

Memo

To: Honorable Mayor and City Council
From: Joe Kohlmann, City Administrator
Date: May 8, 2012
Re: 2011 Audit Presentation

Auditor Stuart Boniwell will be present to discuss the attached 2011 audit. Mr. Boniwell will review the document and respond to any questions you may have for him. No formal action from the City Council is required on this item.

STUART J. BONNIWELL
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April 30, 2012

Mr. Joseph Kohlmann
City Administrator
City of Tonka Bay
4901 Manitou Road
Tonka Bay, MN 55331

Dear Joe:

Enclosed are ^{twelve} thirteen copies of the financial report of the City of Tonka Bay, Minnesota for the year ended December 31, 2011. If additional copies of the report are needed, please contact myself at your convenience.

Thank you.

Sincerely,



Stuart J. Bonniwell, CPA

STUART J. BONNIWELL
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March 27, 2012

Honorable Mayor and Members of the City Council
 City of Tonka Bay, Minnesota

This letter has been prepared in conjunction with the audit of the financial statements and accounting records of the City of Tonka Bay (the City) for the year ended December 31, 2011. My report, dated March 27, 2012, expresses an unqualified report on the financial statements of the City as prepared and presented on the regulatory basis of accounting as prescribed by the State of Minnesota.

The purpose of this letter is to communicate certain comments and observations noted during the audit of the financial statements. These comments are presented for your information and consideration. Comments and recommendations in this report are constructive in nature and should be read in this context; recommendations are intended to improve and/or strengthen internal control, financial management and administration.

Financial Summary

As presented in the financial report, individual fund financial statements of the City are arranged into two broad categories of fund types – governmental and proprietary. Governmental funds account for the City’s general government activities consisting primarily of general administration, public safety, public works, and parks and recreation. Proprietary fund types are those funds, which involve the City providing services to the general public, which are financed primarily through user charges, such as utility operations. Following is a brief discussion of significant activities of each fund type category for the year.

Governmental Funds

As previously noted, the City has adopted the regulatory basis of accounting as prescribed by the State of Minnesota. Under this method, the cash basis method of accounting is used to account for activities of the City’s governmental funds, consisting of the General, Special Revenue and Capital Project Funds.

Fund balances of the individual fund types and changes in fund balance of the governmental funds for the year ended December 31, 2011 are summarized in the following chart.

	Fund Balance		Increase (Decrease)	2010
	2011	2010		Increase (Decrease)
General Fund	\$ 549,550	\$ 532,282	\$ 17,268	\$ 28,966
Special Revenue Funds	364,229	357,014	7,215	(115,813)
Capital Project Funds	374,927	496,143	(121,216)	44,055
	\$ 1,288,706	\$ 1,385,439	\$ (96,733)	\$ (42,792)

Financial Summary, continued

As illustrated in the previous chart, the combined fund balances of the governmental funds totaled \$1,288,706 as of December 31, 2011, a decrease of \$96,733 or approximately 7.0% from the previous year. Revenues and transfers of \$1,433,177 were offset by expenditures and transfers of \$1,529,910 resulting in the decrease. Included in expenditures were major equipment acquisitions of \$76,953 and included among transfers was \$208,155 for utility improvement projects. The City had budgeted for this expenditure and transfers by accumulating and/or setting aside sufficient resources over the years to fund these acquisitions. The magnitude of these expenditures accounts for approximately 18.64% of the total expenditures and transfers related to the governmental funds for the year.

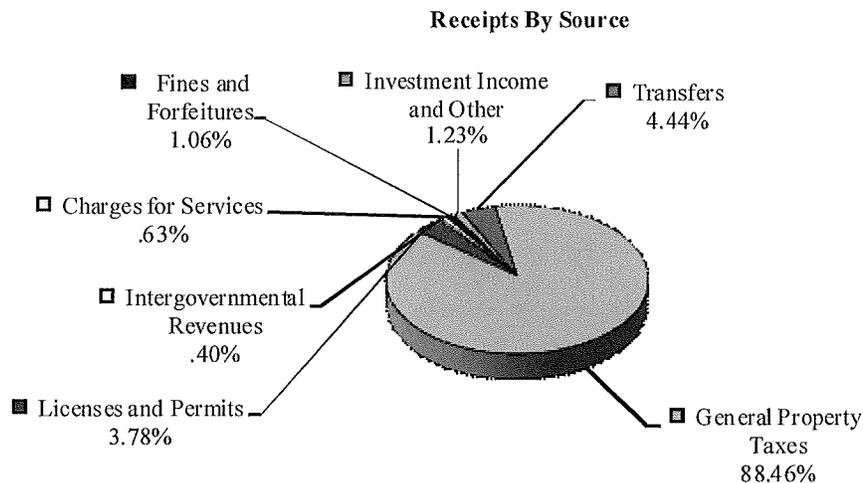
Following are additional comments regarding each of the governmental fund types.

