



CITY OF STURGIS

FINANCIAL STATEMENTS AND INDEPENDENT AUDITOR'S REPORT
DECEMBER 31, 2016



Ketel Thorstenson, LLP

Certified Public Accountants/Business & Personal Consultants

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CITY OF STURGIS

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INDEPENDENT AUDITOR'S REPORT

City Council
City of Sturgis
Sturgis, South Dakota

Report on the Financial Statements

We have audited the accompanying financial statements of the governmental activities, the business-type activities, each major fund, and the aggregate remaining fund information of the **CITY OF STURGIS** (the City), as of and for the year ended December 31, 2016, and the related notes to the financial statements, which collectively comprise the City's basic financial statements as listed in the table of contents.

Management's Responsibility for the Financial Statements

Management is responsible for the preparation and fair presentation of these financial statements in accordance with accounting principles generally accepted in the United States of America; this includes the design, implementation, and maintenance of internal control relevant to the preparation and fair presentation of financial statements that are free from material misstatement, whether due to fraud or error.

Auditor's Responsibility

Our responsibility is to express opinions on these financial statements based on our audit. We conducted our audit in accordance with auditing standards generally accepted in the United States of America and the standards applicable to financial audits contained in *Government Auditing Standards*, issued by the Comptroller General of the United States. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free from material misstatement.

An audit involves performing procedures to obtain audit evidence about the amounts and disclosures in the financial statements. The procedures selected depend on the auditor's judgment, including the assessment of the risks of material misstatement of the financial statements, whether due to fraud or error. In making those risk assessments, the auditor considers internal control relevant to the entity's preparation and fair presentation of the financial statements in order to design audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of the entity's internal control. Accordingly, we express no such opinion. An audit also includes evaluating the appropriateness of accounting policies used and the reasonableness of significant accounting estimates made by management, as well as evaluating the overall presentation of the financial statements.

We believe that the audit evidence we have obtained is sufficient and appropriate to provide a basis for our audit opinions.

Basis for Qualified Opinion on Liquor Fund

During the course of the audit, significant variances were noted in liquor fund gross margins due to additional inventory identified. These variances resulted in an understatement of costs of goods sold in the liquor fund during the year ended December 31, 2016. The amount of the understatement for 2016 was not determined.

Qualified Opinion on Liquor Fund

In our opinion, except for the effects of the matter described in the Basis for Qualified Opinion on Liquor Fund paragraph, the financial statements referred to above present fairly, in all material respects, the financial position of the Liquor Fund of the City as of December 31, 2016, and the changes in financial position and cash flows thereof for the year then ended in accordance with accounting principles generally accepted in the United States of America.

Unmodified Opinions

In our opinion, the financial statements referred to above present fairly, in all material respects, the respective financial position of the governmental activities, the business-type activities, each major fund other than the Liquor Fund, and the aggregate remaining fund information of the City as of December 31, 2016, and the respective changes in financial position and cash flows, where applicable, for the year then ended in conformity with accounting principles generally accepted in the United States of America.

Report on Required Supplementary Information

Accounting principles generally accepted in the United States of America require that the management's discussion and analysis on pages 3 through 12, budgetary comparison information on pages 46 through 49, pension information on pages 50 through 51, and notes to required supplementary information on page 52 be presented to supplement the basic financial statements. Such information, although not a part of the basic financial statements, is required by the Governmental Accounting Standards Board, who considers it to be an essential part of financial reporting for placing the basic financial statements in an appropriate operational, economic, or historical context. We have applied certain limited procedures to the required supplementary information in accordance with auditing standards generally accepted in the United States of America, which consisted of inquiries of management regarding the methods of preparing the information and comparing the information for consistency with management's responses to our inquiries, the basic financial statements, and other knowledge we obtained during our audit of the basic financial statements. We do not express an opinion or provide any assurance on the information because the limited procedures do not provide us with sufficient evidence to express an opinion or provide any assurance.

Report on Other Supplementary Information

Our audit was conducted for the purpose of forming opinions on the financial statements that collectively comprise the City's basic financial statements as a whole. The combining nonmajor fund financial statements and schedule of rally activities on pages 53 through 55 are presented for purposes of additional analysis and are not a required part of the financial statements. The combining nonmajor fund financial statements are the responsibility of management and were derived from and relate directly to the underlying accounting and other records used to prepare the basic financial statements. The combining nonmajor fund financial statements have been subjected to the auditing procedures applied in the audit of the basic financial statements and certain additional procedures, including comparing and reconciling such information directly to the underlying accounting and other records used to prepare the basic financial statements or to the basic financial statements themselves, and other additional procedures in accordance with auditing standards generally accepted in the United States of America. In our opinion, the information is fairly stated in all material respects in relation to the basic financial statements taken as a whole.

The schedule of rally activities on page 55 has not been subjected to the auditing procedures applied in the audit of the basic financial statements and, accordingly, we do not express an opinion or provide any assurance on it.

Other Reporting Required by *Government Auditing Standards*

In accordance with *Government Auditing Standards*, we have also issued our report dated September 7, 2017, on our consideration of the City's internal control over financial reporting and on our tests of its compliance with certain provisions of laws, regulations, contracts, grant agreements, and other matters. The purpose of that report is to describe the scope of our testing of internal control over financial reporting and compliance and the results of that testing, and not to provide an opinion on the internal control over financial reporting or on compliance. That report is an integral part of an audit performed in accordance with *Government Auditing Standards* in considering the City's internal control over financial reporting and compliance.



KETEL THORSTENSON, LLP
Certified Public Accountants

CITY OF STURGIS

MANAGEMENT'S DISCUSSION AND ANALYSIS DECEMBER 31, 2016

This section of the City of Sturgis' annual financial report presents management's discussion and analysis of the City's financial performance during the fiscal year ended on December 31, 2016. Please read it in conjunction with the City's financial statements, which follow this section.

FINANCIAL HIGHLIGHTS

- During the year, the City's revenues generated from charges for services, taxes and other revenues of the governmental programs were \$598,724 less than the \$10,026,822 governmental program expenditures. This includes any transfers in/out. The decrease is due to a decrease in Taxes and in Capital Grants and Contributions. Taxes were down by 7% compared to 2015 but were up 3.5% compared to 2014 and Capital Grants and Contributions were down 11.66% compared to 2015. With 2015 being the 75th Rally, the revenue would be lower in 2016. Expenses were up .004% or \$35,124 compared to 2015. The City continues to see growth in construction of homes and businesses during 2016.
- In the City's business-type activities, revenues exceeded expenses by \$1,290,246, which includes transfers and any activity due to the disposal of fixed assets. The increase is due to a 3% increase in fees in the Wastewater Fund and 5% increase in the Sanitation Fund. The Liquor Fund had an 8% decrease in revenue compared to 2015 but a 20% increase compared to 2014. The Ambulance Fund also had an increase of revenue of 14.6% over 2015. Expenses were up in the Water and Ambulance Funds and down in the Liquor, Wastewater and Sanitation Funds.

OVERVIEW OF THE FINANCIAL STATEMENTS

The financial report is presented in a format consistent with the presentation requirements of the Governmental Accounting Standards Board (GASB) Statement 34.

This annual report consists of three parts – management's discussion and analysis (this section), the basic financial statements (including related notes), and required supplementary information. The basic financial statements include two kinds of statements that present different views of the City:

- The first two statements are government-wide financial statements that provide both long-term and short-term information about the City's overall financial status.
- The remaining statements are fund financial statements that focus on individual parts of the City government, reporting the City's operations in more detail than the government-wide statements.
- The governmental funds statements tell how general government services like public safety were financed in the short-term, as well as what remains for future spending.
- Proprietary fund statements offer short-term and long-term financial information about the activities that the City operates like businesses. The City has five proprietary funds – the Liquor Fund, Water Fund, Wastewater Fund, Sanitation Fund and Ambulance Fund.

The financial statements also include notes that explain some of the information in the financial statements and provide more detailed data. The statements are followed by a section of required supplementary information that further explains and supports the information in the financial statements. In addition to the required elements, we have included a section with combining statements that provide details about our non-major governmental funds, each of which are added together and presented in a single column in the basic financial statements.

CITY OF STURGIS

**MANAGEMENT’S DISCUSSION AND ANALYSIS (CONTINUED)
DECEMBER 31, 2016**

OVERVIEW OF THE FINANCIAL STATEMENTS (CONTINUED)

Figure A-1 summarizes the major features of the City’s financial statements, including the portion of the City government they cover and the types of information they contain. The remainder of the overview section of the management’s discussion and analysis explains the structure and contents of each of the statements.

Figure A-1

	Government-wide Statements	Fund Statements	
		Governmental Funds	Proprietary Funds
Scope	Entire City government (except fiduciary funds and the fiduciary component units)	The activities of the City that are not proprietary or fiduciary, such as finance office, police, fire and parks	Activities the City operates similar to private businesses, such as the water and sewer systems
Required Financial Statements	Statement of Net Position and Statement of Activities	Balance Sheet and Statement of Revenues, Expenditures, and Changes in Fund Balances	Statement of Net Position; Statement of Revenues, Expenses, and Changes in Net Position; and Statement of Cash Flows
Accounting Basis and Measurement Focus	Accrual accounting and economic resources focus	Modified accrual accounting and current financial resources focus	Accrual accounting and economic resources focus
Type of Asset/Liability Information	All assets and liabilities, both financial and capital, and short-term and long-term	Only assets expected to be used up and liabilities that come due during the year or soon thereafter, no capital assets included	All assets and liabilities, both financial and capital, and short-term and long-term
Type of Inflow/Outflow Information	All revenues and expenses during year, regardless of when cash is received or paid	Revenues for which cash is received during or soon after the end of the year; expenditures when goods or services have been received and payment is due during the year or soon thereafter	All revenues and expenses during year, regardless of when cash is received or paid

Government-wide Statements

The government-wide statements report information about the City as a whole using accounting methods similar to those used by private-sector companies. The statement of net position includes all of the government’s assets and liabilities. All of the current year’s revenues and expenses are accounted for in the statement of activities regardless of when cash is received or paid.

