Management Letter

City of Red Wing
Red Wing, 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

June 5, 2015

Management, Honorable Mayor and City Council
City of Red Wing, Minnesota

We have audited the financial statements of the governmental activities, the business-type activities, the discretely presented component unit, each major fund, and the aggregate remaining fund information of the City of Red Wing, Minnesota (the City) as of and for the year ended December 31, 2014, which collectively comprise the City's basic financial statements and have issued our report thereon dated June 5, 2015. Professional standards require that we provide you with information about our responsibilities under generally accepted auditing standards and *Government Auditing Standards* and OMB Circular A-133, as well as certain information related to the planned scope and timing of our audit. We have communicated such information in our letter to you dated April 13, 2015. 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* and *OMB Circular A-133*

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 of the City. Such considerations were solely of 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 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 and other matters, noncompliance with which could have a direct and material effect on the determination of financial statement amounts. However, providing an opinion on compliance with those provisions was not an objective of our audit. Also in accordance with *OMB Circular A-133*, we examined, on a test basis, evidence about the City's compliance with the types of compliance requirements described in the "U.S. Office of Management and Budget (OMB) Circular A-133 Compliance Supplement" applicable to each of its major federal programs for the purpose of expressing an opinion on the City's compliance with those requirements. While our audit provides a reasonable basis for our opinion, it does not provide a legal determination on the City's compliance with those requirements. The results of our tests disclosed no instances of noncompliance or other matters that are required to be reported in accordance with *OMB Circular A-133, Government Auditing Standards* or Minnesota statutes.

Planned Scope and Timing of the Audit

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

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, except for the prior period adjustment in Note 10.

Accounting estimates are an integral part of the financial statements prepared by management and are based on management's knowledge and experience about past and current events and assumptions about future events. Certain accounting estimates are particularly sensitive because of their significance to the financial statements and because of the possibility that future events affecting them may differ significantly from those expected. Significant estimates affecting the financial statements include the capital asset basis, the depreciation on capital assets, allowance for doubtful accounts, the liability for the City's Other Post Employment Benefits (OPEB) and the allocation of payroll.

- Management's estimate of capital asset basis is based on estimated historical cost of the capital assets.

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

- Management's estimate of allowance for doubtful accounts is based on the likelihood of collection of receivables.

- 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.

- Allocations of gross wages and payroll benefits 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 accounting 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.

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Management Representations

We have requested certain representations from management that are included in the management representation letter dated June 5, 2015.

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 Consultations with Other Independent Accountants

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

Other Audit Findings or Issues

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

Other Matters

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.

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Financial Position and Results of Operations

Our principal observations and recommendations are summarized below. These recommendations resulted from our observations made in connection with our audit of the City's financial statements for the year ended December 31, 2014.

General Fund

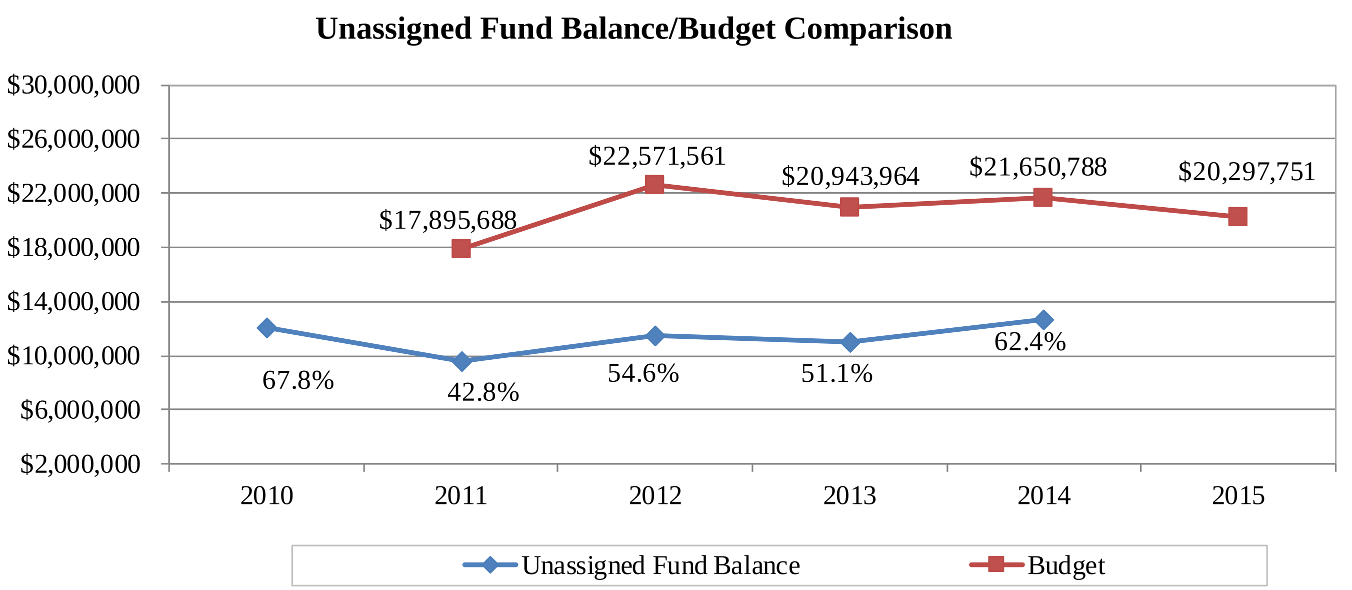
All general governmental functions of the City which are not accounted for in separate funds are included in the General fund.

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

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

Year	Unassigned Fund Balance December 31	Budget Year	General Fund Budget	Percent of Fund Balance to Budget
2010	$ 12,131,659	2011	$ 17,895,688	67.8 %
2011	9,653,893	2012	22,571,561	42.8
2012	11,445,368	2013	20,943,964	54.6
2013	11,058,961	2014	21,650,788	51.1
2014	12,674,073	2015	20,297,751	62.4

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



We have compiled a peer group average derived from information we have requested from the Office of the State Auditor and then compiled data for Cities of the 3rd class which have populations of 10,000-20,000. In 2012 and 2013, the average General fund balance as a percentage of expenditures was 76 percent and 76 percent, respectively. The City's total General fund balance at December 31, 2014 was 118.7 percent of expenditures. Based on comparison to the peer groups, the City's General fund balance is above that average.

The unassigned fund balance increased by $1,615,112 in 2014. The total unassigned fund balance of $12,674,073 represents 62.4 percent of the 2015 budget. Organizations, including the Office of the State Auditor (the OSA) and League of Minnesota Cities (LMC), recommend that a fund balance reserve be anywhere from 35 to 50 percent of planned expenditures. We concur with those recommendations.

Although there is no legislation regulating fund balance, it is a good policy to assign intended use of fund balance. This helps address citizen concerns as to the use of fund balance and tax levels. The City's current fund balance policy strives to maintain 60 percent of the ensuing year's General fund expenditures to assist in maintaining an adequate level of fund balance to meet cash flow requirements for emergency and contingency requirements. We recommend a minimum fund balance for working capital be approximately 40 percent to 50 percent of planned disbursements. So at the current level, unassigned fund balance is slightly higher than is recommended.