General Fund

This fund is the primary operating fund of the City and accounts for the costs of providing services to citizens of the City. For the year the General Fund recorded a surplus of \$17,268, which represents an increase of 3.25% in its fund balance. The surplus increased the fund balance to \$549,550 at December 31, 2011, of which \$527,279 is undesignated and available to finance current year expenditures until tax revenues are received. This undesignated fund balance represents 46.5% of budgeted expenditures for 2012 compared to ratio of 44.2% in the prior year. This relationship is an indication of the financial strength of the City. However, the percentage increase is partially attributed to the reduction in General Fund budgeted expenditures of more than \$70,000 in 2012 – transfer of street maintenance and repairs (\$65,600) to the Capital Improvement Fund. The remaining portion of the fund balance is nonspendable (prepaid expenses) and assigned as a reserve for accumulated employee compensated absences.

For the year ended December 31, 2011 receipts and transfers totaled \$1,185,875. This total was less than budget estimates by \$18,972, a negative variance of 1.57%. Similar to last year, revenues from permit and related fees were significantly less than budgeted amounts; total negative variance in these accounts was \$22,040. In addition, the transfer from the Liquor Fund was limited to \$4,635, a negative variance of \$6,365. These negative revenue variances were offset by increased revenues from fines and forfeitures and insurance dividends.

Following is a graph of receipts and transfers by source for the year:



Honorable Mayor and Members of the City Council
City of Tonka Bay, Minnesota

Financial Summary, continued

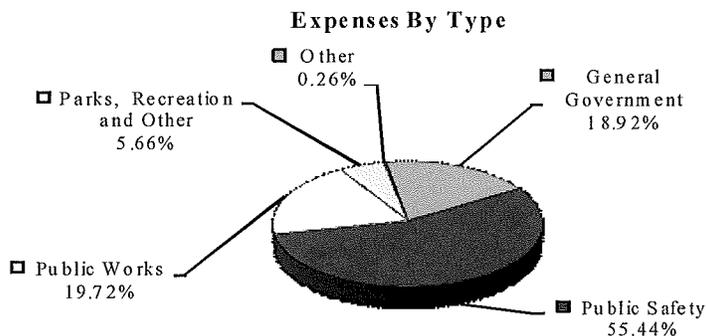
As illustrated by the graph, property taxes are the largest source of revenue of the General Fund; this percentage increased by approximately 1% from the previous year. The current year's tax collection percentage was 98.35% (adjusted for unremitted taxes receivable). During the year delinquent tax collections received resulted in total tax collections exceeding the tax levy amount by a slight amount.

As was the case in 2010, transfers from other funds were the second largest source of revenue for the General Fund. Transfers from the Liquor Fund were budgeted for \$10,000 in 2011; this amount was limited to comply with the minimum fund balance requirements of the Liquor Fund. With interest rates remaining at historical low levels it is unlikely that the City will be able to transfer similar amounts to the General fund in future years. Similarly, transfers from the Antenna Fund correlate to the amount of revenues received from existing lease agreements. If any of these leases are canceled, it may be difficult to transfer the budgeted amounts. Being so heavily reliant on property taxes it is very difficult to maintain City services without increasing property taxes.

Disbursements and transfers for the year totaled \$1,168,607; this total was \$36,240 less than the budget amounts, resulting in a positive variance of 3.0%. Positive variances were realized by each of the City departments within the General Fund. Of the total expenditures in the General Fund, approximately 46% can be directly controlled by the City; the other 54% are associated with public safety services which is determined based on the City's joint powers agreements concerning services provided. As a result of this positive variance, the City was able to eliminate the negative variance caused by the revenue shortages. However, these savings may be difficult to duplicate again if services to citizens are being curtailed and maintenance projects delayed.