CITY OF STURGIS

MANAGEMENT'S DISCUSSION AND ANALYSIS (CONTINUED) DECEMBER 31, 2016

OVERVIEW OF THE FINANCIAL STATEMENTS (CONCLUDED)

Government-wide Statements (Continued)

The two government-wide statements report the City's net position and how they have changed. Net position – the difference between the City's assets and liabilities – is one way to measure the City's financial health or position.

- Increases or decreases in the City's net position are an indicator of whether its financial health is improving or deteriorating, respectively.
- To assess the overall health of the City you need to consider additional non-financial factors such as changes in the City's property tax base and changes in the sales tax revenue base.

The government-wide financial statements of the City are reported in two categories:

- **Governmental Activities** -- This category includes most of the City's basic services, such as police, fire, public works, parks department and general administration. Property taxes, sales taxes, charges for services, state and federal grants, and interest earnings finance most of these activities.
- **Business-type Activities** -- The City charges a fee to customers to help cover the costs of certain services it provides. The City's liquor, water, wastewater, sanitation, and ambulance funds are included here.

Fund Financial Statements

The fund financial statements provide more detailed information about the City's most significant funds – not the City as a whole. Funds are accounting devices that the City uses to keep track of specific sources of funding and spending for particular purposes. State law requires some of the funds. The City Council establishes other funds to control and manage money for particular purposes or to show that it is properly using certain taxes and grants.

The City has two kinds of funds:

- **Governmental Funds** – Most of the City's basic services are included in the governmental funds, which focus on (1) how cash and other financial assets that can readily be converted to cash flow in and out and (2) the balances left at the year-end that are available for spending. Consequently, the governmental funds statements provide a detailed short-term view that helps you determine whether there are more or fewer financial resources that can be spent in the near future to finance the City's programs. Because this information does not encompass the additional long-term focus of the government-wide statements, we provide additional information at the bottom of the governmental funds' statements, or on the subsequent page, that explains the relationship (or differences) between them.
- **Proprietary Funds** – Services for which the City charges customers a fee are generally reported in proprietary funds. Proprietary funds, like the government-wide statements, provide both short-term and long-term financial information. The City's enterprise funds are the same as its business-type activities, but provide more detail and additional information, such as cash flows.

CITY OF STURGIS

MANAGEMENT'S DISCUSSION AND ANALYSIS (CONTINUED)
DECEMBER 31, 2016

FINANCIAL ANALYSIS OF THE CITY AS A WHOLE

Net Position

The City's combined net position increased one percent between fiscal year 2015 and 2016. (See Table A-1).

Table A-1 Summarized Statement of Net Position						
	Governmental Activities		Business-Type Activities		Total	
	<u>2016</u>	<u>2015</u>	<u>2016</u>	<u>2015</u>	<u>2016</u>	<u>2015</u>
Current and Other Assets	\$ 4,019,885	\$ 6,582,421	\$ 3,601,786	\$ 3,418,132	\$ 7,621,671	\$ 10,000,553
Capital Assets	37,809,133	35,888,589	24,410,309	22,898,348	62,219,442	58,786,937
Total Assets	\$ 41,829,018	\$ 42,471,010	\$ 28,012,095	\$ 26,316,480	\$ 69,841,113	\$ 68,787,490
Pension Related Deferred Outflows	\$ 1,247,194	\$ 1,203,087	\$ 671,694	\$ 648,992	\$ 1,918,888	\$ 1,852,079
Long-Term Debt	\$ 5,583,087	\$ 4,714,961	\$ 7,536,523	\$ 7,196,516	\$ 13,119,610	\$ 11,911,477
Other Liabilities	941,911	790,673	1,115,330	477,834	2,057,241	1,268,507
Total Liabilities	6,524,998	5,505,634	8,651,853	7,674,350	15,176,851	13,179,984
Pension Related Deferred Inflows	\$ -	\$ 1,018,525	\$ -	\$ 549,432	\$ -	\$ 1,567,957
<i>Net Position:</i>						
Net Investment in Capital Assets	32,442,911	31,382,410	16,977,996	15,808,351	49,420,907	47,190,761
Restricted	3,689,900	3,797,712	415,095	494,339	4,104,995	4,292,051
Unrestricted	418,403	1,969,816	2,638,845	2,439,000	3,057,248	4,408,816
Total Net Position	\$ 36,551,214	\$ 37,149,938	\$ 20,031,936	\$ 18,741,690	\$ 56,583,150	\$ 55,891,628
Beginning Net Position	\$ 37,149,938	\$ 35,632,003	\$ 18,741,690	\$ 17,904,533	\$ 55,891,628	\$ 53,536,536
Change in Accounting Principle	-	755,327	-	407,453	-	1,162,780
Increase in Net Position	\$ (598,724)	\$ 762,608	\$ 1,290,246	\$ 429,704	\$ 691,522	\$ 1,192,312
Percentage of Increase in Net Position	-2%	2%	7%	2%	1%	2%

The Statement of Net Position reports all financial and capital resources. The statement presents the assets and liabilities in order of relative liquidity. The liabilities with average maturities greater than one year are reported in two components – the amount due within one year and the amount due in more than one year. The difference between the City's assets and liabilities is its net position.

CITY OF STURGIS

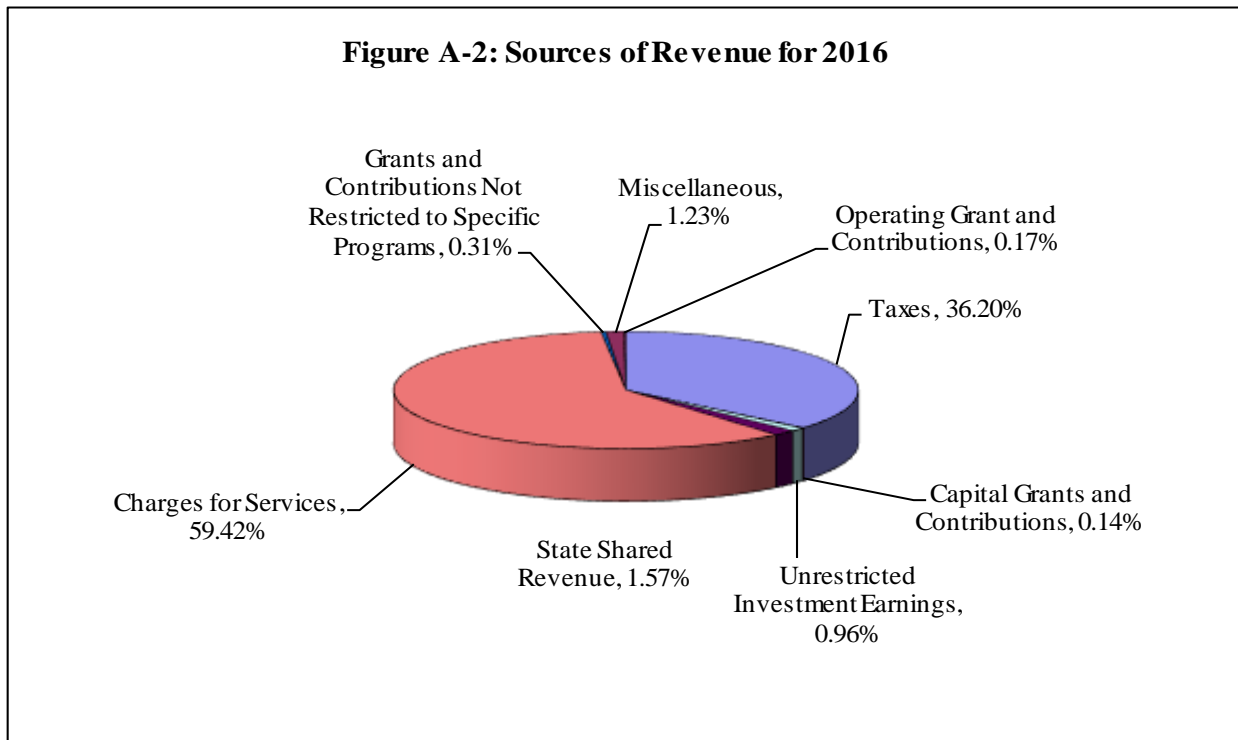
**MANAGEMENT'S DISCUSSION AND ANALYSIS (CONTINUED)
DECEMBER 31, 2016**

FINANCIAL ANALYSIS OF THE CITY AS A WHOLE (CONTINUED)

Changes in Net Position

The City's revenues totaled \$17,899,626 (See Table A-2). Well over half of the City's revenue comes from charges for services and taxes, with 59 cents of every dollar raised coming from charges for services (primarily liquor and water operations) and 36 cents of every dollar raised coming from some type of tax (See Figure A-2). The other five percent of the City's total revenue comes from state and federal grants for capital purposes, operating grants, contributions, state shared revenue, interest and miscellaneous.

The total cost of all programs and services was \$17,208,104 (See Table A-2). The City's expenses cover a range of services, including road maintenance, parks and recreation services and sewer system services. (See Figure A-3).

