

For the Fiscal Year Ended December 31, 2002

(Dollar Amounts Expressed in Thousands)

NOTE 1 - SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

The financial statements of the City of Minneapolis (City) have been prepared in conformity with Generally Accepted Accounting Principles (GAAP) as applied to governmental units. The Governmental Accounting Standards Board (GASB) is the accepted standard-setting body for establishing governmental accounting and financial reporting principles. The more significant of the City's accounting policies are described below.

A - REPORTING ENTITY

The City is a municipal corporation governed by a Mayor-Council form of government. It was incorporated in 1867, and it adopted a Charter on November 2, 1920. The Mayor and 13 City Council Members from individual wards are elected for terms of four years without limit on the number of terms that may be served. The Mayor and City Council are jointly responsible for the annual preparation of a budget and a five-year capital improvement program. The Mayor has veto power, which the Council may override with a vote of nine members. The City employs a Finance Officer who is charged with maintaining and supervising the various accounts and funds of the City as well as several boards and commissions.

As required by GAAP, the basic financial statements present the reporting entity which consists of the primary government, organizations for which the primary government is financially accountable and other organizations for which the nature and significance of their relationship with the primary government are such that exclusion could cause the City's basic financial statements to be misleading or incomplete.

BLENDED COMPONENT UNITS

The following component units have been presented as blended component units because the component unit's governing body is substantially the same as the governing body of the City, or the component unit provides services almost entirely to the primary government.

▪ Minneapolis Community Development Agency

The City Council created the existing Minneapolis Community Development Agency (MCDA) by Ordinance, which was effective June 1, 1981. The MCDA is the redevelopment arm of the City and provides a wide range of services in the areas of housing and economic development. The overall mission of the MCDA is to effect the revitalization of the City through the redevelopment of its commercial, industrial and residential areas. The MCDA Board of Commissioners is composed of the 13 elected City Council Members sitting as the Board and is the principal legislative and administrative body of the MCDA. The City Finance Officer serves as the MCDA Finance Officer. Complete financial statements for the Agency can be obtained from the MCDA at 105 Fifth Avenue South, Minneapolis, Minnesota 55401-2534.

▪ Board of Estimate and Taxation

The Board of Estimate and Taxation (BET) is established under Chapter 15 of the City Charter. It is composed of seven members, two of whom are elected by voters of the City. The Mayor, or the Mayor's appointee, the President of the City Council, and the Chair of the City Council's Ways and Means/Budget Committee are ex-officio members of the board. The Minneapolis Park and Recreation Board and Minneapolis Library Board annually select one of its members to serve on the Board of Estimate and Taxation. By action of the City Council, or such other governing board of a department requesting the sale of bonds, the Board of Estimate and Taxation may vote to incur indebtedness and issue and sell bonds and pledge the full faith and credit of the City for payment of principal and interest. The Board of Estimate and Taxation also establishes the maximum property tax levies for most City funds and maintains responsibility for the internal audit function for the City including boards and commissions that are component units of the City.

NOTE 1 - SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (continued)**DISCRETELY PRESENTED COMPONENT UNITS**

The component unit column in the government-wide financial statements includes the financial data of the City's other component units. The units are reported in a separate column to emphasize that they are legally separate from the City but are included because the primary government is financially accountable and is able to impose its will on the organizations. These units subscribe to the accounting policies and procedures of the primary government.

▪ Minneapolis Library Board

The Minneapolis Library Board (Library Board) was established according to Chapter 17 of the City Charter. It is an eight-member board, six of whom are elected for four-year terms by voters of the City. The Mayor and the City Council each appoint one member. The Library Board is responsible for operating and maintaining libraries located throughout the City. The Mayor recommends the tax levies and budget for the Library Board and the City Council and Mayor approve the allocations of state local government aid for Library Board operations. The Board of Estimate and Taxation approves the property tax levy for the Library Board, and the full faith and credit of the City secure debt issued for projects benefiting the Library Board. The City Finance Officer serves as Treasurer of the Library Board. Complete financial statements for the Library Board can be obtained from the Minneapolis Public Library at 300 Nicollet Mall, Minneapolis, Minnesota, 55401-1992.