Disbursements in 2011 increased by \$20,693 or 1.8% compared to 2010.

Following is a graph of expenses by type:



As previously stated, the fund balance of the General Fund is \$549,550 at December 31, 2011. This fund balance provides a reserve for financing of current year operations until tax settlements are received. It was estimated that the General Fund exhausts most of its cash by the time tax settlements are received. For instance, the November tax settlement received in December applicable to the General Fund was approximately \$500,000. This constitutes approximately 95% of the unassigned fund balance at December 31, 2011. As a result, the major portion of the fund balance is designated for working capital purposes. This reserve also serves as a safeguard against future potential revenue shortages or unexpected expenditures, which may occur throughout the year.

The State Auditor recommends cities maintain an unreserved fund balance in the General Fund of approximately 35% to 40% of operating expenditures. As indicated by these percentages, the City of Tonka Bay satisfies this recommendation and should be commended for maintaining this unreserved balance.

Honorable Mayor and Members of the City Council
 City of Tonka Bay, Minnesota

Financial Summary, continued

Special Revenue Funds

Transfers of \$52,620 were made from the Special Revenue Funds (Liquor and Antenna) to the General Fund during the year. As previously noted, the transfer from the Liquor Fund was limited to \$4,635 to maintain the minimum fund balance requirement set by Council action. Although investment income was \$11,849 this amount was not sufficient to support both the budgeted transfer and the increase in fund balance associated with the consumer price index. The fund balance of the Liquor Fund was \$309,258 at December 31, 2011 and is available for projects at the discretion of the City Council. The budgeted transfer was reduced to \$6,500 in 2012 to reflect anticipated reduction in investment income due to historically low interest rates.

The Antenna Fund recognized lease revenues of \$45,986 for the year, which equaled the amount transferred to the General Fund in 2011. The fund balance of the Antenna Fund was \$51,137 at December 31, 2011 and is assigned as a reserve for the General Fund. Deferred revenue of \$27,683 is recorded pertaining to existing lease agreements; these amounts will be recognized as revenue in future years.

The Southshore Center Fund had no activity during the year.

Capital Project Funds

Cash fund balances and changes in individual Capital Project Funds are illustrated in the following table:

	Fund Balance		Increase
	2011	2010	(Decrease)
Utility Improvement	\$ 427,484	\$ 533,607	\$ (106,123)
Capital Improvement	17,271	41,835	(24,564)
Road Improvement	(74,188)	(83,659)	9,471
Park Improvement	1,632	1,632	-
Seawall Improvement	2,728	2,728	-
	<u>\$ 374,927</u>	<u>\$ 496,143</u>	<u>\$ (121,216)</u>

The decrease in the Utility Improvement Fund is the result of transfers to the Water and Sewer Funds to finance utility improvement projects. Transfers to the Utility Improvement Fund from the Water and Sewer Funds represent the amount of depreciation charged against operations in these funds. These transfers allow the City to maintain a reserve necessary to finance future improvements to the existing utility system. In 2010, \$62,750 was transferred to the utility funds to finance utility improvement projects.

Transfers from other funds and other receipts combined with the existing fund balance in the Capital Improvement Fund financed major equipment acquisitions of \$76,953 made during the year. The fund balance of this fund was \$17,271 at December 31, 2011 and is available to finance capital outlay requirements in the current year. One of the revenue items received in 2011 was the collection of assessments related to the county road project financed by the City. Funds were transferred to the Capital Improvement Fund from the Liquor Fund in 2010 to reimburse this fund for costs attributed to this project. Perhaps the Council would consider transferring these assessment collections back to the Liquor Fund as they are received in an effort to restore the original fund balance of the Liquor Fund.

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 City of Tonka Bay, Minnesota

Financial Summary, continued

The Road Improvement Fund involves the Woodpecker Ridge Road improvement project. The fund balance (deficit) is from construction costs incurred related to this project. This deficit will be reduced annually as collection of assessments levied against benefited property owners are received; these proceeds will be used to repay the advances from other funds utilized to pay construction costs. The outstanding balance of the advances at December 31, 2011 was \$74,188, which matches the fund balance deficit.

The Park Improvement Fund and The Seawall Improvement Fund had no activity during the year.