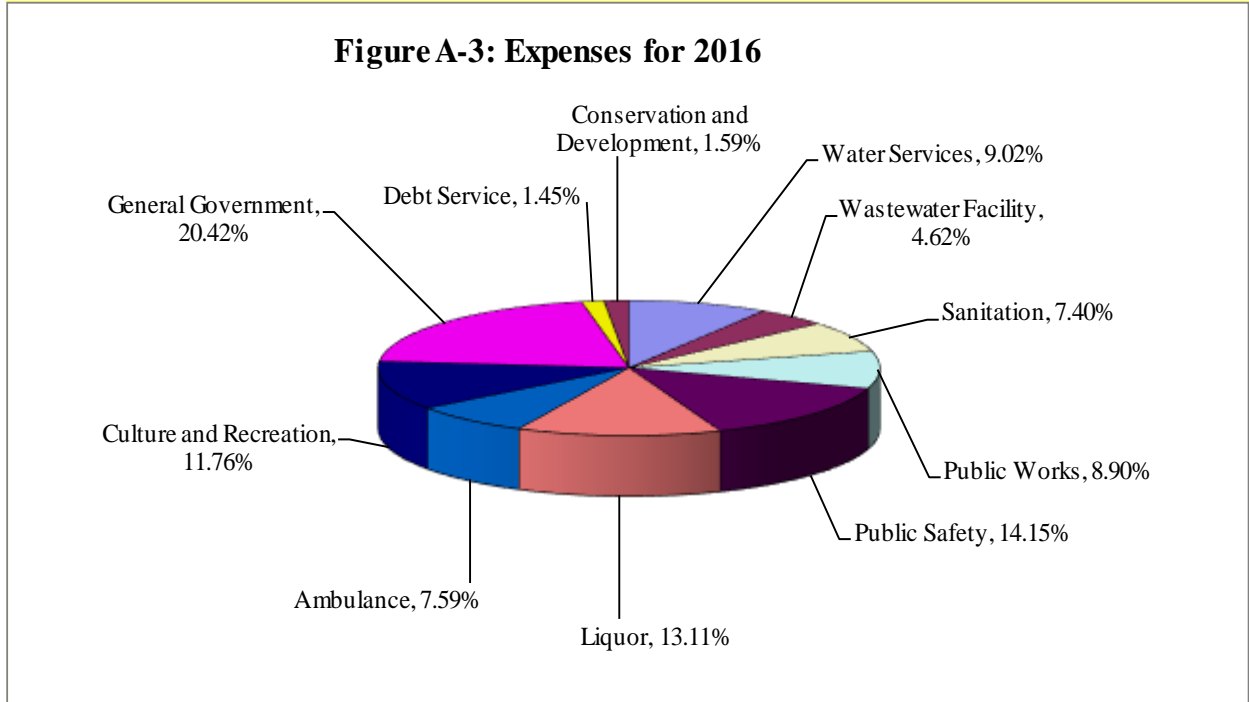


CITY OF STURGIS

**MANAGEMENT'S DISCUSSION AND ANALYSIS (CONTINUED)
DECEMBER 31, 2016**

FINANCIAL ANALYSIS OF THE CITY AS A WHOLE (CONTINUED)

Changes in Net Position (Continued)



CITY OF STURGIS

**MANAGEMENT'S DISCUSSION AND ANALYSIS (CONTINUED)
DECEMBER 31, 2016**

FINANCIAL ANALYSIS OF THE CITY AS A WHOLE (CONTINUED)

Changes in Net Position (Concluded)

Table A-2 and the narrative that follows consider the operations of the governmental and business - type activities.

Table A-2 Changes in Net Position						
	Governmental Activities		Business - Type Activities		Total	
	2016	2015	2016	2015	2016	2015
Revenues						
Program Revenues						
Charges for Services	\$ 2,731,165	\$ 2,952,394	\$ 7,904,216	\$ 7,726,666	\$ 10,635,381	\$ 10,679,060
Operating Grants and Contributions	29,513	10,294	-	-	29,513	10,294
Capital Grants and Contributions	25,212	319,260	-	-	25,212	319,260
General Revenues						
Taxes	6,479,143	6,941,564	-	-	6,479,143	6,941,564
State Shared Revenue	281,111	279,336	-	-	281,111	279,336
Grants and Contributions not Program Specific	21,320	61,911	34,385	-	55,705	61,911
Unrestricted Investment Earnings	161,869	87,506	10,724	20,122	172,593	107,628
Miscellaneous	127,301	128,585	93,667	23,341	220,968	151,926
Total Revenues	9,856,634	10,780,850	8,042,992	7,770,129	17,899,626	18,550,979
Expenses						
General Government	3,513,661	3,260,401	-	-	3,513,661	3,260,401
Public Safety	2,435,561	2,251,644	-	-	2,435,561	2,251,644
Public Works	1,530,814	1,515,176	-	-	1,530,814	1,515,176
Culture and Recreation	2,023,419	1,871,247	-	-	2,023,419	1,871,247
Conservation and Development	273,209	907,206	-	-	273,209	907,206
Debt Service	250,158	186,024	-	-	250,158	186,024
Liquor	-	-	2,256,085	2,484,605	2,256,085	2,484,605
Water Services	-	-	1,551,409	1,328,879	1,551,409	1,328,879
Wastewater Services	-	-	794,859	845,564	794,859	845,564
Sanitation Services	-	-	1,273,133	1,410,807	1,273,133	1,410,807
Ambulance	-	-	1,305,796	1,297,114	1,305,796	1,297,114
Total Expenses	10,026,822	9,991,698	7,181,282	7,366,969	17,208,104	17,358,667
Excess Before Transfers	(170,188)	789,152	861,710	403,160	691,522	1,192,312
Transfers	(428,536)	(26,544)	428,536	26,544	-	-
Increase (Decrease) in Net Position	(598,724)	762,608	1,290,246	429,704	691,522	1,192,312
Change in Accounting Principle	-	755,327	-	-	-	755,327
Ending Net Position	\$ 36,551,214	\$ 37,149,938	\$ 20,031,936	\$ 18,741,690	\$ 56,583,150	\$ 55,891,628

CITY OF STURGIS

MANAGEMENT'S DISCUSSION AND ANALYSIS (CONTINUED) DECEMBER 31, 2016

FINANCIAL ANALYSIS OF THE CITY AS A WHOLE (CONCLUDED)

Governmental Activities

Total revenues of the governmental activities for the City decreased 9% compared to the prior year, while total expenses increased by 0.035%. Comparison of 2016 to 2015 is difficult as the 75th Rally skewed both revenues and expenses for that year. When comparing 2016 revenues to 2014 they were up 22%, while expenses were up 15% compared to 2014. Overall 2016 was a good year and we continue to see growth in Tourism, Construction and in Economic Development.

Business-Type Activities

Operating revenues of the City's business-type activities increased by 4% compared to the prior year, while expenses decreased by 3%. The overall increase in revenues is due to the increase in fees, the economic growth, and usage of services. The use of the Rubble Site continues to grow. The Ambulance continues to have more runs, but more of the charges are being wrote off as the payee (Insurance, Medicare and Medicaid) are not paying the entire charge.

FINANCIAL ANALYSIS OF THE CITY'S FUNDS

The financial analysis of the City's funds mirror those highlighted in the analysis of governmental and business-type activities presented above. The City maintains governmental fund types - General, Special Revenue Funds (including the Capital Improvement, Revolving Loan, and Business Improvement District Funds), Debt Service Funds, Capital Projects Funds and Permanent Funds. The City also maintains five business type funds - Liquor, Water, Wastewater, Sanitation and Ambulance Funds.

BUDGETARY HIGHLIGHTS

Over the course of the year, the City Council revised the City budget three times. These amendments fall into two categories:

- Move contingency money to funds to prevent budget overruns
- Supplemental appropriations to increase the budget to prevent budget overruns

CITY OF STURGIS

**MANAGEMENT'S DISCUSSION AND ANALYSIS (CONTINUED)
DECEMBER 31, 2016**

CAPITAL ASSET ADMINISTRATION

By the end of 2016, the City had invested \$62,219,442 in a broad range of capital assets, including, land, buildings, and various machinery and equipment. (See Table A-3). This amount represents a net increase (including additions and deductions) of \$3,432,505, primarily due to the completion of two TIF projects, a water/sewer project, improvements to the Community Center, City Hall and the Auditorium, Anna Street Storm Water project and repairs to the Airport apron.

	Governmental Activities		Business-type Activities	
	2016	2015	2016	2015
Land	\$ 2,923,815	\$ 2,793,024	\$ 738,681	\$ 738,681
Construction Work in Progress	382,541	585,476	1,578,765	20,937
Buildings	8,707,116	8,404,421	1,511,024	1,571,659
Improvements Other Than Buildings	23,924,056	22,125,424	19,435,066	19,290,341
Machinery and Equipment	1,871,605	1,980,244	1,146,773	1,276,730
Total Capital Assets	\$ 37,809,133	\$ 35,888,589	\$ 24,410,309	\$ 22,898,348

LONG-TERM DEBT

At year-end the City had \$13,119,610 in Sales Tax Revenue Bonds, Contract Payable, General Obligation Bonds and other long-term obligations. This is an increase of \$1,208,133 as shown on Table A-4 below.

	Governmental Activities		Business-type Activities	
	2016	2015	2016	2015
Compensated Absences	\$ 216,865	\$ 208,782	\$ 86,676	\$ 84,147
Tax Increment Financing Obligations	1,548,801	57,583	-	-
Pioneer Bank	-	-	712,501	-
2nd Street Plaza	997,421	1,128,596	-	-
Sales Tax Revenue Bonds	2,820,000	3,320,000	6,137,346	6,337,369
General Obligation Bonds	-	-	600,000	775,000
Total Outstanding Debt and Obligations	\$ 5,583,087	\$ 4,714,961	\$ 7,536,523	\$ 7,196,516

During the current year, the City received a loan from Pioneer Bank and made draws from this loan for two Wastewater projects, the Wastewater Screen project and the East Annex sewer project. The City makes interest only payments until the projects are done. The City makes scheduled payments throughout the year on its other debt balances.

CITY OF STURGIS

MANAGEMENT'S DISCUSSION AND ANALYSIS (CONCLUDED) DECEMBER 31, 2016

ECONOMIC FACTORS AND NEXT YEAR'S BUDGETS AND RATES

The City's current economic position has remained strong and is growing. There was an increase in total property valuation of \$19,092,269 or 5%. The City requested a 4% increase in property tax for the year of 2016 payable in 2017. The growth factor of 2015 taxes payable in 2016 was 0.660%. The growth factor for 2016 taxes payable in 2017 was 3.332%.

The adopted 2017 general fund expenditures budget decreased by 1% as the City did not have a Sponsorship Agent and hired internally for this position. This saved the City the commissions that the agent received from recruiting the Sponsors.

