CITY OF PARK RAPIDS
CITY COUNCIL WORKSHOP
JUNE 25, 2013, 5:30 PM
Park Rapids Public Library-Lower Level
Park Rapids, Minnesota

1. CALL TO ORDER: Mayor Pat Mikesh called the City Council Workshop for June 25th, 2013 to order at 5:30 p.m.

2. ROLL CALL: Present: Mayor Pat Mikesh, Councilmembers Dave Konshok, Rod Nordberg, Erika Randall, and Paul Utke. Absent: None. Staff Present: Administrator John McKinney, Treasurer Angela Brumbaugh, Liquor Store Manager Scott Olson, and Clerk Margie Vik. Others Present: KDV Auditor Jennifer Piekarski, and Anna Erickson from the Enterprise.

3. PRESENTATION:

3.1. 2012 Audit Report by KDV: Jennifer Piekarski thanked the Council for attending the workshop. She thanked Brumbaugh, McKinney, and the city staff for the help they gave during the audit. You have before you the Communications Letter, and the 2012 Audited Financial Statement. The Communications Letter used to be referred to as the Management Letter. The power point presentation will summarize things from both books.

Piekarski stated we did issue the city an unqualified opinion on your financial statements. That's the best and cleanest audit opinion that we can give you. It provides assurance that the financial statements are fairly presented in all material respects. We issue a report on government auditing standards. We did have some findings that we need to report to you. You had some material audit adjustments related to debt. You also have lack of segregation of accounting duties. That is not new to your city. You want to be aware of it, but not be overly concerned about it. It's to make sure that you are involved in the day to day finances. Your treasurer is responsible for so much that happens within the city and there's overlapping duties. We know you're a small city. It's not worth the extra time, effort, and money for more staff.

Piekarski stated the next finding is the preparation of financial statements. This is very common for cities of all sizes. There would be a lot of time and money for the preparation of these big financial statements. The city has chosen to have our firm prepare the financial statements. That's very common and its fine with accounting standards.

Piekarski stated the next one is prior period adjustments. These happen when new information comes to light during our fiscal year 2012 audit that should have happened in fiscal year 2011 or 2010. With the county project we estimated payables, but new information came in during the week of the audit that we overestimated those payments. We had some land that was being booked as a capital asset of the city. It's in the industrial park and really being held for resale so it's not an asset of the city. You're intending to sell it at some future point in time. We reclassified that from an asset of the city to land held for resale. It's an inventory item. We also removed from accounts payable some radios that weren't purchased but were booked. The last one is balancing the cash timely. There was an issue where cash at year end hadn't been balanced until April or May. There is language in the state statute that if something happened at the bank and there was an error on the account after some many days they don't have to correct that if they don't want to.

Piekarski stated this year we implemented new GASB 63 standards. That's causing what used to be the Management Letter is now being called the Communication Letter. It's the same information, but a different title. They asked who is management really. So for clarity it's now called a Communications Letter because we all communicate this information to each other. In the audit financial statement, the opinion is a little longer, instead of net assets we now have net position. These are not significant changes, but its setting up for future GASBs.

Piekarski stated we also do a report on Minnesota Legal Compliance. They put out seven different guides. We have to ask questions to make sure you are following different state statutes. We did have one finding. There wasn't enough collateral at one of the banks to cover the deposits made in the event of a failure. It was cured on January 8th. But we have to test it as of December 31st. In the Communications Letter there's also this required communications consisting of three pages. Nothing has changed there since last year. There are some differences of opinion on some accounting standards with management that we put in there. There is also a financial analysis and recommendations.

Piekarski stated your general fund revenues are down 4.8% from 2011 to 2012. Most of this is in your intergovernmental revenues, the revenue that comes from the state, other cities, the county, and federal government. Those are down $210,000.00. Most of that decrease relates to the fiscal hosting in 2011. The city was the fiscal host for a lot of grants. They took that money and they gave it out to a number of other agencies. You're also going to see a decrease in the expenditures related to this. The other noticeable decrease is in the property taxes. Taxes are up $50,000.00. That's due to a change in the market value credit at the state level. Your level decreased this year by $30,000.00, but in 2011 the state had the market value credit in effect. If your level was at $100.00 the state said we're going to pay $20.00 of that levy, so the levy that's going to be spread across the city will be $80.00. In 2012 they got rid of that credit. The whole amount of the levy was spread across the city. In 2012 the un-allotment was $70,000.00. That's $70,000.00 taken off of the levy that you never got. You couldn't levy for it because the state said it was going to be market value credit but then they never paid it because of their budget cuts. Even though your levy decreased this year, you got more tax revenue due to that change in the market value credit. The state reduced your levy below what it's actually at this year saying they were going to pay part of it. Your revenue went up even as your levy went down.

Piekarski stated your general fund revenues, overall were over budget by $69,000.00. Taxes were under budget by approximately $46,000.00 due to budgeting for the whole levy and not accounting for the delinquents that happen every year. $52,000.00 in property taxes were delinquent, payable for 2012. The taxes line also includes your franchise and miscellaneous taxes in the city. The miscellaneous revenues are over budget by $57,000.00. Most of that is due to budgeting conservatively for your investment income. It's nice to see revenues over budget and expenditures low, so it results in a positive change in your general fund.