Proprietary Funds

Unlike accounting for governmental funds, the accrual basis of accounting is prescribed by the regulatory basis of accounting for proprietary fund types as opposed to the cash basis.

Operations of proprietary funds are intended to be self-sustaining. Expenses (including depreciation) of providing goods or services to the public on a continuing basis are financed or recovered through user charges and fees. The accrual basis of accounting is utilized to account for all costs and expenses (including depreciation) of providing services to aid in determine the applicable user rates.

The following chart summarizes the operations of the various proprietary funds maintained by the City.

	Water Fund	Sewer Fund	Garbage Fund	Recycling Fund	Storm Water Fund	Dock Fund
Operating Revenues	\$ 256,365	\$ 362,392	\$ 99,639	\$ 60,606	\$ 23,051	\$ 79,760
Operating Expenses	288,575	331,104	92,632	71,652	11,323	41,774
Operating Income (Loss)	(32,210)	31,288	7,007	(11,046)	11,728	37,986
Other Revenues	5,528	1,084		130	2,349	
Income (Loss)	(26,682)	32,372	7,007	(10,916)	14,077	37,986
Transfers In (Out)	110,669	(8,461)				(18,353)
 Net Income (Loss)	 <u>\$ 83,987</u>	 <u>\$ 23,911</u>	 <u>\$ 7,007</u>	 <u>\$ (10,916)</u>	 <u>\$ 14,077</u>	 <u>\$ 19,633</u>
 Net Assets at December 31, 2011	 <u>\$1,176,730</u>	 <u>\$ 965,080</u>	 <u>\$ 77,547</u>	 <u>\$ 49,455</u>	 <u>\$ 106,142</u>	 <u>\$ 230,709</u>
 Net Income (Loss) - 2010	 <u>\$ (29,993)</u>	 <u>\$ 47,791</u>	 <u>\$ 10,236</u>	 <u>\$ (6,676)</u>	 <u>\$ 14,608</u>	 <u>\$ 51,354</u>

The Water Fund sustained a loss from operations (before transfers) of \$26,682 for the year compared to a loss of \$8,340 for the previous year. The Sewer Fund reported net income of \$32,372 compared to income of \$61,506 for the previous year. Operating revenues for both utility funds remained similar to the previous year, however, operating expenses of both funds increased. Operating expenses of the Water Fund increased by \$24,000 due primarily to increased maintenance costs and depreciation expenses. Expenses of the Sewer Fund increased by \$34,000 attributed to increases in treatment charges (\$22,000) and other services (\$12,000). Transfers from the Utility Improvement Fund to these utility funds totaled \$208,155 for the year; these funds were utilized to finance utility improvement projects and an anticipated operating loss in the Water Fund. Continuing with the practice commencing in 2009, these two funds transferred the amount of depreciation charges to the Utility Improvement Fund to provide funds to finance future system improvements. Net assets of these two funds are primarily invested in capital assets, which are not available to pay operating expenses.

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City of Tonka Bay, Minnesota

Financial Summary, continued

Operations of the other proprietary funds were consistent with prior year's operations, as each of these funds reflected net income from operations with the exception of the Recycling Fund. The Recycling Fund sustained a minor loss for the year similar to last year. Net assets of these funds at December 31, 2011 are sufficient to maintain operations in 2012. Net assets from these funds are being maintained to provide a measure of security against increasing operating costs of future operations.

Net assets of the Dock Fund increased by \$37,986 in 2011 compared to \$51,354 in 2010; the decrease in net income is attributed to the dredging costs incurred by the City. Net assets of the Dock Fund were sufficient to finance the dock expansion project in 2011.

Operations of these funds need to be continually monitored to ensure operating revenues are sufficient to meet the operating expenses of each of the proprietary funds.

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This report is intended solely for the use of the City Council and management of City of Tonka Bay and is not intended to be and should not be used by anyone other than these specified parties. If the Council wishes, I would be pleased to meet and discuss any of the observations, comments, or other matters pertaining to the audit with the City Council or management at your convenience.

I wish to express my appreciation for the courtesies and cooperation extended by City personnel during the audit and the opportunity to be of service to City of Tonka Bay. I look forward to continuing working with you in the future.

Stuart J. Bonniwell
Certified Public Accountant