The City's business-type activities, sanitation fees will increase by 3% and wastewater fees will increase by 3% in 2016 and the Water rates will increase 3%. The ambulance fund continues to anticipate higher revenue due to the high demand for ambulance service in the area but anticipates more write-offs due to the fact that Medicare and Medicaid is paying less.

CONTACTING THE CITY'S FINANCIAL MANAGEMENT

This financial report is designed to provide our citizens, taxpayers, customers, and investors and creditors with a general overview of the City's finances and to demonstrate the City's accountability for the money it receives. If you have questions about this report or need additional information, contact the City of Sturgis' Finance Office, 1040 Harley-Davidson Way, Suite 103, Sturgis, SD 57785.

CITY OF STURGIS

STATEMENT OF NET POSITION
DECEMBER 31, 2016

	GOVERNMENTAL ACTIVITIES	BUSINESS-TYPE ACTIVITIES	TOTAL
Assets			
Cash and Cash Equivalents (Note 2)	\$ 2,604,375	\$ 1,314,526	\$ 3,918,901
Receivables, Net	719,409	572,810	1,292,219
Notes Receivable (Note 10)	480,985	-	480,985
Internal Balances (Note 6)	(1,193,165)	1,193,165	-
Inventories	1,485	472,423	473,908
Other Assets	37,087	15,425	52,512
Investment Real Estate Held for Sale	608,100	-	608,100
Restricted Assets:			
Cash with Fiscal Agent (Note 5)	625,765	33,437	659,202
Deposits (Note 9)	135,844	-	135,844
Capital Assets (Note 4)			
Land and Construction Work in Progress	3,306,356	2,317,446	5,623,802
Other Capital Assets, Net of Depreciation	34,502,777	22,092,863	56,595,640
Total Assets	41,829,018	28,012,095	69,841,113
Deferred Outflows of Resources			
Pension Related Deferred Outflows of Resources (Note 8)	1,247,194	671,694	1,918,888
Total Assets and Deferred Outflows of Resources	\$ 43,076,212	\$ 28,683,789	\$ 71,760,001
Liabilities			
Accounts Payable	\$ 282,611	\$ 584,907	\$ 867,518
Other Current Liabilities	95,817	240,387	336,204
Net Pension Liability (Note 8):	563,483	290,036	853,519
Noncurrent Liabilities (Note 5):			
Due Within One Year	782,357	457,001	1,239,358
Due in More Than One Year	4,800,730	7,079,522	11,880,252
Total Liabilities	6,524,998	8,651,853	15,176,851
Net Position			
Net Investment in Capital Assets	32,442,911	16,977,996	49,420,907
Restricted for:			
Debt Service	625,765	33,437	659,202
SDPAA (Note 9)	135,844	-	135,844
Revolving Loans	752,941	-	752,941
BID Tax	8,491	-	8,491
BBB Tax	726,387	-	726,387
Library Purposes	253,830	-	253,830
SDRS Pension (Note 8)	683,711	381,658	1,065,369
Permanently Restricted Purposes:			
Expendable	125,396	-	125,396
Nonexpendable	377,535	-	377,535
Unrestricted	418,403	2,638,845	3,057,248
Total Net Position	36,551,214	20,031,936	56,583,150
Total Liabilities and Net Position	\$ 43,076,212	\$ 28,683,789	\$ 71,760,001

The accompanying notes are an integral part of the financial statements.

CITY OF STURGIS

STATEMENT OF ACTIVITIES
FOR THE YEAR ENDED DECEMBER 31, 2016

	----- Program Revenues -----				Net (Expense) Revenue and		Total
	Expenses	Charges for Services	Operating Grants and Contributions	Capital Grants and Contributions	Governmental Activities	Business-Type Activities	
Functions/Programs							
Primary Government							
Governmental Activities:							
General Government	\$ 3,513,661	\$ 2,384,837	\$ -	\$ -	\$ (1,128,824)	\$ -	\$ (1,128,824)
Public Safety	2,435,561	63,624	29,513	-	(2,342,424)	-	(2,342,424)
Public Works	1,530,814	24,479	-	-	(1,506,335)	-	(1,506,335)
Health and Welfare	-	5,799	-	-	5,799	-	5,799
Culture and Recreation	2,023,419	252,426	-	-	(1,770,993)	-	(1,770,993)
Conservation and Development	273,209	-	-	25,212	(247,997)	-	(247,997)
Interest on Long-Term Debt	250,158	-	-	-	(250,158)	-	(250,158)
Total Governmental Activities	10,026,822	2,731,165	29,513	25,212	(7,240,932)	-	(7,240,932)
Business-Type Activities:							
Liquor	2,256,085	2,386,063	-	-	-	129,978	129,978
Water	1,551,409	1,810,586	-	-	-	259,177	259,177
Wastewater	794,859	1,231,674	-	-	-	436,815	436,815
Sanitation	1,273,133	1,395,109	-	-	-	121,976	121,976
Ambulance	1,305,796	1,080,784	-	-	-	(225,012)	(225,012)
Total Business-Type Activities	7,181,282	7,904,216	-	-	-	722,934	722,934
Total Primary Government	\$ 17,208,104	\$ 10,635,381	\$ 29,513	\$ 25,212	(7,240,932)	722,934	(6,517,998)
General Revenues:							
Taxes:							
Property Taxes					2,863,343	-	2,863,343
Sales Taxes					3,615,800	-	3,615,800
State Shared Revenue					281,111	-	281,111
Grants and Contributions Not Restricted							
to Specific Programs					21,320	34,385	55,705
Unrestricted Investment Earnings					161,869	10,724	172,593
Miscellaneous Revenue					127,301	93,667	220,968
Transfers					(428,536)	428,536	-
Total General Revenues and Transfers					6,642,208	567,312	7,209,520
Change in Net Position					(598,724)	1,290,246	691,522
Net Position, Beginning					37,149,938	18,741,690	55,891,628
Net Position, Ending					\$ 36,551,214	\$ 20,031,936	\$ 56,583,150

The accompanying notes are an integral part of the financial statements.

CITY OF STURGIS

**BALANCE SHEET - GOVERNMENTAL FUNDS
DECEMBER 31, 2016**

	General Fund	Capital Improvement Fund	Revolving Loan Fund
Assets			
101 Cash (Note 2)	\$ 163,977	\$ 48,077	\$ 79,304
105 Savings Certificates (Note 2)	632,783	-	134,670
106 Restricted Cash with Fiscal Agent (Note 5)	-	625,765	-
108 Property Taxes Receivable	130,541	-	-
108 Sales Tax Receivable	163,745	109,164	-
115 Accounts Receivable, Net	25,318	-	65,900
121 Special Assessments Receivable	1,790	-	-
128 Notes Receivable (Note 10)	-	7,918	473,067
131 Due from Other Funds (Note 6)	399,031	-	-
132 Due from Federal/State Government (Note 11)	183,436	-	-
133 Advance to Other Funds (Note 6)	1,230,420	-	559,669
142 Inventory of Supplies Purchased for Resale	1,485	-	-
151 Investment Held for Sale	-	-	-
154.1 Restricted Deposits (Note 9)	135,844	-	-
155 Prepaid Expense	37,087	-	-
Total Assets	\$ 3,105,457	\$ 790,924	\$ 1,312,610
Liabilities, Deferred Inflows of Resources and Fund Balances			
<i>Liabilities</i>			
202 Accounts Payable	\$ 201,685	\$ 7,025	\$ -
208 Due to Other Funds (Note 6)	-	278,568	-
216 Accrued Wages Payable	59,114	-	-
217 Accrued Taxes Payable	1,799	-	-
220 Deposits	1,700	-	-
236 Advance from Other Funds (Note 6)	-	810,000	-
Total Liabilities	264,298	1,095,593	-
<i>Deferred Inflows of Resources</i>			
245 Unavailable Revenue - Property Taxes	90,873	-	-
246 Unavailable Revenue - Special Assessments	-	-	-
Total Deferred Inflows of Resources	90,873	-	-
<i>Fund Balances (Note 1)</i>			
263 Nonspendable	1,404,836	-	559,669
264 Restricted	-	625,765	752,941
265 Committed	131,845	-	-
266 Assigned	73,165	-	-
267 Unassigned	1,140,440	(930,434)	-
Total Fund Balances	2,750,286	(304,669)	1,312,610
Total Liabilities, Deferred Inflows of Resources and Fund Balances	\$ 3,105,457	\$ 790,924	\$ 1,312,610

The accompanying notes are an integral part of the financial statements.

<u>TIF</u> <u>Funds</u>	<u>Other</u> <u>Governmental</u> <u>Funds</u>	<u>Total</u> <u>Governmental</u> <u>Funds</u>
\$ 667,841	\$ 450,188	\$ 1,409,387
-	427,535	1,194,988
-	-	625,765
-	-	130,541
-	15,355	288,264
-	54	91,272
-	24,106	25,896
-	-	480,985
-	-	399,031
-	-	183,436
-	-	1,790,089
-	-	1,485
-	608,100	608,100
-	-	135,844
-	-	37,087
\$ 667,841	\$ 1,525,338	\$ 7,402,170

\$ 64,315	\$ 9,586	\$ 282,611
29,003	-	307,571
-	-	59,114
-	7	1,806
-	-	1,700
2,264,714	-	3,074,714
<u>2,358,032</u>	<u>9,593</u>	<u>3,727,516</u>

-	-	90,873
-	24,106	24,106
-	24,106	114,979

-	377,535	2,342,040
-	1,114,104	2,492,810
-	-	131,845
-	-	73,165
(1,690,191)	-	(1,480,185)
<u>(1,690,191)</u>	<u>1,491,639</u>	<u>3,559,675</u>

\$ 667,841	\$ 1,525,338	\$ 7,402,170
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CITY OF STURGIS

**RECONCILIATION OF GOVERNMENTAL FUNDS BALANCE SHEET
TO GOVERNMENT-WIDE STATEMENT OF NET POSITION
DECEMBER 31, 2016**

Total Fund Balances - Governmental Funds \$ 3,559,675

Amounts reported for governmental activities in the Statement
of Net Position are different because:

Capital assets used in governmental activities are not current financial resources and
therefore are not reported in the funds. 37,809,133

Net pension liability reported in governmental activities is not due and payable in the
current period and therefore is not reported in the funds. (563,483)

Pension related deferred outflows are components of pension asset and therefore are
not reported in the funds. 1,247,194

Long-term liabilities, including bonds payable, tax increment financing obligations,
and compensated absences are not due and payable in the current period and
therefore not reported in the funds. (5,583,087)

Accrued interest on long-term debt is not due and payable in the current period and
therefore is not reported in the funds. (33,197)

Assets such as delinquent taxes receivable, special assessments, and grants are not
available to pay for current period expenditures and therefore are deferred in the
funds. 114,979

Total Net Position - Governmental Funds **\$ 36,551,214**

The accompanying notes are an integral part of the financial statements.