▪ Minneapolis Park and Recreation Board

The Minneapolis Park and Recreation Board (Park Board) was established according to Chapter 16 of the City Charter. The nine-member board is elected by the voters of the City and is responsible for developing and maintaining parkland and parkways as well as planting and maintaining the City's boulevard trees. The Mayor recommends the tax levies and budget for the Park Board, and the City Council and Mayor approve the allocation of the state local government aid for Park Board operations. All Park Board actions are submitted to the Mayor and a mayoral veto may be overridden by a vote of two thirds of the members of the Park Board. The Board of Estimate and Taxation approves the maximum property tax levy for the Park Board, and the full faith and credit of the City secure debt issued for Park Board projects. The City Finance Officer acts as Treasurer of the Park Board. Complete financial statements for the Park Board can be obtained from the Minneapolis Park and Recreation Board at 200 Grain Exchange Building, 400 South Fourth Street, Minneapolis, Minnesota, 55415-1400.

▪ Municipal Building Commission

The Municipal Building Commission (MBC) is an organization established January 4, 1904, by the State of Minnesota, to operate and maintain the City Hall/County Court House Building, which was erected pursuant to Chapter 395 of the Special Laws of 1887. The four commissioners are, the Chairman of the Hennepin County Board of Commissioners, the Mayor of the City of Minneapolis, an appointee of the Hennepin County Board, and an appointee of the Minneapolis City Council. The Mayor recommends the tax levy and budget for the City's share of the MBC's operations and the City Council and Mayor approve the allocation of the state local governmental aid to the MBC.

RELATED ORGANIZATIONS

The City's officials are also responsible for appointing members of the boards of other organizations but the City's accountability for these organizations does not extend beyond making the appointments. The following organizations are related organizations, which have not been included in the reporting entity:

NOTE 1 - SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (continued)**▪ Metropolitan Sports Facilities Commission**

The Metropolitan Sports Facilities Commission (Commission) is an appointed commission established under 1977 Minnesota laws. Of the seven members of the Commission, the City of Minneapolis appoints six. The Commissioners serve four-year terms and removal is for cause only. The primary responsibility of the Commission is to serve as owners, operators, and landlords of the Hubert H. Humphrey Metrodome Sports Facility in Minneapolis. Major tenants of the Metrodome Sports Facility are the Minnesota Twins and the Minnesota Vikings. Complete financial statements for the Commission can be obtained from the Metropolitan Sports Facilities Commission at 900 South Fifth Street, Minneapolis, Minnesota, 55415-1903.

▪ Minneapolis Public Housing Authority

The Minneapolis Public Housing Authority (MPHA) is the public agency responsible for administering public housing and Section 8 rental assistance programs for eligible individuals and families in Minneapolis. A nine-member Board of Commissioners governs MPHA. The Mayor of Minneapolis appoints the Board Chairperson and four Commissioners; four Commissioners (one of whom must be a public housing family development resident) are appointed by the City Council. The mission of the MPHA is to provide well-managed high-quality housing for eligible families and individuals; to increase the supply of affordable rental housing; and to assist public housing residents in realizing goals of economic independence and self-sufficiency. Complete financial statements for the MPHA can be obtained from the Minneapolis Public Housing Authority at 1001 Washington Avenue North, Minneapolis, Minnesota, 55401-1043.

JOINT VENTURES

The City is a participant in several joint ventures in which it retains an ongoing financial interest or an ongoing financial responsibility.

▪ Minneapolis/Saint Paul Housing Finance Board

The Minneapolis/Saint Paul Housing Finance Board was established in accordance with a Joint Powers Agreement entered into between the Housing and Redevelopment Authority of the City of Saint Paul, the MCDA, and accepted by the cities of Minneapolis and Saint Paul under State of Minnesota laws. The MCDA's oversight responsibility of the Board is limited to its governing body's ability to appoint only three of the six members of the Board. The territorial jurisdiction of the Board extends beyond the corporate limits of the City of Minneapolis. The percentage share of the MCDA in the Board's assets, liabilities and equity cannot be determined at fiscal year-end. Complete financial statements for the Minneapolis/Saint Paul Housing Finance Board can be obtained from the MCDA at Suite 700, Crown Roller Mill, 105 Fifth Avenue South, Minneapolis, Minnesota 55401-2534.

▪ Minneapolis Neighborhood Revitalization Policy Board

The Minneapolis Neighborhood Revitalization Policy Board (NRPB) was established in accordance with a Joint Powers Agreement entered into between the Hennepin County Board of Commissioners, the Board of Directors of Special School District No. 1, the Library Board, the Park Board, and the Mayor and City Council under authority of State of Minnesota laws. The NRPB is composed of 20 members and includes public officials as well as representatives of neighborhood and community interest organizations.