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

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

The 2014 General fund operations are summarized as follows:

	Final Budgeted Amounts	Actual Amounts	Variance with Final Budget
Revenues	$ 17,991,946	$ 18,300,966	$ 309,020
Expenditures	16,792,574	14,724,635	2,067,939
Excess (deficiency) of revenues over (under) expenditures	1,199,372	3,576,331	2,376,959
Other financing sources (uses)			
Sale of capital assets	6,060	19,777	13,717
Transfers in	501,650	364,686	(136,964)
Bonds issued	1,074,720	1,082,869	8,149
Premiums on bonds issued	-	19,612	19,612
Transfers out	(4,858,214)	(3,402,537)	1,455,677
Total other financing sources (uses)	(3,275,784)	(1,915,593)	1,360,191
Net change in fund balances	$ (2,076,412)	1,660,738	$ 3,737,150
Fund balances, January 1		15,812,892	
Fund balances, December 31		$ 17,473,630	

Some of the significant variances are as follows:

- Total property taxes were under budget by $124,817.
- Total investment income was over budget by $378,932.
- Total public works expenditures were over budget by $188,587.
- Total culture and recreation expenditures were over budget by $247,535.
- Capital outlay expenditures were under budget by $2,008,048 due to the timing of capital projects.
- Transfers out were under budget by $1,455,677.

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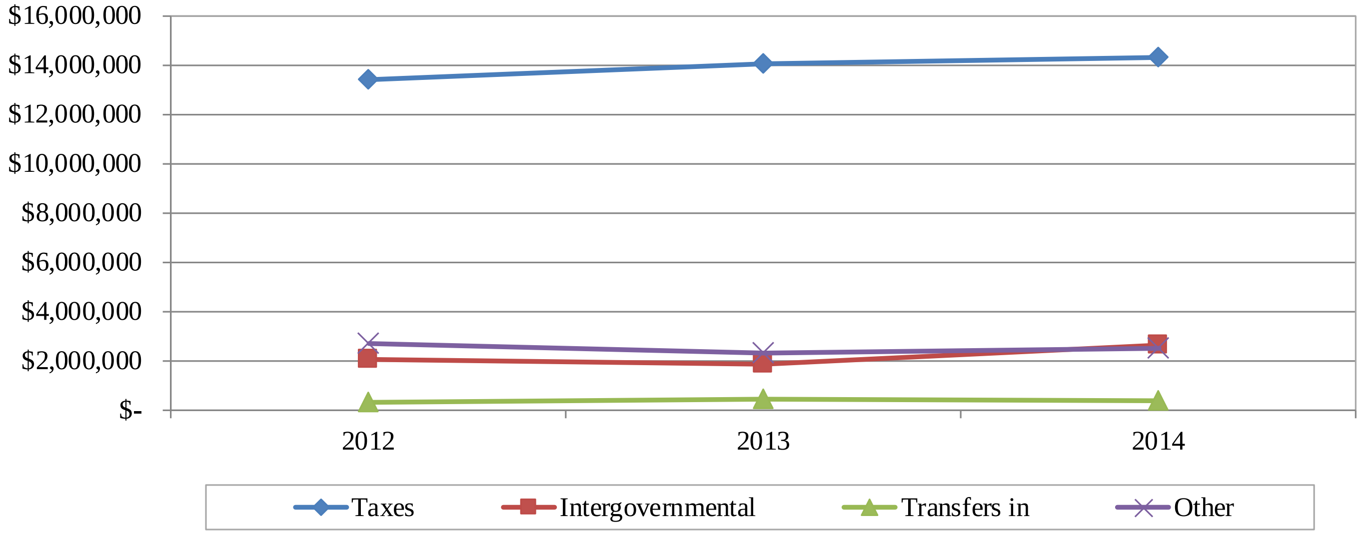
A comparison of General fund revenues and transfers for the last three years is presented below:

Source	2012	2013	2014	Percent of Total	Per Capita
Taxes	$ 13,412,988	$ 14,007,005	$ 14,285,145	72.3 %	$ 866
Special assessments	28,655	-	5,719	-	-
Licenses and permits	60,253	60,632	63,551	0.3	4
Intergovernmental	2,032,055	1,885,453	2,638,706	13.3	160
Charges for services	614,194	533,891	454,922	2.3	28
Fines and forfeits	86,136	77,698	73,872	0.4	4
Investment earnings (loss)	235,350	(340,275)	543,932	2.7	33
Miscellaneous	406,390	429,148	254,896	1.3	15
Transfers in	332,471	466,741	364,686	1.8	22
Debt issued	1,276,467	1,565,419	1,082,869	5.5	66
Premiums on bonds issued	-	-	19,612	0.1	1
Total revenues and transfers	$ 18,484,959	$ 18,685,712	$ 19,787,910	100.0 %	$ 1,199

General Fund Revenues by Source



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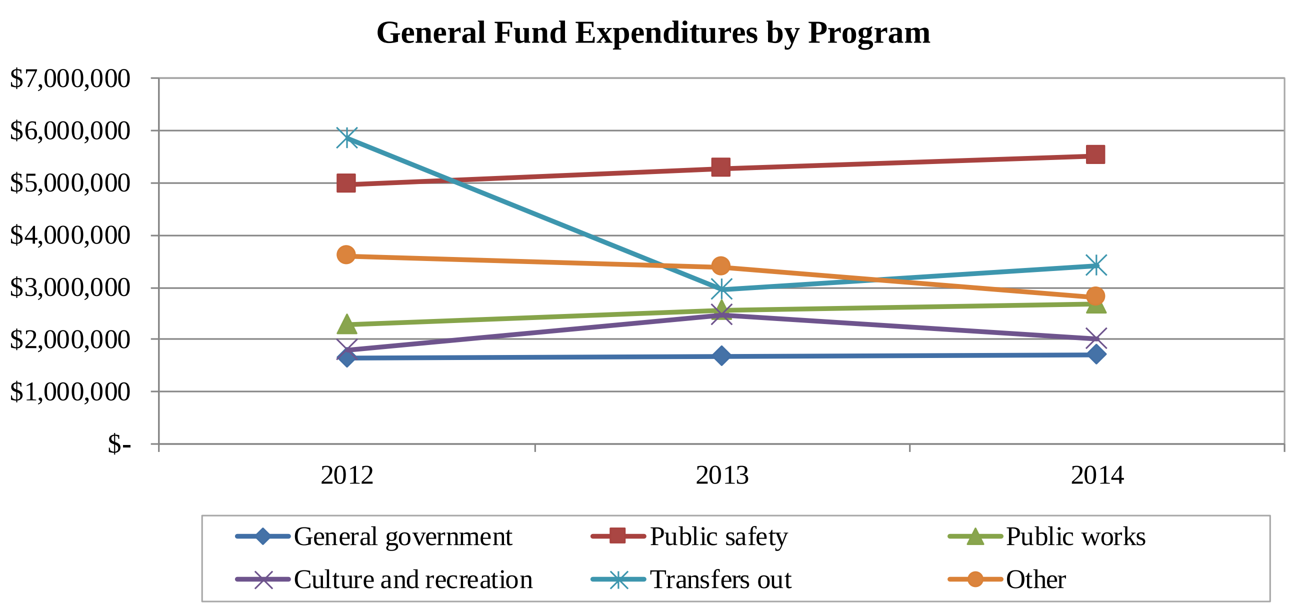
A comparison of General fund expenditures and transfers for the last three years is presented below:

Program	2012	2013	2014	Percent of Total	Per Capita	Peer Group Per Capita
Current						
General government	$ 1,637,430	$ 1,675,393	$ 1,715,823	9.5 %	$ 104	$ 113
Public safety	4,982,345	5,284,428	5,503,176	30.1	334	221
Public works	2,299,457	2,566,251	2,695,229	14.9	163	108
Sanitation	36,804	95,464	49,680	0.3	3	-
Culture and recreation	1,811,197	2,463,239	2,013,727	11.1	122	63
Economic development	995,835	428,067	229,260	1.3	14	8
Cemeteries	277,906	293,358	323,860	1.8	20	-
Transit	-	16,181	22,904	0.1	1	-
Contingencies and other	140,355	154,763	85,994	0.5	5	12
Total current	12,181,329	12,977,144	12,639,653	69.6	766	525
Capital outlay	2,057,505	2,289,768	2,084,982	11.5	126	16
Debt service	96,076	103,347	-	-	-	-
Transfers out	5,858,790	2,968,220	3,402,537	18.9	206	-
Total expenditures and transfers	$ 20,193,700	$ 18,338,479	$ 18,127,172	100.0 %	$ 1,098	$ 541

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 available from the Office of the State Auditor. Different peer group averages are used for cities of the 3rd class.