CITY OF STURGIS

**STATEMENT OF REVENUES, EXPENDITURES, AND CHANGES IN FUND BALANCES
GOVERNMENTAL FUNDS
FOR THE YEAR ENDED DECEMBER 31, 2016**

	<u>General Fund</u>	<u>Capital Improvement Fund</u>	<u>Revolving Loan Fund</u>	<u>TIF Funds</u>	<u>Other Governmental Funds</u>	<u>Total Governmental Funds</u>	
Revenue							
<i>Taxes:</i>							
311	General Property Taxes (Note 3)	\$ 2,782,087	\$ -	\$ -	\$ 55,987	\$ -	\$ 2,838,074
313	General Sales and Use Taxes	1,974,389	1,316,259	-	-	325,152	3,615,800
315	Amusement Taxes	816	-	-	-	-	816
319	Penalties and Interest on Delinquent Taxes	8,637	-	-	-	182	8,819
320	Licenses and Permits	701,532	-	-	-	-	701,532
<i>Intergovernmental Revenue:</i>							
331	Federal Grants	271,242	-	-	-	-	271,242
334	State Grants	23,879	-	-	-	-	23,879
335	Bank Franchise Tax	9,383	-	-	-	-	9,383
335	Liquor Tax Reversion	43,218	-	-	-	-	43,218
335	Motor Vehicle Licenses	89,135	-	-	-	-	89,135
335.1	Local Government Highway and Bridge Fund	139,375	-	-	-	-	139,375
338	County Highway and Bridge Reserve Tax	5,855	-	-	-	-	5,855
338	Port of Entry	12,981	-	-	-	-	12,981
339	Other	5,643	-	-	-	-	5,643
<i>Charges for Goods and Services:</i>							
341	General Government	1,426,532	220,273	-	-	36,500	1,683,305
342	Public Safety	58,066	-	-	-	-	58,066
345	Health	5,799	-	-	-	-	5,799
346	Culture and Recreation	252,426	-	-	-	-	252,426
349	Other	15,426	-	-	-	-	15,426
<i>Fines and Forfeits:</i>							
351	Court Fines and Costs	5,558	-	-	-	-	5,558
<i>Miscellaneous Revenue:</i>							
361	Investment Earnings	146,755	-	9,754	435	4,925	161,869
363	Special Assessments	-	-	-	-	25,212	25,212
362	Rentals/Airport Hangar Lease	17,069	-	-	-	-	17,069
367	Contributions and Donations from Private Sources	13,820	7,500	-	-	-	21,320
369	Other	9,404	-	-	-	11,344	20,748
Total Revenue		8,019,027	1,544,032	9,754	56,422	403,315	10,032,550

CITY OF STURGIS

STATEMENT OF REVENUES, EXPENDITURES, AND CHANGES IN FUND BALANCES (CONTINUED)
 GOVERNMENTAL FUNDS
 FOR THE YEAR ENDED DECEMBER 31, 2016

	<u>General Fund</u>	<u>Capital Improvement Fund</u>	<u>Revolving Loan Fund</u>	<u>TIF Funds</u>	<u>Other Governmental Funds</u>	<u>Total Governmental Funds</u>
Expenditures						
<i>General Government:</i>						
411 Legislative	220,584	-	-	-	-	220,584
414 Financial Administration	1,103,633	-	-	-	-	1,103,633
419 Other (Note 12)	1,812,729	8,890	-	-	59,835	1,881,454
<i>Public Safety:</i>						
421 Police	2,106,772	-	-	-	-	2,106,772
422 Fire	129,118	-	-	-	-	129,118
<i>Public Works:</i>						
431 Highway and Streets	799,621	14,349	-	-	-	813,970
435 Airport	58,794	-	-	-	-	58,794
437 Cemeteries	94,703	-	-	-	-	94,703
<i>Culture and Recreation:</i>						
451 Recreation	700,546	22,977	-	-	-	723,523
452 Parks	606,982	-	-	-	-	606,982
455 Library	322,830	13,400	-	-	1,420	337,650
456 Auditorium	38,829	-	-	-	-	38,829
460 Conservation and Development	-	-	1,000	-	272,209	273,209
470 Debt Service	-	785,207	-	159,868	-	945,075
485 Capital Outlay	117,776	1,459,880	-	2,034,767	-	3,612,423
Total Expenditures	8,112,917	2,304,703	1,000	2,194,635	333,464	12,946,719
Excess of Revenue Over (Under)						
Expenditures	(93,890)	(760,671)	8,754	(2,138,213)	69,851	(2,914,169)
Other Financing Sources (Uses)						
391.01 Transfers In (Note 7)	110,000	-	-	-	-	110,000
391.04 Compensation for Loss or Damage to Capital Assets	74,058	-	-	-	-	74,058
391.29 Other Long-Term Debt Issued	-	-	-	1,548,801	-	1,548,801
511 Transfers Out (Note 7)	(40,053)	-	-	-	-	(40,053)
Total Other Financing Sources (Uses)	144,005	-	-	1,548,801	-	1,692,806
Net Change in Fund Balances	50,115	(760,671)	8,754	(589,412)	69,851	(1,221,363)
Fund Balance, December 31, 2015	2,700,171	456,002	1,303,856	(1,100,779)	1,421,788	4,781,038
Fund Balance, December 31, 2016	\$ 2,750,286	\$ (304,669)	\$ 1,312,610	\$ (1,690,191)	\$ 1,491,639	\$ 3,559,675

The accompanying notes are an integral part of the financial statements.

CITY OF STURGIS

RECONCILIATION OF GOVERNMENTAL FUNDS STATEMENT OF REVENUES, EXPENDITURES AND CHANGES IN FUND BALANCES TO GOVERNMENT-WIDE STATEMENT OF ACTIVITIES FOR THE YEAR ENDED DECEMBER 31, 2016

Net Change in Fund Balances - Total Government Funds \$ (1,221,363)

Amounts reported for governmental activities in the Statement of Activities are different because:

Governmental funds report capital outlays as expenditures. However, in the Statement of Activities the cost of those assets is allocated over their estimated lives and reported as depreciation expense.	2,445,147
Capital assets transferred to water and sewer proprietary funds.	(498,483)
The governmental funds reflect proceeds from capital asset sales, if any, while the Statement of Activities reports a loss on sale or disposal of capital assets.	(26,120)
The governmental funds report grant revenue when the funds become available, while the Statement of Activities reports grant revenue when earned.	(265,608)
Governmental funds report property taxes and special assessments as revenue when funds become available, but the Statement of Activities includes the property tax and special assessments as revenue when earned.	15,634
Repayment of bond principal, tax increment financing, and long-term debt are expenditures in the governmental funds, but the repayment reduces long-term liabilities in the Statement of Net Position.	688,758
Borrowings on long-term debt is an other financing source in the governmental funds, but increases long-term debt in the Statement of Net Position.	(1,548,801)
Governmental funds do not reflect the change in accrued leave, but the Statement of Activities reflects the change in accrued leave through expenditures.	(8,083)
Accrued interest on long-term debt is not due and payable in the current period and therefore is not reported in the funds. The amount represents the change in accrued interest during the current period.	6,159
Changes in the pension related deferred outflows/inflows, pension liability and related pension expenses are not reported in the governmental fund statements.	(185,964)
Change in Net Position of Governmental Activities	\$ (598,724)

The accompanying notes are an integral part of the financial statements.

CITY OF STURGIS

STATEMENT OF NET POSITION
 PROPRIETARY FUNDS
 DECEMBER 31, 2016

Assets and Deferred Outflows of Resources	<u>Liquor</u> <u>Fund</u>	<u>Water</u> <u>Fund</u>	<u>Wastewater</u> <u>Fund</u>	<u>Sanitation</u> <u>Fund</u>	<u>Ambulance</u> <u>Fund</u>	<u>Total</u> <u>Proprietary</u> <u>Funds</u>
Current Assets						
101 Cash (Note 2)	\$ 4,000	\$ 630,236	\$ 256,749	\$ 423,541	\$ -	\$ 1,314,526
107 Restricted Cash (Note 5)	24,588	8,849	-	-	-	33,437
115 Accounts Receivable, Net	28,847	134,379	111,925	72,490	225,169	572,810
131 Due from Other Funds (Note 6)	-	270,526	151,194	249,414	-	671,134
142 Inventory of Supplies Purchased for Resale	472,423	-	-	-	-	472,423
155 Prepaid Expenses	3,408	3,008	2,002	3,016	3,991	15,425
Total Current Assets	533,266	1,046,998	521,870	748,461	229,160	3,079,755
Noncurrent Assets						
133 Advance to Other Funds (Note 6)	-	1,444,294	-	-	-	1,444,294
Capital Assets (Note 4)						
160 Land	6,500	1,800	646,214	84,167	-	738,681
162 Buildings	826,042	181,183	445,257	310,994	359,809	2,123,285
163 Accumulated Depreciation - Buildings	(150,190)	(71,870)	(201,620)	(99,228)	(89,353)	(612,261)
164 Improvements Other Than Buildings	-	17,110,647	11,336,832	22,789	-	28,470,268
165 Accumulated Depreciation - Improvements Other Than Buildings	-	(5,194,098)	(3,823,422)	(17,682)	-	(9,035,202)
166 Machinery and Equipment	55,030	837,256	694,834	2,416,772	982,793	4,986,685
167 Accumulated Depreciation - Machinery and Equipment	(15,962)	(633,437)	(597,279)	(2,018,630)	(574,604)	(3,839,912)
168 Construction in Progress	-	504,050	1,074,715	-	-	1,578,765
Total Noncurrent Assets	721,420	14,179,825	9,575,531	699,182	678,645	25,854,603
Total Assets	1,254,686	15,226,823	10,097,401	1,447,643	907,805	28,934,358
Deferred Outflows of Resources						
196 Pension Related Deferred Outflows (Note 8)	43,526	88,810	114,283	150,432	274,643	671,694
Total Assets and Deferred Outflows of Resources	\$ 1,298,212	\$ 15,315,633	\$ 10,211,684	\$ 1,598,075	\$ 1,182,448	\$ 29,606,052