Nordberg questioned do you have an opinion as to whether our amount of delinquent taxes is good or bad compared to anyone else? Piekarski stated it depends city to city and how their local economy is. I'd say this is pretty normal for the cities that I work with.

Piekarski stated charges for services were over your budget by $8,000.00. That was due to increased fire calls. In 2011, the general fund expenditures were down 6.9%. Most of the functions had minor fluctuations. Capital outlay is down by $245,000.00. Most of that is the flow through fiscal host funding that we looked at on the revenue side. We saw that revenues were down. Now you can see the expenditures are down as well. Public works is up $44,000.00. There's increased salaries there and inflation with the chemical and fuel costs. Those things can fluctuate year to year.

Piekarski stated overall the general fund expenditures compared to the budget are under budget $83,000.00. Public safety was under budget by $24,000.00. There were some positions that were open for part of the year as people retired or left. Capital outlay was about $29,000.00 under budget. At budget time there were some software and computers approved in the budget to be purchased in 2012. They were purchased in December of 2011. The money was spent but the timing of the purchase put it in 2011.

Piekarski stated the cash and investments graph looks at just the general fund on a monthly basis regarding where is that cash sitting at year end. From January to June there is a steady decline in your cash. In July you have a big spike from your property tax settlement in July. You get another one in December. You need a large cash balance to get you through that next six months because you're not getting a lot of revenue in. The unassigned general fund balance is at 48.1% of current expenditures. If you got no more cash, that fund balance would cover 48% of your expenses. Your fund balance policy states 50%. You're close.

Piekarski stated your tax capacity, levy, and rates, compared to the state over five years, shows the tax capacity has gone down about 8.4%. There's a big drop, $314,000.00, from 2011 to 2012. These numbers are from the state. Konshok questioned is that tied to property estimated market values? Brumbaugh answered yes. Konshok stated we finally saw the decrease in market value in 2012. Piekarski stated over the same five year period your levy has increased 29.5%. Your tax capacity is up 18% from 2008 to 2012. This happens as your levy goes up and the tax capacity is going down, it's causing the percentage to be higher. The state average in 2012 was 46.26%, or over 18% less than the city's current rate. That's for funding on the projects you have issued bonds for. You need to levy for them and it causes the tax capacity rate to go up.

Nordberg questioned in comparison what does that mean? It looks like in the past we've been consistently above the average. Piekarski stated you went from about 10% higher than the state average. Now you're at 8% over. When you look at why your levy is going up, and your tax capacity, a lot of that levy is towards your bonds, for your projects. McKinney questioned what about the state credit? We had to collect. But it's not collection, its levy. Piekarski stated this just looks at your levy before that credit.

Konshok questioned is there anything that you're seeing going on in other cities that we can do better? There's not a lot we can necessarily do on a lot of these items. Piekarski stated you need to be aware of costs before having the projects go through without identifying a funding source. You spend a lot of time putting the budget together every year. A project that doesn't have a funding source will hit your fund balance. You might have to raise taxes to help cover that. I work with a lot of small cities. Before projects are done, staff has to come up with how it's going to be paid for. McKinney stated your comment was to the amount that we are levying, which would mean that we did have it in the budget or we wouldn't have been able to levy for it. Piekarski stated if you spend all the general fund levy this year you know you need to get more money to build up the fund balances. Some cities look at the fund balance and say we have to be at 50% by either cutting costs or raising more money. The levy is the way a lot of cities bring the money level up.

Nordberg questioned of the $1.9 million in the 2012 fund balance, some of that must be a reserve that we can't spend. I'm looking to see how much we can spend, that's usable. Piekarski stated the city has looked at assigning $777,000.00 of the fund balance for projects. $716,000.00 is for general government. These fund balances are one big project for the city if something happens, like a tornado. You'll need that funding now. You'll get money back from different funding sources in the future. It's good to set aside that money to have in case of emergencies. The unassigned portion of the city's fund balance is just under $1.2 million. The assigned amounts are for the library, the Heartland Bus, police and fire equipment. Those assignments are made at the Council or administration level for things that you want to set aside money for. Nordberg stated so it's the $1.197 million, which is about 48.1% of our annual budget.

Piekarski stated overall the water fund had an operating loss of $127,000.00. This does include depreciation, which is a not cash expense of $390,000.00. The operating revenues are down $10,000.00 while your expenses have increased $16,000.00. Over a five year period your expenses have continued to increase while the revenue is declining. That's primarily due to the water usage. The state implemented those new water rates where as you use more, you're getting charged more. In a lot of cities we have seen this decrease in usage. Last summer you did implement that restriction on the water usage. There was decreased usage from that as well. Excluding depreciation, you are making income, but that's not helping to fund future projects. The depreciation is set aside to help future projects. You're looking at a water treatment plant. This goes for the sewer fund as well, a lot of cities initiate a policy to look at rates and expenses to decide how much of the depreciation that they want to fund, 20%, 30%, or 50%. The sewer is an infrastructure intensive fund. It's hard to fund it 100%. But it does help to set aside money for future projects. The revenue is also down in the sewer fund by $4,000.00, while the operating expenses are up $63,000.00. Of that $63,000.00 a lot of that is depreciation. There were a couple of projects that finished over the year that got added as capital assets and started depreciating. In both the water and sewer funds those current year expenses did not include the principle and interest payments on the debt. That is cash that you need to collect and spend money on but it's not including those operating expenses. The debt is just a reduction in the long term liability. You might say we have that operating income but you also have to pay off your debt every year.

