equity method, unallocated insurance contracts, and synthetic guaranteed investment contracts. A government is permitted in certain circumstances to establish the fair value of an investment that does not have a readily determinable fair value by using the net asset value per share (or its equivalent) of the investment.

This Statement requires measurement at acquisition value (an entry price) for donated capital assets, donated works of art, historical treasures, and similar assets and capital assets received in a service concession arrangement. These assets were previously required to be measured at fair value.

Fair Value Disclosures

This Statement requires disclosures to be made about fair value measurements, the level of fair value hierarchy, and valuation techniques. Governments should organize these disclosures by type of asset or liability reported at fair value. It also requires additional disclosures regarding investments in certain entities that calculate net asset value per share (or its equivalent).

The requirements of this Statement are effective for financial statements for periods beginning after June 15, 2015. Earlier application is encouraged.

How the Changes in This Statement Will Improve Financial Reporting

The requirements of this Statement will enhance comparability of financial statements among governments by requiring measurement of certain assets and liabilities at fair value using a consistent and more detailed definition of fair value and accepted valuation techniques. This Statement also will enhance fair value application guidance and related disclosures in order to provide information to financial statement users about the impact of fair value measurements on a government's financial position.

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

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 recommendation in this 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 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
March 19, 2015

People + Process. Going Beyond the Numbers