Special Revenue Funds

Special revenue funds have revenue from specific sourced to be used for specific purpose. Listed below are the special revenue funds of the City along with the fund balances for 2014 and 2013 and the net change:

Fund	Fund Balances December 31 2014	Fund Balances December 31 2013	Increase (Decrease)
Major			
PERA Perpetual	$ 9,023,298	$ 8,356,454	$ 666,844
Nonmajor			
Health Initiatives	(964)	(3,222)	2,258
Airport	36,511	(13,959)	50,470
Library	775,865	722,800	53,065
US EPA Hazardous Substances	-	-	-
US EPA Petroleum	-	(33)	33
DTED Loan	141,613	128,979	12,634
CDBG Revolving	228,700	400,000	(171,300)
Sister Cities	6,261	8,000	(1,739)
Tax Increment District #7	14,962	9,271	5,691
Inspection	91,647	66,671	24,976
Library Memorial	21,379	20,539	840
Total	$ 10,339,272	$ 9,695,500	$ 643,772

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:

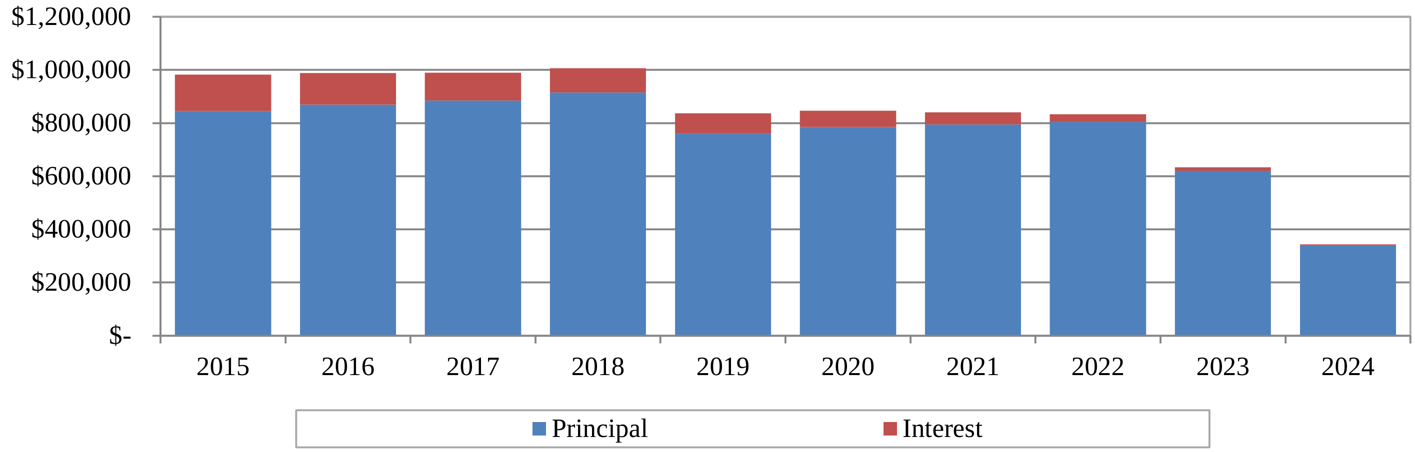
- Residual project proceeds from the related capital projects fund
- Investment earnings
- State or Federal grants
- Transfers from other funds

The following is a summary of Debt Service fund assets and outstanding debt as of December 31, 2014:

Debt Description	December 31, 2014 Total Cash and Investments	Total Assets	Outstanding Debt	Final Maturity Date
G.O. Bonds				
2011A G.O. Bonds	$ 162,011	$ 166,939	$ 1,500,000	2022
2012A G.O. Bonds	268,687	269,265	2,075,000	2023
2013A G.O. Bonds	301,913	303,266	2,930,000	2024
2014A G.O. Equipment Certificates	-	-	1,115,000	2024
Total G.O. Bonds	$ 732,611	$ 739,470	$ 7,620,000	
Future Interest on Debt			$ 680,212	

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

The annual debt service requirements for the next 10 years for the debt detailed above are as follows:



Capital Projects Funds

Capital projects funds are used to account for the acquisition and construction of major capital facilities other than those financed by proprietary funds. The fund balances of the capital projects funds were as follows at December 31, 2014 and 2013:

Fund	Fund Balances December 31 2014	2013	Increase (Decrease)
Major			
Capital Improvement Assessment	$ 6,821,265	$ 6,416,221	$ 405,044
West Avenue Reconstruction	(657,089)	(88,017)	(569,072)
Nonmajor			
Public Safety Center	-	-	-
Airport Federal Projects	25,612	8,376	17,236
Robert Street Extension Project	(761)	-	(761)
East 5th Street Bridge Project	360,451	631,832	(271,381)
Sheldon Renewal Project	240,240	-	240,240
Parkland Acquisition	(12,275)	(14,325)	2,050
2012 Street Reconstruction Project	50,067	50,067	-
2013 Street Reconstruction Project	(10,593)	(741,037)	730,444
2014 Street Reconstruction Project	-	(1,169)	1,169
2015 Street Reconstruction Project	(707)	-	(707)
Spring Creek/Highway 61 Intersection	2,645	2,645	-
Cannon Bottom Road	(769)	(769)	-
Memorial Park Project	(173,872)	(128,234)	(45,638)
Safe Routes to School Project	-	-	-
River Renaissance Levee Road to Jackson Street	(384,707)	53,258	(437,965)
Spring Creek/TH 61 Access Project	(9,813)	(7,437)	(2,376)
Sturgeon Lake Road Overpass	(40,442)	(16,012)	(24,430)
Old Highway 19 Project	79,573	74,590	4,983
Highway 63 River Crossing Bridge	(2,948)	1,557	(4,505)
Moundview Drive	279	279	-
Highway 61 Reconstruction	(27,630)	(139,483)	111,853
Street Reclamation/Reconditioning	794	794	-
Sidewalk Construction Project	8,184	8,428	(244)
Street and Alley Improvements	(17,139)	(22,655)	5,516
Total	$ 6,250,365	$ 6,088,909	$ 161,456

The City should analyze project's status each year and close those that are completed. The deficits in the other funds should be evaluated to ensure they are consistent with financing expectations.