Nordberg questioned is there a correlating chart that has the dollar amount of the balance of the water and sewer fund, if you wanted to use that depreciation for something other than paying off? This is per year? Piekarski stated the income without depreciation for the sewer fund is the orange line. It has been decreasing every year as well. McKinney questioned how do you reflect the P and I payments that are taken out of revenue if it's not in this chart? Piekarski stated in the financial statements, that's what they call below the line after the revenue and expenses there's other operating income and expenses. That's where the interest payments are. The principal payments are shown on the statement of net position. As you make principal payments it reduces cash and reduces that liability. McKinney questioned is there any chart that shows what the incomes or operating expenses are with that combined, or do we have to go to three different places? Piekarski stated since they are enterprise funds these financial statements show more as a business. We don't have the statements put together to show the principal as part of the cash. The cash flow statements might give you a better picture.

McKinney stated if someone were to look at this they're not going to see a big expense if we're paying debt payments. Piekarski stated you're not going to see that because of the nature of the fund and how the statements have to be presented. McKinney stated if we pledged revenue to make debt service payments and we don't reflect it here as a expense, when we start looking at rates we're going to have to go look at those other documents to find the true cash position. Piekarski stated in the sewer fund the only debt you currently have is the debt that RDO is paying for. Look at your financial statements and you'll see a note receivable from them. You're getting money to pay off that service debt from them. It's offsetting there. In the water fund, that is the city's payment.

Piekarski stated the gross profit percentage for the liquor fund is 25% this year. Sales rep is at $98,000.00, while costs were at $61,000.00. Overall your increased net position for fiscal year 2012, the amount of money you set aside for that fund was $206,000.00. In 2010 and 2011 the city transferred out more from the fund then the store generated in operating income causing a negative change in that position. In 2012 there wasn't as much transferred out so you increased your net position there. Looking ahead for 2013 in the city's capital budget you have already planned transfers out of $568,000.00. The 2012 levels of what the store made for income, that's three years' worth of income from that store. Those transfers are going to need to be reduced, or be non-existent to just get back to where you are currently. At some point in the future if the store needs new equipment, roof, or a building, those transfers are going to have to be decreased as well to help fund their operations.

McKinney questioned from an accounting standpoint how do you deal with the capital expenditures that are in the liquor store, paid from the liquor fund are they treated any differently from the other capital expenditures? Piekarski stated it's like if you had capital expenses in your water fund they just stay right in there, they don't get transferred out. The expenses show as a capital asset instead. McKinney questioned but it's still an expense item? Piekarski stated it wouldn't show as an expense it would just increase your capital assets on the balance sheet.

Nordberg questioned do we have reserve requirements on the liquor store like we do on water and sewer? Somewhere I've seen the net balance in the checking account of the liquor reserves, which is different from the annual net position. Utke stated there shouldn't be any for the liquor store other than having it for the future. Nordberg stated theoretically we could take 100%. Utke stated the state isn't dictating that to us, it's an operational decision. Piekarski stated it's what the city wants to set aside. I'm not aware of any state restrictions. McKinney stated unless you have some debt payable from that fund which you would pledge, which we don't.

Piekarski stated the annual principal and interest payments for the bonds is shown on a graph. From 2015 to 2016 there is a big decrease in debt. That's not that you are paying off a debt and you have more money to spend. In 2012 you issued an advance refunding of the 2007 bond. For the 2012 debt you have cash sitting with a fiscal agent, the cash received is sitting out in an escrow account, paying on the 2012 bond, until the call date of that 2007 bond that cash will then be used to pay off your 2007 bond instead of making principal and interest payments on the 2007 bond the city will then make principal and interest payments on the 2012 bond. You're not losing one of your debts so you can pay something off it's just a change in the funding. You took advantage of some lower interest rates, but the call date doesn't happen until 2015. You're still paying for ten bonds. Just one of them gets paid out of the escrow account and then you start paying on a different one. You're still carrying both debts on your books, but you'll be paying for the same amount in the end.

McKinney questioned are there any other GASB rules coming our way. Piekarski stated there's always new GASB rules. GASB 65 gets implemented next year. It will take off some issuance costs, and deferred in-flows and out-flows on the statement of debt position. It's taking all your numbers that are there and moving them around.

4. ADJOURNMENT: **A motion was made by Utke, seconded by Randall and unanimously carried to adjourn the special meeting at 6:03 p.m.**

[seal] ________________________________

Mayor Pat Mikesh

ATTEST:

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Margie M. Vik
City Clerk