The majority of members are persons other than the representatives of the jurisdictions, which entered into the Joint Powers Agreement. The percentage of each jurisdiction's share in the NRPB's assets, liabilities, and equity cannot be determined at fiscal year-end. Complete financial statements for the NRPB can be obtained from the Minneapolis Neighborhood Revitalization Policy Board at Suite 425, Crown Roller Mill, 105 Fifth Avenue South, Minneapolis, Minnesota, 55401-2585.

NOTE 1 - SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (continued)**▪ Minneapolis Youth Coordinating Board**

The Minneapolis Youth Coordinating Board (YCB) was established in accordance with a Joint Powers Agreement entered into between the Hennepin County Board of Commissioners, the Board of Directors of Special School District No. 1, the Library Board, the Park Board, the Mayor and the City Council under authority of State of Minnesota laws. The YCB, which numbers 12 in size, includes the Mayor, two members each from the Hennepin County Board of Commissioners and the Board of Directors of Special School District No. 1, two representatives from the City Council, one member each from the Park Board and Library Board, one member each from the Minneapolis State Legislature House and Senate delegations, and a Judge assigned by the Chief Judge of the District Court. The percentage of each jurisdiction's share in the YCB's assets, liabilities, and equity cannot be determined at fiscal year-end. Complete financial statements for the YCB can be obtained from the Minneapolis Youth Coordinating Board at Room 310½ City Hall, 350 South Fifth Street, Minneapolis, Minnesota 55415-1376.

B – CHANGES IN ACCOUNTING PRINCIPLE*Governmental Accounting Standards Board (GASB) Statements No. 33 and 36*

In December 1998 and in April 2000, the Governmental Accounting Standards Board (GASB) issued Statement No. 33, *Accounting and Financial Reporting for Nonexchange Transactions*, and Statement No. 36, *Recipient Reporting for Certain Shared Nonexchange Revenues – an amendment of GASB Statement No. 33*, respectively. These statements establish accounting and financial reporting standards for nonexchange transactions involving financial or capital resources (for example, most taxes, grants, and private donations). In a nonexchange transaction, the City receives resources (cash or other) of greater value than the value of the benefit given in return. The City has adopted these statements for its fiscal year ended December 31, 2001, and the cumulative effect of adopting these statements was not significant to the City as a whole.

GASB Statements No. 34, 37, and 38

The GASB issued Statement No. 34 (June 1999), *Basic Financial Statements – and Management's Discussion and Analysis – for State and Local Governments*, Statement No. 37 (June 2001), *Basic Financial Statements – and Management's Discussion and Analysis – for State and Local Governments – Omnibus*, and Statement No. 38 (June 2001), *Certain Financial Statement Note Disclosures*. This statement modifies, adds, and deletes various note disclosure requirements. These statements collectively comprise a change in financial reporting requirements for state and local governments. Some of the most significant changes in financial reporting include the addition of management's discussion and analysis as required supplementary information; the addition of the City-wide financial statement of net assets and statement of activities; the requirement for all property, plant, and equipment assets, including infrastructure assets such as roads, bridges, traffic signals, etc. to be reported net of accumulated depreciation on the City-wide financial statements; the elimination of all significant interfund transactions within the City-wide financial statements; and the use of the direct method for presenting information on specific cash flows within the statement of cash flows. GASB Statement No. 38 also addresses revenue recognition policies, actions taken in response to legal violations, debt service requirements, variable-rate debt, receivable and payable balances, interfund transfers and balances, and short-term debt. Additional information regarding the impact of adopting GASB Statements No. 34, 37, and 38 is presented in Note 2.

GASB Statement No. 39

In May 2002, the GASB issued Statement No. 39, *Determining Whether Certain Organizations Are Component Units*. This statement is effective for the City for the year ending December 31, 2004. Generally, this statement requires reporting, as a component unit, an organization that raises and holds economic resources for the direct benefit of a governmental unit. The effect of GASB Statement No. 39 on the City's fiscal year 2004 financial statements has not been determined.