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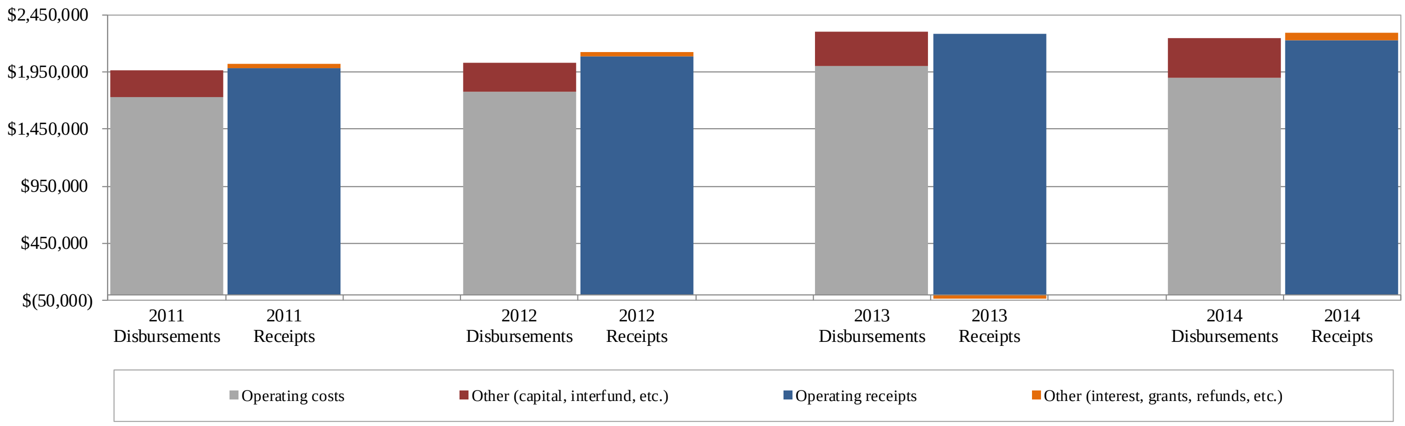
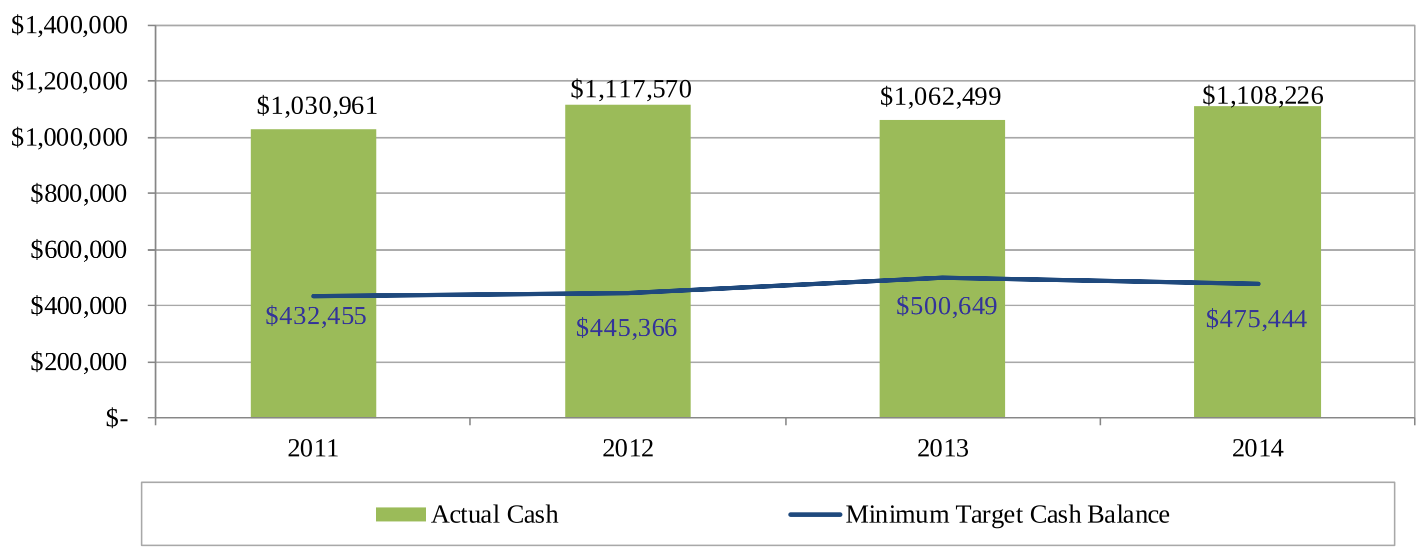
Enterprise Funds

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

Refuse and Recycling Fund Cash Flows



Refuse and Recycling Fund Cash Balance



The minimum target cash balance is based off of 25 percent of operating costs for the fund.

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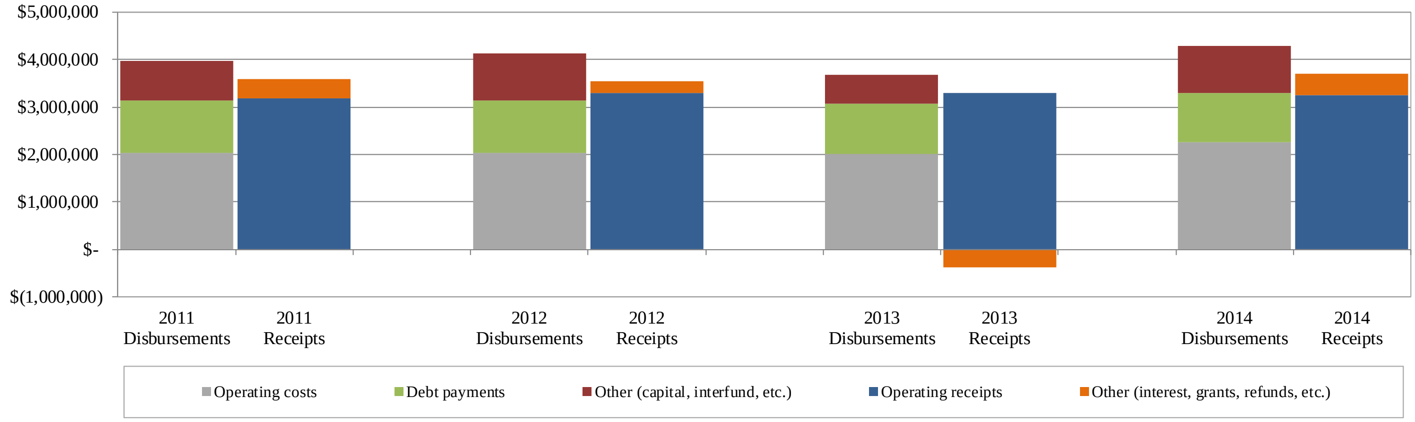
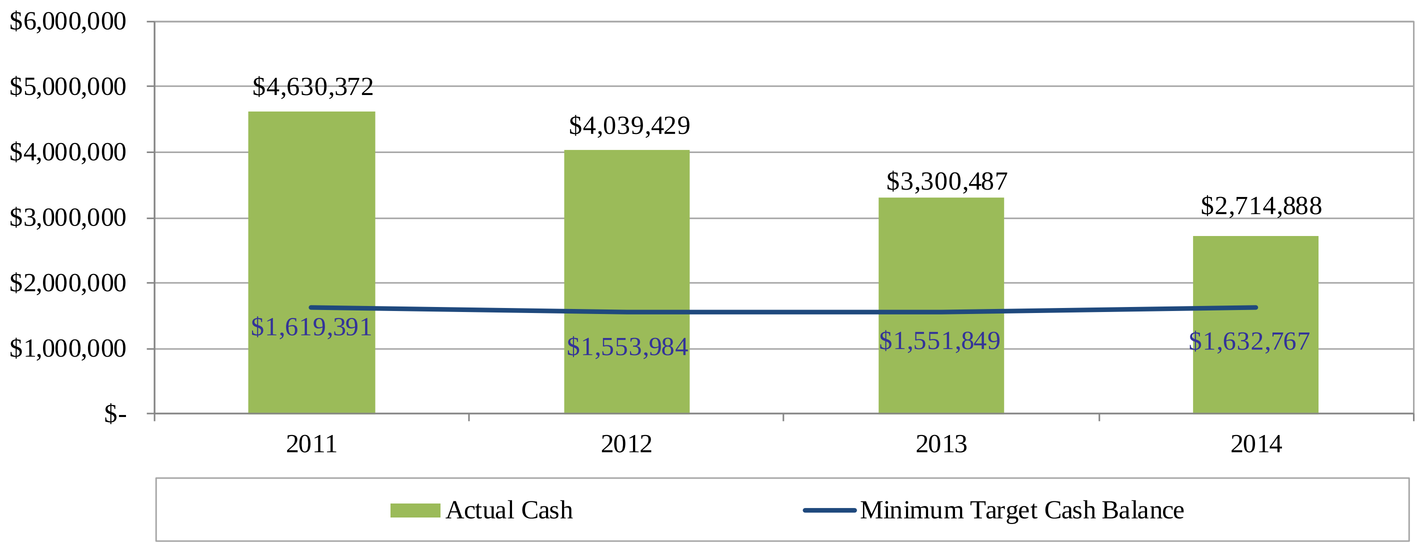
Water Utility Fund Cash Flows