Liabilities and Net Position	Liquor Fund	Water Fund	Wastewater Fund	Sanitation Fund	Ambulance Fund	Total Proprietary Funds
Current Liabilities						
202 Accounts Payable	\$ 125,679	\$ 100,583	\$ 324,962	\$ 17,768	\$ 15,915	\$ 584,907
208 Due to Other Funds (Note 6)	241,522	-	-	-	521,072	762,594
215 Accrued Interest Payable	13,362	18,786	2,242	-	-	34,390
216 Accrued Wages Payable	4,734	6,619	4,419	6,955	12,413	35,140
217 Accrued Taxes Payable	15,160	19	-	-	-	15,179
220 Customer Deposits	1,200	154,478	-	-	-	155,678
226 Bonds Payable - Current (Note 5)	10,840	199,065	160,420	-	-	370,325
233 Accrued Leave Payable (Note 5)	1,258	26,249	25,378	28,139	5,652	86,676
Total Current Liabilities	413,755	505,799	517,421	52,862	555,052	2,044,889
Long-Term Liabilities						
231 Bonds Payable (Note 5)	728,114	5,048,945	1,302,463	-	-	7,079,522
239 Net Pension Liability (Note 8)	21,805	57,108	43,059	67,098	100,966	290,036
242 Advance from Other Fund (Note 6)	-	-	159,669	-	-	159,669
Total Long-Term Liabilities	749,919	5,106,053	1,505,191	67,098	100,966	7,529,227
Total Liabilities	1,163,674	5,611,852	2,022,612	119,960	656,018	9,574,116
Net Position						
253.10 Net Investment in Capital Assets	-	7,487,521	8,112,648	699,182	678,645	16,977,996
253.21 Restricted for Revenue Bond Debt Service (Note 5)	24,588	8,849	-	-	-	33,437
253.29 Restricted for SDRS Pension Purposes (Note 8)	21,721	31,702	71,224	83,334	173,677	381,658
253.9 Unrestricted (Deficit)	88,229	2,175,709	5,200	695,599	(325,892)	2,638,845
Total Net Position	134,538	9,703,781	8,189,072	1,478,115	526,430	20,031,936
Total Liabilities and Net Position	\$ 1,298,212	\$ 15,315,633	\$ 10,211,684	\$ 1,598,075	\$ 1,182,448	\$ 29,606,052

The accompanying notes are an integral part of the financial statements.

CITY OF STURGIS

STATEMENT OF REVENUES, EXPENSES, AND CHANGES IN FUND NET POSITION
 PROPRIETARY FUNDS
 FOR THE YEAR ENDED DECEMBER 31, 2016

	<u>Liquor Fund</u>	<u>Water Fund</u>	<u>Wastewater Fund</u>	<u>Sanitation Fund</u>	<u>Ambulance Fund</u>	<u>Total Proprietary Funds</u>
Total Operating Revenue						
380 Charges for Goods and Services (Note 5)	\$ 2,386,063	\$ 1,810,586	\$ 1,231,674	\$ 1,395,109	\$ 1,080,784	\$ 7,904,216
Operating Expenses						
410 Personal Services	265,641	480,182	299,210	520,946	948,290	2,514,269
420 Other Current Expense	219,544	534,457	205,583	658,205	265,183	1,882,972
426.2 Materials (Cost of Goods Sold)	1,710,169	-	-	-	-	1,710,169
457 Depreciation (Note 4)	30,932	372,402	257,119	93,982	92,323	846,758
Total Operating Expenses	2,226,286	1,387,041	761,912	1,273,133	1,305,796	6,954,168
Operating Income (Loss)	159,777	423,545	469,762	121,976	(225,012)	950,048
Nonoperating Revenue (Expense)						
361 Investment Earnings (Note 2)	10,724	-	-	-	-	10,724
369 Other	678	14,000	-	20,594	65,932	101,204
391.40 Compensation for Loss or Damage to Capital Assets	-	-	-	-	1,848	1,848
442 Interest Expense	(29,799)	(164,368)	(32,947)	-	-	(227,114)
492 Gain (Loss) on Disposition of Assets	(9,385)	-	-	-	-	(9,385)
Total Nonoperating Revenue (Expense)	(27,782)	(150,368)	(32,947)	20,594	67,780	(122,723)
Income (Loss) before Transfers, Grants and Contributions	131,995	273,177	436,815	142,570	(157,232)	827,325
331 Federal Grants	-	-	-	-	34,385	34,385
391.07 Capital Contributions	-	304,848	193,635	-	-	498,483
391.10 Transfers In (Note 7)	-	28,053	-	12,000	-	40,053
511 Transfers Out (Note 7)	-	-	(100,000)	(10,000)	-	(110,000)
Total Transfers and Contributions	-	332,901	93,635	2,000	34,385	462,921
Change in Net Position	131,995	606,078	530,450	144,570	(122,847)	1,290,246
December 31, 2015	2,543	9,097,703	7,658,622	1,333,545	649,277	18,741,690
Net Position, December 31, 2016	\$ 134,538	\$ 9,703,781	\$ 8,189,072	\$ 1,478,115	\$ 526,430	\$ 20,031,936

The accompanying notes are an integral part of the financial statements.

CITY OF STURGIS

**STATEMENT OF CASH FLOWS
 PROPRIETARY FUNDS
 FOR THE YEAR ENDED DECEMBER 31, 2016**

	Liquor Fund	Water Fund	Wastewater Fund
Cash Flows from Operating Activities			
Receipts from Customers	\$ 2,387,212	\$ 1,821,393	\$ 1,226,443
Payments to Suppliers	(2,060,590)	(439,669)	(221,411)
Payments to Employees	(255,717)	(450,453)	(291,669)
Net Cash Flows Provided by (Used in) Operating Activities	70,905	931,271	713,363
Cash Flows from Noncapital Financing Activities			
Transfers In	-	28,053	-
Transfers Out	-	-	(100,000)
Internal Activity - Receipts from (Payments to) Other Funds	(1,837)	(220,040)	(202,586)
Cash Receipts from Notes Receivable	-	-	-
Net Cash Flows Provided by (Used in) Noncapital Financing Activities	(1,837)	(191,987)	(302,586)
Cash Flows from Capital and Related Financing Activities			
Purchases of Capital Assets	(34,173)	(713,398)	(98,043)
Principal Borrowings on Debt	-	-	-
Principal Paid on Debt	(10,982)	(195,121)	(168,920)
Interest Paid	(29,997)	(165,953)	(33,317)
Other Receipts	678	14,000	-
Net Cash Flows Provided by (Used in) Capital and Related Financing Activities	(74,474)	(1,060,472)	(300,280)
Cash Flows Provided by Investing Activities			
Cash Received from Investment Earnings	10,724	-	-
Increase (Decrease) in Cash and Cash Equivalents	5,318	(321,188)	110,497
Cash and Cash Equivalents, 2015	23,270	960,273	146,252
Cash and Cash Equivalents, 2016	\$ 28,588	\$ 639,085	\$ 256,749
Reconciliation of Operating Income to Net Cash Provided by (Used in) Operating Activities			
Operating Income (Loss)	\$ 159,777	\$ 423,545	\$ 469,762
<i>Adjustments to Reconcile Operating Income (Loss) to Net Cash</i>			
<i>Flows Provided by (Used in) Operating Activities:</i>			
Depreciation Expense	30,932	372,402	257,119
Change in Assets and Liabilities:			
Accounts Receivable	999	10,419	(5,231)
Inventory of Supplies Purchased for Resale	(143,992)	-	-
Prepaid Expenses	(1,014)	1,550	(53)
Pension Asset	23,814	48,028	63,161
Pension Related Deferred Outflows	(1,706)	(4,470)	(3,370)
Accounts Payable	12,827	93,296	(15,775)
Accrued Wages Payable	1,288	(479)	(4,311)
Accrued Taxes Payable	1,302	(58)	-
Customer Deposits	150	388	-
Accrued Leave Payable	127	944	2,900
Pension Liability	21,805	57,108	43,059
Pension Related Deferred Inflows	(35,404)	(71,402)	(93,898)
Net Cash Flows Provided by (Used in) Operating Activities	\$ 70,905	\$ 931,271	\$ 713,363
Noncash Capital and Related Financing Activities			
Loss on Sale of Capital Assets	\$ 9,385	\$ -	\$ -
Capital Assets Contributed	-	304,848	193,635
Purchase of Capital Assets with Long-Term Debt	-	-	712,501
Purchase of Capital Assets through Accounts Payable	-	-	277,121

The accompanying notes are an integral part of the financial statements.