NOTE 1 - SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (continued)**C – BASIS OF PRESENTATION****GOVERNMENT-WIDE FINANCIAL STATEMENTS**

The *statement of net assets* and *statement of activities* display information about the primary government (the City) and its component units using the economic resources measurement focus and the accrual basis of accounting. Revenues are recorded when earned and expenses are recorded when a liability is incurred, regardless of the timing of related cash flows. Property taxes are recognized as revenues in the year for which they are levied. Grants and similar items are recognized as revenue as soon as all eligibility requirements imposed by the provider, if any, have been met. These statements include the financial activities of the overall government, except for fiduciary activities. Eliminations have been made to minimize the double counting of internal activities. These statements distinguish between *governmental* and *business-type activities* of the City and between the City and its discretely presented component units. *Governmental* activities, which normally are supported by taxes and intergovernmental revenues, are reported separately from *business-type* activities, which rely, to a significant extent on fees charged to external parties.

The *statement of activities* presents a comparison between direct expenses and program revenues for each segment of the *business-type* activities of the City and for each function of the City's *governmental* activities. Direct expenses are those that are specifically associated with a program or function, and therefore, are clearly identifiable to a particular function. Program revenues include 1) charges paid by the recipients of goods and services offered by the programs and 2) grants and contributions that are restricted to meeting the operational or capital requirements of a particular program. Revenues not classified as program revenues, including all taxes, are presented instead as general revenues.

When both restricted and unrestricted net assets are available, restricted resources are used only after the unrestricted resources are depleted.

FUND FINANCIAL STATEMENTS

The accounts of the City are organized and operated on the basis of funds. A fund is an independent fiscal and accounting entity with a self-balancing set of accounts. Fund accounting segregates funds according to their intended purpose and is used to aid management in demonstrating compliance with finance-related legal and contractual provisions. The minimum number of funds is maintained consistent with legal and managerial requirements.

The fund financial statements provide information about the City's funds. Funds are classified into three categories: *Governmental*, *Proprietary*, and *Fiduciary*, each category is divided into separate fund types. The emphasis of fund financial statements is on major governmental and enterprise funds, each displayed in a separate column. All remaining governmental and enterprise funds are separately aggregated and reported as non-major funds.

Proprietary fund *operating* revenues, such as charges for services, result from exchange transactions associated with the principal activity of the fund. Exchange transactions are those in which each party receives and gives up essentially equal values. *Nonoperating* revenues, such as subsidies and investment earnings, result from nonexchange transactions or ancillary activities.

GOVERNMENTAL FUNDS

All governmental funds are reported using the current financial resources measurement focus and are accounted for using the modified accrual basis of accounting. Their revenues are recognized when they become measurable and available as net current assets. For this purpose, the City considers revenues to be available if they are collected within 60 days of the end of the current fiscal period. Tax revenues are recognized in the year for which the taxes are levied. Property tax levies are approved and certified to the County in December prior to the year collectible. The County acts as a collection agency. Such tax levies constitute a lien on the property on January 1st of the year collectible. Taxes are payable to the County in two installments by the fifteenth day of May and the fifteenth day of October. City property taxes are recognized as revenues when they become measurable and available to finance expenditures of the current period.

NOTE 1 - SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (continued)

Major revenues that are determined to be susceptible to accrual include property taxes, special assessments, grants-in-aid, intergovernmental revenues, rentals, and Intra-city charges. Interest on investments, short-term notes and loans receivable are accrued; interest on special assessments receivable is not accrued. Major revenues that are determined not to be susceptible to accrual because they are not available soon enough to pay liabilities of the current period or are not objectively measurable include delinquent property taxes and assessments, licenses, permits, fines and forfeitures.

Governmental fund expenditures are generally recognized under the modified accrual basis of accounting when the related fund liability is incurred, except for principal and interest on general long-term debt which is recognized when due. Compensated absences, which include accumulated unpaid vacation, compensatory time and severance pay, are not payable from expendable available financial resources, except to the extent there are available resources in the Self-Insurance Internal Service Fund for vested severance pay. Compensated absences are considered expenditures when paid to employees.

The accounting and reporting treatment applied to the assets and liabilities associated with a fund are determined by its measurement focus. All governmental funds are accounted for on a spending, or "financial flow," measurement focus. This means that only current assets and current liabilities, as defined by GAAP, are generally included on the balance sheets. Reported fund balance (net current assets) is considered a measure of "available spendable resources." Governmental fund operating statements present increases (revenues and other financing sources) and decreases (expenditures and other financing uses) in net current assets. Accordingly, governmental funds are said to present a summary of sources and uses of "available spendable resources" during a period.

Special reporting treatments are also applied to governmental fund inventories to indicate that the inventories do not represent "available spendable resources," even though they are a component of net current assets.