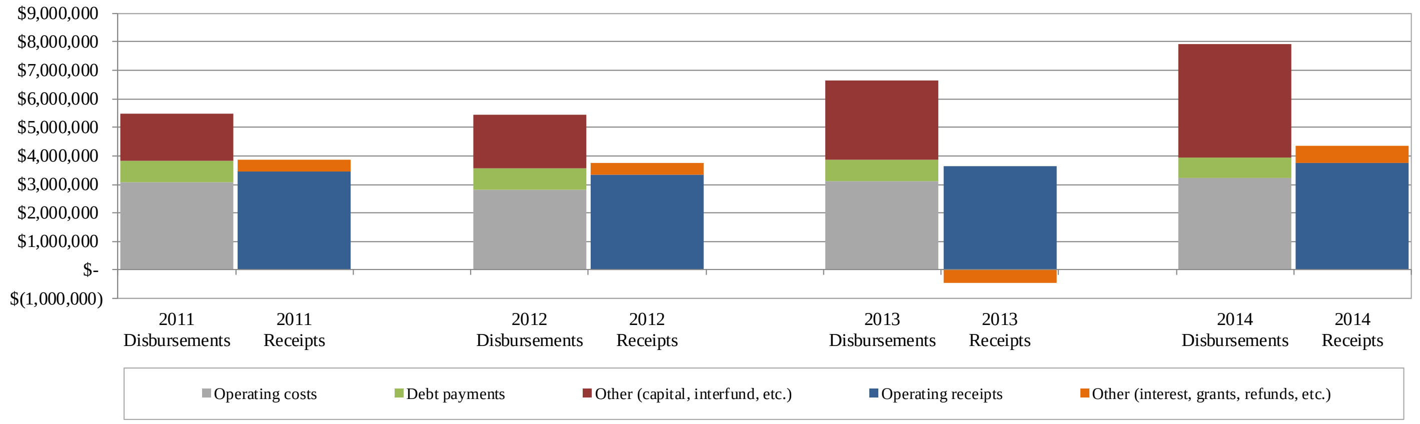
Water Utility Fund Cash Balance



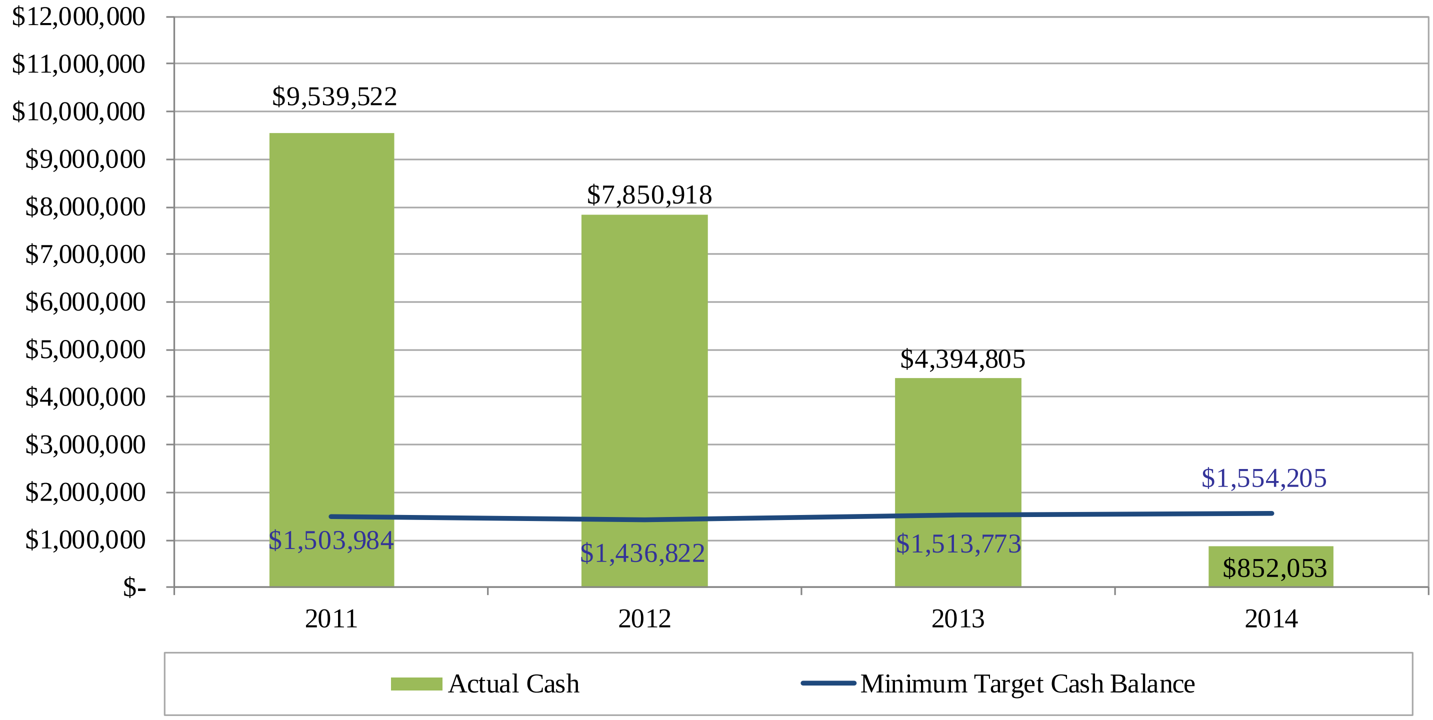
The minimum target cash balance is based off of 25 percent of operating costs plus the next year's debt payments for the fund.