Sanitation Fund	Ambulance Fund	Total Proprietary Funds
\$ 1,389,917	\$ 991,474	\$ 7,816,439
(674,083)	(241,686)	(3,637,439)
(501,117)	(938,838)	(2,437,794)
<u>214,717</u>	<u>(189,050)</u>	<u>1,741,206</u>
12,000	-	40,053
(10,000)	-	(110,000)
(109,619)	121,270	(412,812)
-	-	-
<u>(107,619)</u>	<u>121,270</u>	<u>(482,759)</u>
-	(34,385)	(879,999)
-	-	-
-	-	(375,023)
-	-	(229,267)
20,594	102,165	137,437
<u>20,594</u>	<u>67,780</u>	<u>(1,346,852)</u>
-	-	10,724
127,692	-	(77,681)
295,849	-	1,425,644
\$ 423,541	\$ -	\$ 1,347,963

\$ 121,976	\$ (225,012)	\$ 950,048
93,982	92,323	846,758
(5,192)	(89,310)	(88,315)
-	-	(143,992)
883	12,842	14,208
82,674	151,899	369,576
(5,253)	(7,903)	(22,702)
(16,761)	10,655	84,242
(6,156)	(3,874)	(13,532)
-	-	1,244
-	-	538
4,374	(5,816)	2,529
67,098	100,966	290,036
(122,908)	(225,820)	(549,432)
\$ 214,717	\$ (189,050)	\$ 1,741,206

\$ -	\$ -	\$ 9,385
-	-	498,483
-	-	712,501
-	-	277,121

CITY OF STURGIS

NOTES TO FINANCIAL STATEMENTS DECEMBER 31, 2016

(1) Summary of Significant Accounting Policies

Reporting Entity

The reporting entity of the City of Sturgis (the City), consists of the primary government (which includes all of the funds, organizations, institutions, agencies, departments, and offices that make up the legal entity, plus those funds for which the primary government has a fiduciary responsibility; those 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 their exclusion would cause the financial reporting entity's financial statements to be misleading or incomplete).

Basis of Presentation

Government-wide Financial Statements:

The Statement of Net Position and Statement of Activities display information about the reporting entity as a whole. They include all funds of the reporting entity except for fiduciary funds. The statements distinguish between governmental and business-type activities. Governmental activities generally are financed through taxes, intergovernmental revenues, and other non-exchange revenues. Business-type activities are financed in whole or in part by fees charged to external parties for goods or services.

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 (a) charges paid by recipients of goods and services offered by the programs and (b) grants and contributions that are restricted to meeting the operational or capital requirements of a particular program. Revenues that are not classified as program revenues, including all taxes, are presented as general revenues.

Fund Financial Statements:

Fund financial statements of the reporting entity are organized into funds, each of which is considered to be a separate accounting entity. Each fund is accounted for by providing a separate set of self-balancing accounts that constitute its assets, liabilities, fund equity, revenues, and expenditures/expenses. Funds are organized into three major categories: governmental, proprietary, and fiduciary. An emphasis is placed on major funds within the governmental and proprietary categories. A fund is considered major if it is the primary operating fund of the City or it meets the following criteria:

1. Total assets, liabilities and deferred inflows and outflows of resources, revenues, or expenditures/expenses of the individual governmental or enterprise fund are at least 10 percent of the corresponding total for all funds of that category or type, and
2. Total assets, liabilities and deferred inflows and outflows of resources, revenues, or expenditures/expenses of the individual governmental or enterprise fund are at least 5 percent of the corresponding total for all governmental and enterprise funds combined, or
3. Management has elected to classify one or more governmental or enterprise funds as major for consistency in reporting from year to year, or because of public interest in the fund's operations.

CITY OF STURGIS

**NOTES TO FINANCIAL STATEMENTS (CONTINUED)
DECEMBER 31, 2016**

(1) Summary of Significant Accounting Policies (Continued)

Basis of Presentation (Continued)

The major funds of the City financial reporting entity are described below:

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. The general fund is always considered to be a major fund.

Special Revenue Funds - special revenue funds are used to account for the proceeds of specific revenue sources (other than trusts for individuals, private organizations, or other governments or for major capital projects) that are legally restricted to expenditures for specified purposes.

Capital Improvement Fund – Under Ordinance 2012-01, at least 40 percent of the tax levied under Title 20 Tax, Chapter 20.01 Municipal Sales and Service Tax, and Use Tax shall be used only for capital improvements, land acquisition, debt reduction, and the purchase of machinery and equipment. This is a major fund.

Revolving Loan Fund - to account for federal grants and other municipal monies used for financing improvements. The fund may be used both to pay the portion of the cost of an improvement and to advance the portion of such costs to businesses which are to be repaid over a period of years. This is a major fund.

Debt Service Funds - debt service funds are used to account for the accumulation of resources for, and the payment of, general long-term debt principal, interest, and related costs. The City has the following debt service fund:

TIF Debt Service Fund – TIF funds are Tax Increment Financing Districts allowed by SDCL 11-9-24 to account for the proceeds of incremental property taxes, restricted for the payment of principal and interest on debt issued to finance a public improvement. Separate accounts are maintained for TIF Districts #9, #10, #11, #12, and #13 revenues and expenditures. This is a major fund.

Capital Projects Funds - capital projects funds are used to account for financial resources to be used for the acquisition or construction of major capital facilities (other than those financed by proprietary funds or trust funds for individuals, private organizations, or other governments). There are no major capital projects funds.

Permanent Funds - permanent funds are used to report resources that are legally restricted to the extent that only earnings, and not principal, may be used for purposes that support the City's programs - that is for the benefit of the City and its citizenry. There are no major permanent funds.

Proprietary Funds:

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.

CITY OF STURGIS

**NOTES TO FINANCIAL STATEMENTS (CONTINUED)
DECEMBER 31, 2016**

(1) Summary of Significant Accounting Policies (Continued)

Basis of Presentation (Concluded)

Proprietary Funds (Continued):

Proprietary Funds include:

Liquor Fund - financed primarily by the sale of liquor; this fund accounts for construction and operation of the City liquor store. This is a major fund.

Water Fund - financed primarily by user charges; this fund accounts for the construction and operation of the City waterworks system and related facilities (SDCL 9-47-1). This is a major fund.

Wastewater Fund - financed primarily by user charges; this fund accounts for the construction and operation of the City sanitary sewer system and related facilities (SDCL 9-48-2). This is a major fund.

Sanitation Fund - financed primarily by user charges; this fund accounts for the construction and operation of the City rubble site and collection and disposal of solid waste and includes activity from the Special Sanitation Fund. This is a major fund.

Ambulance Fund - financed primarily by user charges; this fund accounts for construction and operation of the City ambulance service. This is a major fund.

Measurement Focus and Basis of Accounting

Measurement focus is a term used to describe how transactions are recorded within the various financial statements. Basis of accounting refers to when revenues and expenditures or expenses are recognized in the accounts and reported in the financial statements, regardless of the measurement focus.

Measurement Focus:

Government-wide Financial Statements:

In the government-wide Statement of Net Position and Statement of Activities, both governmental and business-type activities are presented using the economic resources measurement focus, applied on the accrual basis of accounting.

Non-exchange transactions, in which the City gives (or receives) value without directly receiving (or giving) equal value in exchange, include property taxes, grants, entitlements and donations. On an accrual basis, revenue from property taxes is recognized in the fiscal year for which the taxes are levied. Revenues from grants, entitlements and donations are recognized in the year in which all eligibility requirements have been satisfied.

Fund Financial Statements:

In the fund financial statements, the current financial resources measurement focus and the modified accrual basis of accounting are applied to governmental funds, while the economic resources measurement focus and the accrual basis of accounting are applied to the proprietary and fiduciary funds.

CITY OF STURGIS

**NOTES TO FINANCIAL STATEMENTS (CONTINUED)
DECEMBER 31, 2016**

(1) Summary of Significant Accounting Policies (Continued)

Measurement Focus and Basis of Accounting (Continued)

Basis of Accounting:

Government-wide Financial Statements:

In the Government-wide Statement of Net Position and Statement of Activities, governmental and business-type activities are presented using the accrual basis of accounting. Under the accrual basis of accounting, revenues and related assets are recorded when earned (usually when the right to receive cash vests); and expenses and related liabilities are recorded when an obligation is incurred (usually when the obligation to pay cash in the future vests).

Fund Financial Statements:

All governmental fund types are accounted for using the modified accrual basis of accounting. Their revenues, including property taxes, are recognized when they become measurable and available. Available means resources are collected or to be collected soon enough after the end of the fiscal year that they can be used to pay the bills of the current period. The accrual period for the City does not exceed one bill-paying cycle, and for the City, the length of that cycle is 60 days. The revenues which are accrued at December 31, 2016 are sales tax revenues and intergovernmental revenue.

Under the modified accrual basis of accounting, receivables may be measurable, but not available. Available means collectible within the current period or soon enough thereafter to be used to pay liabilities of the current period. Reported deferred inflows of resources are those where asset recognition criteria have been met, but for which revenue recognition criteria have not been met.

Expenditures are generally recognized when the related fund liability is incurred. Exceptions to this general rule include principal and interest on general long-term debt, which are recognized when due.

All proprietary funds are accounted for using the accrual basis of accounting. Their revenues are recognized when they are earned, and their expenses are recognized when they are incurred.

Interfund Eliminations and Reclassifications

Government-wide Financial Statements:

In the process of aggregating data for the government-wide financial statements, some amounts reported as interfund activity and balances in the fund financial statements have been eliminated or reclassified, as follows:

In order to minimize the grossing-up effect on assets and liabilities within the governmental and business-type activities columns of the primary government, amounts reported as interfund receivables and payables have been eliminated in the governmental and business-type activities columns, except for the net, residual amounts due between governmental and business-type activities, which are presented as internal balances.

CITY OF STURGIS

**NOTES TO FINANCIAL STATEMENTS (CONTINUED)
DECEMBER 31, 2016**

(1) Summary of Significant Accounting Policies (Continued)

Interfund Eliminations and Reclassifications (Continued)

Fund Financial Statements:

Noncurrent portions of long-term interfund receivables (reported in Advance to asset accounts) are equally offset by a nonspendable fund balance account which indicates that they do not constitute available spendable resources since they are not a component of net current assets. Current portions of interfund receivables (reported in Due from asset accounts) are considered available spendable resources.

Capital Assets

Capital assets include land, buildings, machinery and equipment, and all other tangible or intangible assets that are used in operations and that have initial useful lives extending beyond a single reporting period. Infrastructure assets are long-lived capital assets that normally are stationary in nature and can be preserved for a significantly greater number of years than most capital assets.