Because of their spending measurement focus, expenditure recognition for governmental fund types is limited to exclude amounts represented by non-current liabilities. Since they do not affect net current assets, long-term amounts are not recognized as governmental fund type expenditures or fund liabilities. They are instead reported as liabilities in the government-wide statement of net assets and statement of activities.

The City reports the following major governmental funds:

- **General Fund**

The General Fund is the general operating fund of the City. It is used to account for all financial resources except those required to be accounted for in another fund. For the City, the General Fund includes such activities as public safety, public works, health and welfare, and general government administration.

- **Special Revenue Fund - Community Development Agency**

This fund is used to account for the general fund and the special revenue fund activities of the MCDA (a component unit of the City of Minneapolis).

- **Special Revenue Fund - Convention Center**

This fund is used to account for the ownership, maintenance and operations of the Minneapolis Convention Center, along with the proceeds of local sales and use taxes.

- **Capital Project Fund - Permanent Improvement**

This fund is used to account for capital acquisition, construction and improvement projects including bridge construction, sidewalk construction, street construction, completion of the Minneapolis Convention Center, energy conversion projects, infrastructure projects, and many information and technology system projects.

NOTE 1 - SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (continued)**▪ Debt Service Fund - Development**

This fund is used primarily to account for debt of projects supported by property tax increments, transfers of sales tax revenues from the Convention Center Special Revenue Fund for related debt, and a State grant relating to completion of the Convention Center.

PROPRIETARY FUNDS

Proprietary funds are accounted for using the accrual basis of accounting. Revenues are recognized when they are earned. Unbilled utility service receivables are recorded at year-end. Expenses are recognized when they are incurred. Compensated absences are considered expenses when they are incurred.

In accordance with GASB Statement No. 20-Accounting and Financial Reporting for Proprietary Funds and Other Governmental Entities that use Proprietary Fund Accounting, the City has chosen not to apply accounting standards issued by the Financial Accounting Standards Board after November 30, 1989, to its proprietary funds.

All proprietary funds are accounted for on a cost of services or "capital maintenance" measurement focus. This means that all assets and all liabilities (whether current or non-current) associated with their activity are included on the balance sheets. Their reported net assets are categorized as invested in capital assets net of related debt, restricted, and unrestricted. Proprietary fund type operating statements present increases (revenues) and decreases (expenses) in net total assets.

Depreciation of all exhaustible capital assets used by proprietary funds is charged as an expense against their operations. Accumulated depreciation is reported on proprietary fund balance sheets.

Interest is capitalized on proprietary fund assets acquired with tax-exempt debt. The amount of interest to be capitalized is calculated by offsetting interest expense incurred from the date of the borrowing until completion of the project against interest earned on invested proceeds over the same period.

Proprietary funds distinguish *operating* revenues and expenses from *nonoperating* items. *Operating* revenues and expenses generally result from providing services and producing and delivering goods in connection with a proprietary fund's principal ongoing business operations. The principal operating revenues of the City's enterprise and internal service funds are charges to customers for sales and services. *Operating* expenses for the City's enterprise funds and internal service funds include the cost of sales and services, administrative expenses, and depreciation on capital assets. All revenues and expenses not meeting this definition are reported as nonoperating revenues and expenses.

Enterprise Funds

Enterprise funds are used to account for operations: (a) that are financed and operated in a manner similar to private business enterprises--where the intent of the governing body is that the costs (expenses, including depreciation) of providing goods or services to the general public on a continuing basis be financed or recovered primarily through user charges; or (b) where the governing body has decided that periodic determination of revenues earned, expenses incurred, and/or net income is appropriate for capital maintenance, public policy, management control, accountability, or other purposes.

The City reports the following major enterprise funds:

▪ Sewer Rental Fund

This fund is used to account for sewage fees collected from customers connected to the City's sewer system and for all expenses of operating this system. This fund also accounts for storm water management activities.

NOTE 1 - SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (continued)**▪ Solid Waste and Recycling Fund**

This fund is used to account for the revenues and expenses for solid waste collection, disposal and recycling activities.

▪ Water Works Fund

This fund is used to account for the operation, maintenance, and construction projects related to the water delivery system. This fund also accounts for the operations related to the billings for water, sewage, and solid waste fees.

▪ Community Development Agency Enterprise Fund

This fund is used to account for the enterprise fund activities of the MCDA (a component unit of the City of Minneapolis).

▪ Municipal Parking Fund

This fund is used to account for the operation, maintenance, and construction of the City's parking facilities as well as on-street parking and the Municipal Impound Lot.