	2011	2012	2013	2014
Bonds payable	$ 10,612,000	$ 9,801,000	$ 9,029,000	$ 8,235,000

Sewer Utility Fund Cash Flows



Sewer Utility Fund Cash Balance



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

	2011	2012	2013	2014
Bonds payable	$ 6,375,520	$ 5,821,987	$ 5,251,686	$ 4,664,345

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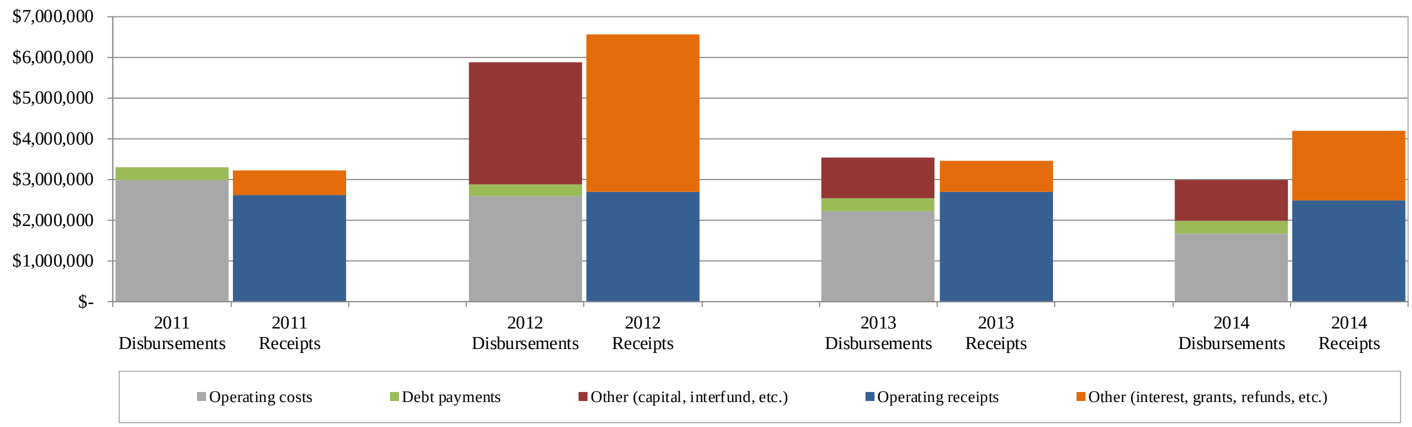
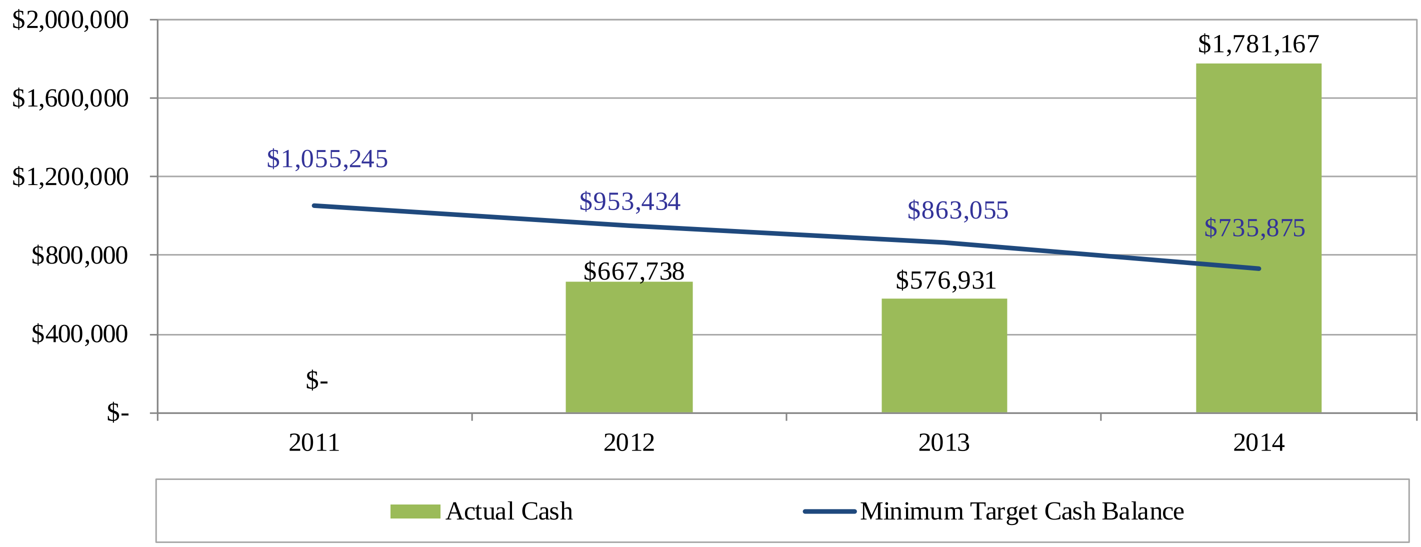
Solid Waste Campus Fund Cash Flows



Solid Waste Campus Fund Cash Balance

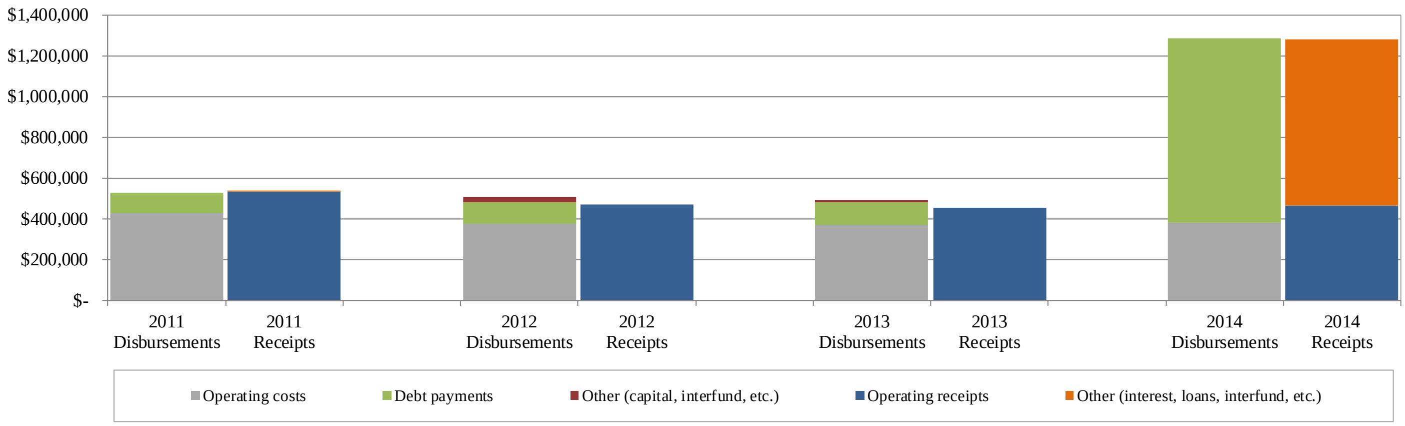


The minimum target cash balance is based off of 25 percent of operating costs plus the next year's debt payments for the fund.

