Comparison and Overview
2003 Finances for Cities Under and Over 2,500 in Population

Revenues

Total revenues of the governmental funds for all Minnesota cities totaled $3.84 billion in 2003. This represents a decrease of 1.7 percent from 2002 revenues. Total revenues of cities over 2,500 in population decreased 2.0 percent, while revenues of cities under 2,500 in population increased 1.0 percent.

There are significant differences in how city services are funded between the two city types. Cities under 2,500 are much more dependent on intergovernmental revenues than cities over 2,500. In 2003, intergovernmental revenues accounted for 39.3 percent of total revenues for cities less than 2,500 in population compared to 29.2 percent for cities over 2,500 in population. Among all cities, intergovernmental revenues accounted for 30.1 percent of total revenues.

Large cities make up for the difference in intergovernmental revenues by taking advantage of other tax revenue streams such as tax increments from tax increment financing (TIF) districts, franchise, lodging, and local sales taxes. As a whole, tax revenue from all sources accounted for 40.1 percent of large city revenues in 2003, compared to 28.5 percent of small city revenues. Large cities also utilize tax increment financing to a much greater extent than small cities. Revenue derived from TIF districts accounted for 2.6 percent of small city total revenues compared to 6.8 percent for large cities.

Property taxes account for a similar share of total revenues for these two groups of cities. For large cities, property taxes accounted for 28.0 percent of total revenues compared to 25.5 percent for small cities. For all cities, property taxes accounted for 27.8 percent of total revenues.

On a per capita basis, large cities had total revenues of about $78 more than small cities ($945 to $867).

Expenditures

Total expenditures of the governmental funds for all cities totaled $4.64 billion in 2003. This represented an increase of 2.0 percent over 2002 and reflects an increase of 1.3 percent among large cities and 8.8 percent among small cities.

The spending priorities of cities under 2,500 in population differ from those cities over 2,500 in population. For example, cities under 2,500 tend to direct a greater percentage of their resources to general government (13.9 %) and less to culture and recreation (7.2 %) than cities over 2,500 (10.6% and 11.8 % respectively). In addition, streets and highways are the largest category of spending for cities under 2,500 (22.9 %) compared to public safety for those cities over 2,500 (22.1 %).

Long-Term Debt

Another area where small and large cities differ is in their use of debt. Overall, small cities tend to carry a greater debt burden than large cities. In 2003, small cities carried long-term debt of $859.5 million, or $2,127 per capita, compared to $6.89 billion, or $1,865 per capita for large cities.

Unreserved Fund Balances of the General and Special Revenue Funds

A clear difference between the two city types is in the level of unreserved fund balances for the 508 cities using a modified accrual basis of accounting. Small cities maintain significantly higher fund balances than large cities. In 2003, unreserved fund balances as a percent of current expenditures averaged 98.7 percent for small cities compared to 52.9 percent for large cities. The State Auditor's Office recommends that most cities keep their fund balance at between 30 and 50 percent of total current expenditures. Under the Auditor's guidelines, the average fund balance of small cities would be classified as "High" and that of large cities as "Moderately High."

For cities in Minnesota, the classification "over or under 2,500 in population" helps to determine the type of governmental accounting to which cities must adhere. All cities over 2,500 must have an annual audit following Generally Accepted Accounting Principals (GAAP), a modified accrual basis of accounting. Cities under 2,500 may opt to use a cash basis of accounting. In 2003, 299 of the 644 small cities (47%) had a GAAP audit. This difference in accounting methods is most pronounced when reporting fund balances. Cities that use a modified accrual basis of accounting report their fund balances as reserved, unreserved designated, and unreserved undesignated for each fund they have. Cities that use a cash basis of accounting report a single cash balance for all funds. Because of this difference, this report only examines the fund balance of the 508 cities (both large and small) that use a modified accrual basis of accounting.

Among the 299 small cities that use a modified accrual basis of accounting, 168 (56.2%) had an unreserved fund balance greater than 100 percent of total current expenditures. Among the 209 large cities, 43 cities (20.6%) had an unreserved fund balance greater than 100 percent of total current expenditures. Unreserved fund balances as a percent of total current expenditures ranged from –194.8 percent to 508.2 percent among small cities. Among large cities, the range was from –84.8 percent to 572.5 percent.

The State Auditor has concerns about the financial health of cities maintaining a fund balance below 20 percent of total current expenditures. These cities may not have enough reserves to carry them through financial downturns or unexpected contingencies. The Auditor also has concerns about cities that maintain fund balances far exceeding what is needed to carry them through financial downturns. Taxpayers in cities that have either low or high unreserved fund balances should press their local officials to explain the city's fund balance policy. It is also important to note that this analysis does not include the unreserved fund balances of capital project or debt service funds. These are the funds where one might expect to see higher fund balances, because they should be used to account for future capital projects or proceeds from borrowing.

Accounting Difference for Cities Over and Under 2,500 in Population

Cities using a Modified Accrual Basis of accounting recognize an economic transaction or event as revenue in the operating statement when the revenue is both measurable and *available* to liquidate liabilities of the current period. Available means collectible in the current period or soon enough thereafter to pay liabilities of the current period. Similarly, expenditures are generally recognized when an event or transaction is expected to draw on current spendable resources.

Cities under 2,500 may opt to use a cash basis of accounting. In 2003, 345 of the 644 small cities (53.6%) opted to use a cash basis of accounting. Cash basis accounting provides for the recording of revenues when received in cash and the recording of expenditures when paid in cash. While cash basis accounting may be allowed under Minnesota Statutes, it does not facilitate as accurate a reporting of financial position as generally accepted accounting principals.