Additionally, the City reports the following fund types:

▪ 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, or to other governments, on a cost-reimbursement basis.

▪ Agency Funds

Financial statements of agency funds, which are used to account for assets held by the City as an agent for individuals, private organizations, other governments, and/or other funds, are reported using the economic resources measurement focus and the accrual basis of accounting. Agency funds assets, liabilities, and net assets are included in the fiduciary statement of net assets.

D – BUDGETS

Annual budgets are adopted on a basis consistent with generally accepted accounting principles for the general and special revenue funds. Capital projects funds adopt project-length budgets and budgetary control for debt service funds is achieved through general obligation bond indenture provisions.

NOTE 1 - SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (continued)

The 2001 process for the 2002 budget involved the following:

- January - February City department heads presented annual work plans and accomplishments to Executive Committee; referred then to relevant Policy Committee for review and file.

Finance Department presented preliminary year-end budget status report to Ways and Means/Budget Committee.

Mayor and City Council reviewed and established or reaffirmed annual City goals and objectives to provide framework for annual Enterprise Priority-Setting Process and annual budget.
- March – April Capital Improvement Budget Development – Capital improvement proposals were reviewed by the Budget Coordination Unit, the City Planning Commission and the Capital Long-Range Improvement Committee (CLIC).
- March – June Enterprise Priority-Setting Process – City services were measured for their contribution to progressing towards City goals.
- June - July Operating Budget Development – Departments prepared department operating budget requests; “Current Service Level Budgets” reflected current year costs of providing the same level of service as provided in the prior year, and “Decision Package Requests” described policy changes or alternatives requested by departments.
- July - August The Mayor submitted a budget framework to the City Council no later than August 15. The framework included a recommendation on annual property tax levy amount and set priorities and parameters that provided final direction for departments to establish their “Department Target Budgets.”
- September The Board of Estimate and Taxation set the maximum property tax levy for the City, Municipal Building Commission, Public Housing Authority, Library Board and Park Board.
City Departments prepared “Target Strategies” that met the criteria outlined in the Mayor’s Budget Framework Address.
- October - November The Mayor held departmental budget hearings to review Department Target Budget proposals and other additional policy changes, alternative funding choices and requests. The Mayor also met with representatives from CLIC in preparation of finalizing the capital budget recommendation. The Mayor presented a final budget recommendation to the Council in November.
- November – December The City Council held public hearings on the Budget. Departments presented their Mayor-Recommended Department Budgets to the Ways and Means/Budget Committee. The Ways and Means/Budget Committee approved and moved forward a final recommended budget to the City Council.
- December “Truth in Taxation” public hearings held.
The City Council adopted a final budget and tax levy.

NOTE 1 - SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (continued)

The legal level of budgetary control is at the department level within a fund. The City Coordinator’s Office and the Public Works Department are considered to be legal levels of budgetary control within a fund even though budgetary data is presented at the level of the Departments within the Coordinator’s Office and the Divisions within the Public Works Department. Budgetary amendments at the department/fund level must be approved by the City Council. Appropriations lapse at year-end.

Purchase orders, contracts, and other commitments are recorded as encumbrances, which reserve appropriation authority. This accounting practice is an extension of formal budgetary integration in the general and special revenue funds. Encumbrances outstanding at year-end are reported as reservations of fund balance and do not represent GAAP expenditures.

Supplemental budget revisions were made during the course of the year and the effects of these revisions are summarized below:

	Expenditure Budget at beginning of year	Changes during year	Expenditure Budget at end of year
General Fund	\$248,822	\$2,883	\$251,705
Grants – Federal	15,972	21,451	37,423
CDBG	22,335	2,775	25,110
Grants - Other	9,260	9,384	18,644
Convention Center	69,509	1,652	71,161
Employee Retirement	9,357	6,420	15,777
Municipal Building Comm.	6,965	171	7,136
Police Spec. Rev.	1,255	189	1,444
Arena Reserve	-	2,763	2,763
Community Development Ag.	304,623	57,891	362,514
TOTAL	\$688,098	\$105,579	\$793,677

E – NON-CURRENT GOVERNMENTAL ASSETS/LIABILITIES

GASB Statement No. 34 eliminates the presentation of account groups, but provides for these records to be maintained and incorporates the information into the *Governmental* Activities column in the government-wide *statement of net assets*.