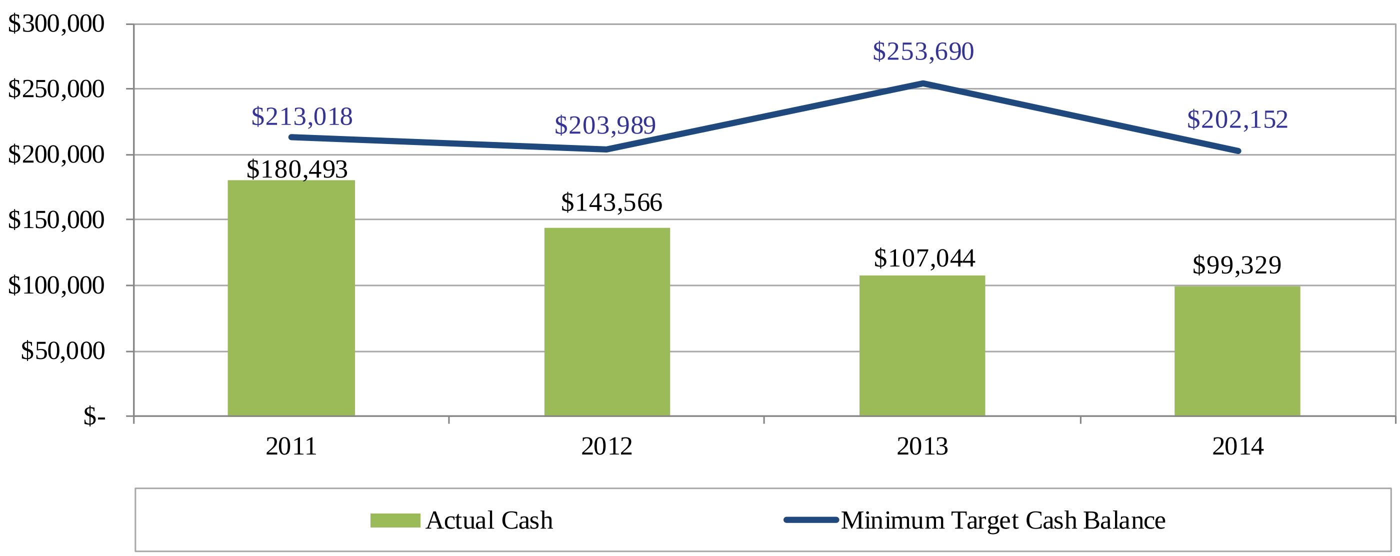
	2011	2012	2013	2014
Bonds payable	$ 3,845,000	$ 3,695,000	$ 3,540,000	$ 3,380,000

As shown above, the solid waste campus operations incurred an operating loss for three of the past four years. The City has funded this deficit in 2013, 2012 and 2011 with transfers from the General fund each year. The City has made significant changes to the solid waste campus operation which resulted in operating income in 2014. These changes have allowed the City to discontinue the operating subsidies. In 2014, the City's General fund received an additional $1,000,000 in LGA from the State. The City opted to use this funding for capital purposes related to the Solid Waste Campus and budgeted such as a transfer from the General fund. Please note this is a unique and one-time appropriation from the State and that it is capital related.

Marina Fund Cash Flows



Marina Fund Cash Balance



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

	2011	2012	2013	2014
Bonds/interfund advances payable	$ 920,000	$ 835,000	$ 745,000	$ 717,114

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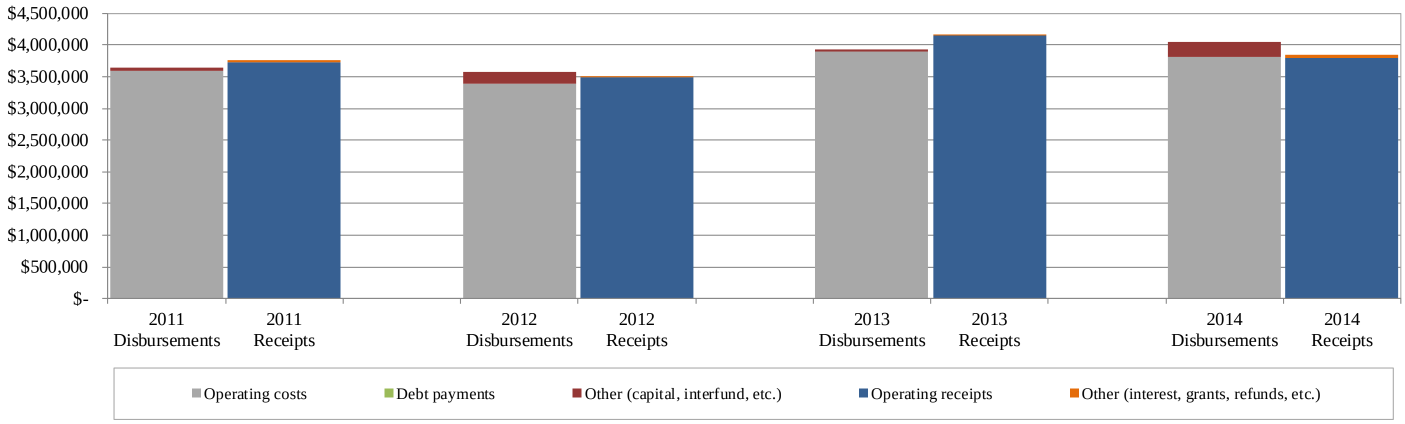
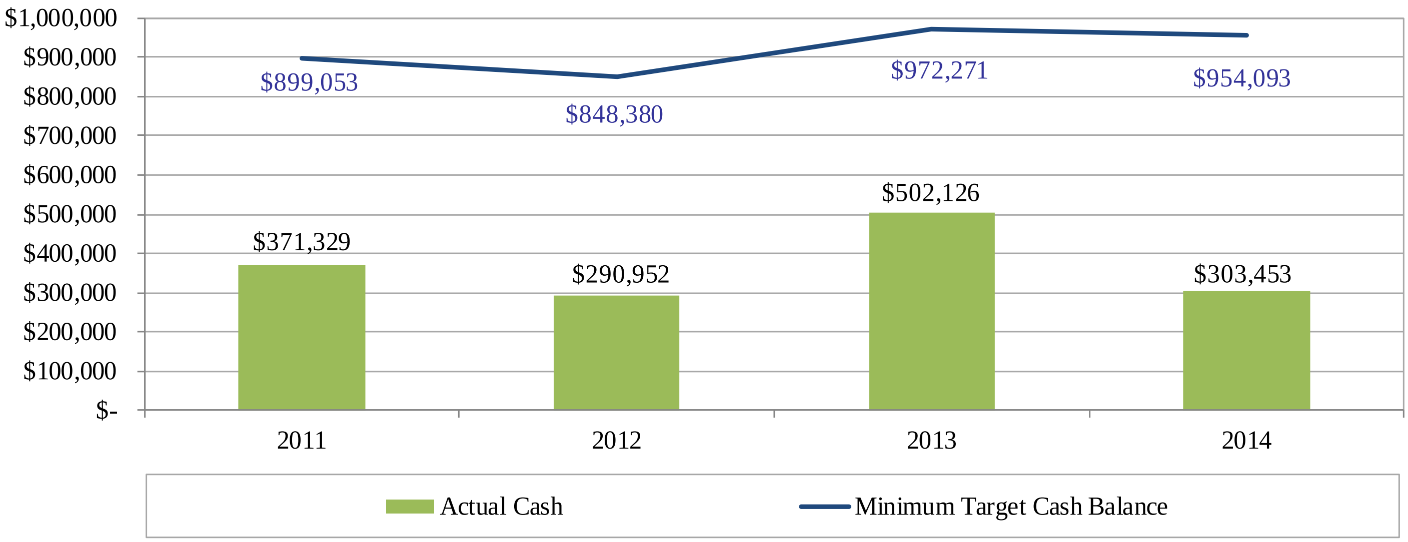
Ambulance Fund Cash Flows