F - DEPOSITS AND INVESTMENTS

The City's cash and cash equivalents are considered to be cash on hand, demand deposits and investments with original maturities of three months or less from the date of purchase. The City maintains a general portfolio which is a pool of investments covering pooled cash and cash equivalents for the Primary Government as well as the discretely presented component units of the Municipal Building Commission, Park Board, and the Library Board. The City has contracted with three investment management firms for management of some of these investments. The City also, from time to time, invests non-pooled cash within individual funds. All investments are reported at fair value.

Minnesota Statutes Chapter 118A and the City Charter require the city to collateralize deposits at designated depositories. The City Finance Officer has arranged for the Federal Reserve Bank of Minneapolis to act as the City's agent in the safekeeping of securities as collateral.

In accordance with Minnesota Statutes Chapter 118A, and with the City Charter, the City invested in (1) direct, guaranteed or insured obligations of the U.S. Treasury, (2) shares of an investment company (with restrictions), (3) general obligations of government jurisdictions (with restrictions), (4) bankers acceptances, (5) commercial paper, (6) guaranteed investment contracts (with restrictions), (7) repurchase agreements (with restrictions) and (8) common stock (restricted to Library Board and as authorized by 1967 Minnesota laws).

NOTE 1 - SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (continued)

The City and its investment management firms will exercise extreme caution in the use of derivative instruments, keeping abreast of future information on risk management issues and will consider derivatives only when a sufficient understanding of the products and expertise to manage them has been developed and analyzed. Any derivatives will also be required to pass the stress testing requirements of Minnesota Statutes Chapter 118A.

Interest income in the investment pool, net of daily amortization of premiums and discounts, is calculated daily and allocated to participating funds based on each fund's share of equity (positive or negative) in the investment pool. Some funds, such as debt service funds, retain their daily allocation of interest income while other funds, which are not required to retain their allocated interest, pass the interest on to either the City General Fund or to the Community Development Agency Special Revenue Fund. The proprietary funds of the City may, from time to time, have negative equity in the investment pool and as a result may be required to pay a Capital Use Charge as Interest on Interfund Loans based on Council policy. Also, periodically the City distributes interest income from its General Fund to various projects below the fund level, as may be required, on the basis of the calculated average daily cash balance of the project and the average yield of the City's general portfolio.

G - INVENTORIES OF MATERIALS AND SUPPLIES

Depending on the nature of the item, inventories are valued using the moving average valuation method or using the last price of the item purchased. Also, and depending on the nature of the item or the fund in which the inventory is recorded, the costs of inventories are recorded as expenses/expenditures when purchased, or when consumed rather than when purchased. Governmental fund inventories are recorded as expenditures at the time the inventory is consumed. Reported inventories of governmental funds are equally offset by a fund balance reservation to indicate that portion of fund balance not available for future appropriation. Inventory recorded in the proprietary funds is expensed as the supplies and materials are consumed.

H - LOANS RECEIVABLE

Loans receivable recorded in the governmental funds consist of business loans using funds provided through State and Federal Grants and Loan Recapture. The loans have been collateralized and call for periodic payments of principal and interest.

Loans receivable recorded in the enterprise funds consist primarily of low interest home improvement and home mortgage loans, which are secured by either a first or second mortgage. Interest on loans is recorded where applicable.

Several developers under various financial arrangements have agreed to pay back development loans only if certain events occur. Because the likelihood of these events occurring is unknown, these loans are not presented in the accompanying financial statements. These loans include redevelopment agreements, neighborhood economic, commercial, and housing development loans, and second mortgages on rehabilitated homes. Some of these loans may be forgiven for continued owner occupancy, the attainment of certain employment goals, or the continuation of specified services.

I - CAPITAL ASSETS

Capital assets (including infrastructure) are recorded at historical cost or at estimated historical cost if actual historical cost is not available. Contributed capital assets are valued at their estimated fair market value on the date contributed. Capital assets include infrastructure (e.g. roads, bridges, water/sewer, and lighting systems), land, buildings, improvements, and equipment. The City defines capital assets as assets with an individual cost of more than \$5,000; or \$35,000 per group of assets by year for bike paths, street signage, street lighting and traffic signals; and \$100,000 per group of assets for parking meters. Capital assets used in operations are depreciated or amortized (assets under capital leases) using the straight-line method over the lesser of the capital lease period or their estimated useful lives in the government-wide statements and proprietary funds.

NOTE 1 - SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (continued)

The estimated useful lives are as follows:

Infrastructure	15 to 100 years
Structures and Improvements	25 to 50 years
Equipment	5 to 15 years
Public Improvements	20 to 40 years

Maintenance and repairs are charged to operations when incurred. Betterments and major improvements, which significantly increase values, change capacities or extend useful lives, are capitalized. Upon sale or retirement of fixed assets, the cost and related accumulated depreciation are removed from the respective accounts and any resulting gain or loss is included in the results of operations.

J – COMPENSATED ABSENCES

The City accrues compensated absences (annual and sick leave benefits) when vested. The current portions of the governmental funds’ compensated absences liabilities are recorded as other liabilities in the Self-Insurance internal service fund. The non-current portions are recorded in the government-wide financial statements and represent a reconciling item between the fund and government-wide presentation.

K – INTERFUND TRANSACTIONS

Interfund transactions are reflected as either loans, services provided, reimbursements or transfers. Loans are reported as receivables or payables as appropriate, are subject to elimination upon consolidation and are referred to as either “due to/from other funds” (i.e., current portion of interfund loans) or “advances to/from other funds” (i.e. non current portion of interfund loans). Any residual balances outstanding between the governmental activities and the business-type activities are reported in the government-wide financial statements as “internal balances.” Advances to other funds, as reported in the fund financial statements, are offset by a fund balance reserve account in applicable governmental funds to indicate they are not available for appropriation and are not available financial resources.

Services provided, deemed to be at market or near market rates, are treated as revenues and expenditures/expenses. Reimbursements occur when a fund incurs costs that are eventually repaid through charges to the benefiting fund. All other interfund transactions are treated as transfers. Transfers between governmental or proprietary funds are netted as part of the reconciliation to the government-wide presentation.

L - PROPERTIES HELD FOR RESALE - ENTERPRISE FUNDS

Properties held for resale in the Community Development Agency Enterprise Fund have been obtained as a result of repossessions in default situations. Repossessed properties are held solely to be re-marketed as part of the ongoing operations of the programs. They are valued at the outstanding principal balance of the related bonds, which is not in excess of the realizable value; or are valued at the amount of the related loan balance at the time of default plus subsequent improvement costs.

M - DEBT SERVICE AND REQUIREMENTS

The debt service funds service all long-term obligations with the exception of bonds payable recorded within the proprietary funds. Some general long-term debt obligations are serviced in part by Council approved transfers from enterprise funds. Minnesota State Law requires agencies issuing general obligation bonds to certify an irrevocable tax levy to the County Auditor covering annual principal and interest requirements plus 5% (deducting, in certain cases, estimated tax increments and certain other revenue) at the time bonds are issued. The annual tax levy can be reduced by an amount equal to the issuing agency’s annual certification of funds on hand.

NOTE 1 - SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (continued)

N – RECLASSIFICATIONS

Certain reclassifications have been made to prior year’s data to conform to the December 31, 2002 financial statement presentation. These reclassifications had no effect on income or fund equity as previously reported.

O – ESTIMATES

The preparation of basic financial statements in conformity with generally accepted accounting principles requires management to make estimates and assumptions that affect certain reported amounts and disclosures. Accordingly, actual results could differ from those estimates.

NOTE 2 –CHANGES IN ACCOUNTING PRINCIPLE

Implementation of Governmental Accounting Standards Board Statement (GASB) No. 34 and Restatement of Equity

Effective January 1, 2002, the City implemented GASB 34, “Basic Financial Statements and Management’s Discussion and Analysis for State and Local Governments.” This statement significantly changes the financial reporting model and reporting requirements for the government’s infrastructure. Implementation of GASB 34 resulted in certain retroactive adjustments to beginning net assets for governmental activities.

The following table outlines the changes in fund balance/net assets as reported on the government-wide statements:

	Primary Government		
	Governmental Activities	Business-type Activities	Total
Fund balance/net assets, December 31, 2001 as previously reported	\$ 363,623	\$ 327,412	\$ 691,035
Adjustment to capital assets including the identification of assets for capitalization and recording depreciation on assets for government-wide statement purposes	650,992	-	650,992
Recording long-term liabilities for government-wide statement purposes	(993,187)	-	(993,187)
Recognizing deferred revenue when earned based on full accrual accounting versus when available	35,496	-	35,496
Fund Changes in Accounting Principle and Reclassifications	<u>59,330</u>	<u>201,920</u>	<u>261,250</u>
Net assets, January 1, 2002	<u>\$ 116,254</u>	<u>\$ 529,332</u>	<u>\$ 645,586</u>