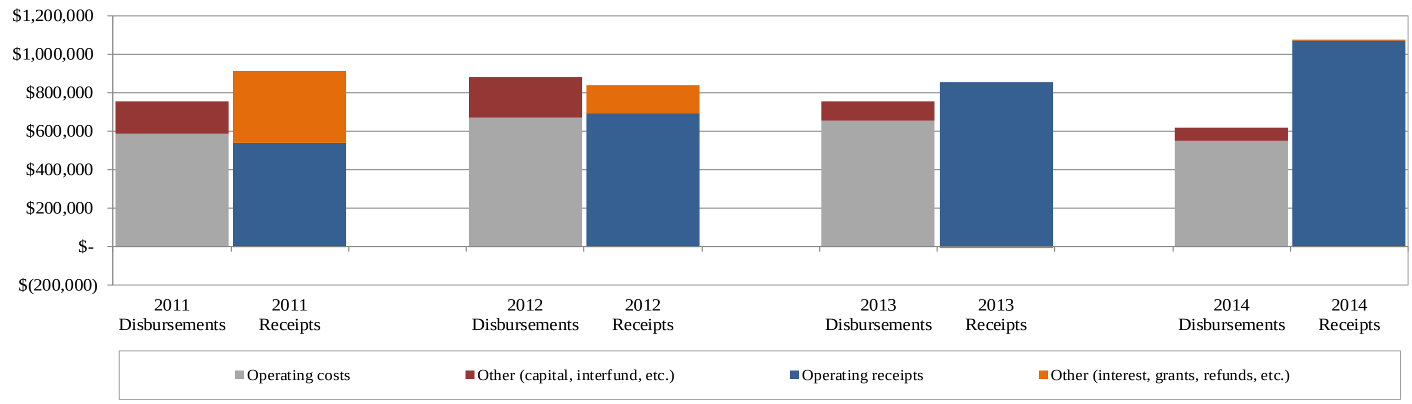


Ambulance Fund Cash Balance

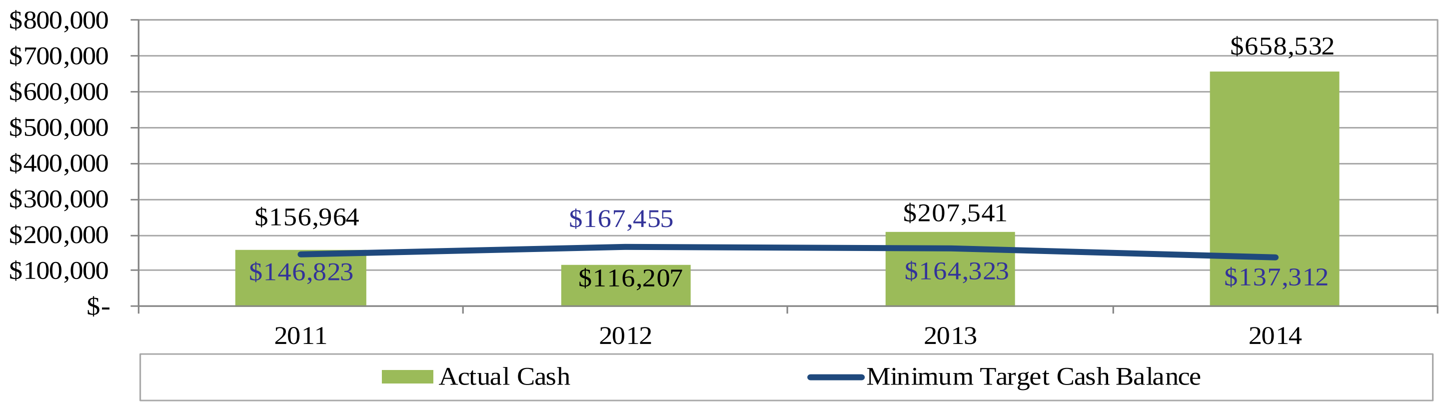


The minimum target cash balance is based off of 25 percent of operating costs for the fund.

Storm Water Fund Cash Flows



Storm Water Fund Cash Balance



The minimum target cash balance is based off of 25 percent of operating costs for the fund.

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

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

Internal Service Funds

Internal service funds are used to account for the financing of goods or services provided by one department or agency to other departments or agencies of the City and to other governments, on a cost reimbursement basis. A comparison of the net position for the past three years is as follows:

	2012	2013	2014
Administrative Services	$ -	$ -	$ -
Central Services	369,019	400,147	409,262
Risk Management	4,609,353	4,932,437	5,443,796
Information Technology	388,434	452,282	485,108
Postemployment Benefits	-	-	-
Engineering	364,907	738,978	677,011
Total	$ 5,731,713	$ 6,523,844	$ 7,015,177

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 requested from the Office of the State Auditor. The peer group averages used for the City were 3rd class (10,000 – 20,000) and regional centers identified by the League of Minnesota Cities. The majority of these ratios facilitate the use of economic resources focus and accrual basis of accounting at the government-wide level. A combination of liquidity (ability to pay its most immediate obligations), solvency (ability to pay its long-term obligations), funding (comparison of financial amounts and economic indicators to measure changes in financial capacity over time) and common-size (comparison of financial data with other cities regardless of size) ratios are shown below.

Ratio	Calculation	Source	Year 2011	2012	2013	2014
Debt to assets	Total liabilities/total assets	Government-wide	21%	20%	20%	18%
			32%	*33%*	*32%*	*N/A*
			27%	*30%*	*28%*	*N/A*
Debt service coverage	Net cash provided by operations/ enterprise fund debt payments	Enterprise funds	60%	90%	111%	84%
			91%	*119%*	*142%*	*N/A*
			179%	*176%*	*135%*	*N/A*
Debt per capita	Bonded debt/population	Government-wide	$ 1,864	$ 1,542	$ 1,550	$ 1,449
			$ 2,253	*$ 2,641*	*$ 2,637*	*N/A*
			$ 2,584	*$ 2,935*	*$ 2,835*	*N/A*
Current expenditures per capita	Governmental fund current expenditures / population	Governmental funds	$ 853	$ 941	$ 1,013	$ 962
			$ 636	*$ 601*	*$ 633*	*N/A*
			$ 721	*$ 694*	*$ 695*	*N/A*
Capital expenditures per capita	Governmental fund capital expenditures / population	Governmental funds	$ 193	$ 462	$ 481	$ 508
			$ 257	*$ 295*	*$ 267*	*N/A*
			$ 368	*$ 405*	*$ 335*	*N/A*
Capital assets % left to depreciate - Governmental	Net capital assets/ gross capital assets	Government-wide	46%	42%	43%	45%
			63%	*60%*	*59%*	*N/A*
			63%	*60%*	*60%*	*N/A*
Capital assets % left to depreciate - Business-type	Net capital assets/ gross capital assets	Government-wide	78%	62%	60%	58%
			68%	*62%*	*61%*	*N/A*
			60%	*58%*	*59%*	*N/A*

Represents the City of Red Wing and Port Authority
Represents the Peer Group Ratio (3rd class cities)
Represents the Peer Group Ratio (Regional centers)

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Debt-to-Assets Leverage Ratio (Solvency Ratio)

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

Debt Service Coverage Ratio (Solvency Ratio)

The debt coverage ratio is a comparison of cash generated by operations to total debt service payments (principal and interest) of enterprise funds. This ratio indicates if there are sufficient cash flows from operations to meet debt service obligations. Except in cases where other nonoperating revenues (i.e. taxes, assessments, transfers from other funds, etc.) are used to fund debt service payments, an acceptable ratio would be above 1.

Current Expenditures per Capita (Funding Ratio)

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

Capital Expenditures per Capita (Funding Ratio)

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

Capital Assets Percentage (Common-size Ratio)

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

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Future Accounting Standard Changes

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

GASB Statement No. 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.

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Future Accounting Standard Changes - Continued

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.

Fair Value Measurement

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.

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.

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Future Accounting Standard Changes - Continued

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.

(1) *Note*. From GASB Pronouncements Summaries. Copyright 2014 by the Financial Accounting Foundation, 401 Merritt 7, Norwalk, CT 06856, USA, and is reproduced with permission.

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

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

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

Abdo, Eick & Meyers, LLP

ABDO, EICK & MEYERS, LLP
Mankato, Minnesota
June 5, 2015

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