The accounting treatment over capital assets depends on whether the assets are used in governmental fund operations or proprietary fund operations and whether they are reported in the government-wide or fund financial statements.

Government-wide Financial Statements:

Capital assets are recorded at historical cost, or estimated cost, where actual cost could not be determined. Donated capital assets are valued at their estimated fair value on the date donated. Reported cost values include ancillary charges necessary to place the asset into its intended location and condition for use. Subsequent to initial capitalization, improvements or betterments that are significant and which extend the useful life of a capital asset are also capitalized.

For governmental activities capital assets, construction-period interest is not capitalized, in accordance with USGAAP; while for capital assets used in business-type activities; construction-period interest is capitalized in accordance with USGAAP.

Infrastructure assets used in general government operations, consisting of certain improvements other than buildings, including roads, bridges, sidewalks, drainage systems, and lighting systems, acquired prior to January 1, 2004, were not required to be capitalized by the City. Infrastructure assets acquired since January 1, 2004, are recorded at cost, and classified as "Improvements Other than Buildings."

Depreciation of all exhaustible capital assets is recorded as an allocated expense in the Government-wide Statement of Activities. Accumulated depreciation is reported on the Government-wide Statement of Net Position and on each proprietary fund's Statement of Net Position/Balance Sheet.

Capitalization thresholds (the dollar values above which asset acquisitions are added to the capital asset accounts), depreciation methods, and estimated useful lives of capital assets reported in the government-wide statements and proprietary funds are as follows:

	<u>Capitalization Threshold</u>	<u>Depreciation Method</u>	<u>Estimated Useful Life</u>
Land	\$ -0-	----N/A-----	---N/A-----
Buildings	\$ 15,000	Straight-line	10-50 years
Improvements Other Than Buildings	\$ 15,000	Straight-line	10-50 years
Machinery and Equipment	\$ 10,000	Straight-line	5-40 years

CITY OF STURGIS

NOTES TO FINANCIAL STATEMENTS (CONTINUED) DECEMBER 31, 2016

(1) Summary of Significant Accounting Policies (Continued)

Capital Assets (Continued)

Land is an inexhaustible capital asset and is not depreciated.

Fund Financial Statements:

In the fund financial statements, capital assets used in governmental fund operations are accounted for as capital outlay expenditures of the appropriate governmental fund upon acquisition. Capital assets used in proprietary fund operations are accounted for on the accrual basis, the same as in the government-wide statements.

Long-Term Liabilities

The accounting treatment of long-term liabilities depends on whether the assets are used in governmental fund operations or proprietary fund operations and whether they are reported in the government-wide or fund financial statements.

All long-term liabilities to be repaid from governmental and business-type resources are reported as liabilities in the government-wide statements. The long-term liabilities primarily consist of general obligation bonds, revenue bonds, tax increment financing, contract payable, and compensated absences.

In the fund financial statements, debt proceeds are reported as revenues (other financing sources), while payments of principal and interest are reported as expenditures when they become due. The accounting for proprietary fund long-term debt is on the accrual basis, the same in the fund statements as in the government-wide statements.

Program Revenues

Program revenues derive directly from the program itself or from parties other than the City's taxpayers or citizenry, as a whole. Program revenues are classified into three categories, as follows:

1. Charges for services – These arise from charges to customers, applicants, or others who purchase, use, or directly benefit from the goods, services, or privileges provided, or are otherwise directly affected by the services.
2. Program-specific operating grants and contributions – These arise from mandatory and voluntary non-exchange transactions with other governments, organizations, or individuals that are restricted for use in a particular program.
3. Program-specific capital grants and contributions – These arise from mandatory and voluntary non-exchange transactions with other governments, organizations, or individuals that are restricted for the acquisition of capital assets for use in a particular program.

Proprietary Funds Revenue and Expense Classifications

In the proprietary funds' Statement of Activities, revenues and expenses are classified in a manner consistent with how they are classified in the Statement of Cash Flows. That is, transactions for which related cash flows are reported as capital and related financing activities, noncapital financing activities, or investing activities are not reported as components of operating revenues or expenses.

Cash and Cash Equivalents

The City pools the cash resources of its funds for cash management purposes. The proprietary funds essentially have access to the entire amount of their cash resources on demand. Accordingly, each proprietary fund's equity in the cash management pool is considered to be cash and cash equivalents for the purpose of the Statement of Cash Flows.

CITY OF STURGIS

**NOTES TO FINANCIAL STATEMENTS (CONTINUED)
DECEMBER 31, 2016**

(1) Summary of Significant Accounting Policies (Continued)

Equity Classifications

Government-wide Financial Statements:

Equity is classified as net position and is displayed in three components:

1. Net investment in capital assets – Consists of capital assets, including restricted capital assets, net of accumulated depreciation (if applicable) and reduced by the outstanding balances of any bonds, mortgages, notes, or other borrowings that are attributable to the acquisition, construction, or improvement of those assets.
2. Restricted net position – Consists of net position with constraints placed on their use either by (a) external groups such as creditors, grantors, contributors, or laws and regulations of other governments; or (b) law through constitutional provisions or enabling legislation.
3. Unrestricted net position – All other net position that do not meet the definition of restricted or net investment in capital assets.

Fund Financial Statements:

The City classifies governmental fund balance as follows:

Nonspendable – includes fund balance amounts that cannot be spent either because it is not in spendable form or because of legal or contractual constraints.

Restricted – includes fund balance amounts that are constrained for specific purposes which are externally imposed by providers, such as creditors or amounts constrained due to constitutional provisions or enabling legislation.

Committed – includes fund balance amounts that are constrained for specific purposes that are internally imposed by the government through formal action of the highest level of decision making authority and does not lapse at year-end. The City has two committed fund balances for the year ended December 31, 2016. The Brick Fund and Capital Improvement Fund were created through ordinances passed by the City Council, the highest decision making authority. The City Council would have to pass ordinances to remove the commitments. However, due to a deficit fund balance at year-end, the Capital Improvement fund is presenting a negative unassigned fund balance, rather than a committed balance.

Assigned – includes fund balance amounts that are intended to be used for specific purposes that are neither considered restricted or committed. Fund balance may be assigned by the City Council, Mayor, or Finance Officer.

Unassigned – includes positive fund balance within the General Fund which has not been classified within the above-mentioned categories and negative fund balances in other governmental funds.

CITY OF STURGIS

NOTES TO FINANCIAL STATEMENTS (CONTINUED)
DECEMBER 31, 2016

(1) Summary of Significant Accounting Policies (Continued)

Equity Classifications (Continued)

With regard to the City's governmental funds, the City uses restricted amounts first when both restricted and unrestricted fund balances are available unless there are legal documents/contracts that prohibit doing this, such as a grant agreement requiring dollar-for-dollar spending. Additionally, the City would first use committed, then assigned, and lastly unassigned amounts of unrestricted fund balance when expenditures are made. The City set a minimum fund balance policy within the general fund to keep on hand at least two months of regular fund operating revenues or regular general fund operating expenditures.

Proprietary fund equity is classified the same as in the government-wide financial statements. The City does not have a formal minimum fund balance policy. With regard to the City's proprietary funds, it is the City's policy to first use restricted net position, prior to the use of unrestricted net position, when an expense is incurred for purposes for which both restricted and unrestricted net position are available.

As of December 31, 2016, the City had the following governmental fund classifications:

	General Fund	Capital Improvement Fund	Revolving Loan Fund	TIF Funds	Other Governmental Funds	Total Governmental Funds
263 Nonspendable:						
263.01 Nonspendable - Inventory	\$ 1,485	\$ -	\$ -	\$ -	\$ -	\$ 1,485
263.02 Nonspendable - Prepaid Expenses	37,087	-	-	-	-	37,087
263.04 Nonspendable - Advances	1,230,420	-	559,669	-	-	1,790,089
263.49 Nonspendable - SDPAA Reserve (Note 9)	135,844	-	-	-	-	135,844
263.51 Nonspendable - Perpetual Care Cemetery	-	-	-	-	50,000	50,000
263.99 Nonspendable - Library Trust	-	-	-	-	327,535	327,535
	1,404,836	-	559,669	-	377,535	2,342,040
264 Restricted:						
264.01 Restricted - Debt Service	-	625,765	-	-	-	625,765
264.03 Restricted - Perpetual Care Cemetery	-	-	-	-	125,396	125,396
264.04 Restricted - BBB Tax	-	-	-	-	726,387	726,387
264.05 Restricted - Library Purposes	-	-	-	-	253,830	253,830
264.09 Restricted - BID Tax	-	-	-	-	8,491	8,491
264.97 Restricted - Revolving Loan	-	-	752,941	-	-	752,941
	-	625,765	752,941	-	1,114,104	2,492,810
265 Committed						
265.97 Committed - Brick Fund	131,845	-	-	-	-	131,845
266 Assigned						
266.01 Assigned - Subsequent Year's Budget	73,165	-	-	-	-	73,165
267 Unassigned	1,140,440	(930,434)	-	(1,690,191)	-	(1,480,185)
Total Fund Balances	\$ 2,750,286	\$ (304,669)	\$ 1,312,610	\$ (1,690,191)	\$ 1,491,639	\$ 3,559,675

CITY OF STURGIS

**NOTES TO FINANCIAL STATEMENTS (CONTINUED)
DECEMBER 31, 2016**

(1) Summary of Significant Accounting Policies (Concluded)

Inventory of Supplies Purchased for Resale

Inventory consists of inventory held for resale, which is recorded at the lower of cost or market, using the first-in, first-out method. Inventory is recorded as an asset at the time of purchase, and charged to expense as it is consumed.

Compensated Absences

Full time employees earn up to two weeks of paid vacation, three weeks after the employee has been employed for five years, and four weeks after the employee has been employed for ten years. Maximum annual accrued carryover is forty hours. Upon termination, an employee is entitled to receive compensation for their accrued annual leave balance at their normal wage rate.

Sick leave is earned by full-time employees at the rate of eight hours per month to a maximum of 1,000 hours. Upon termination, employees are not entitled to receive compensation for their accrued sick leave balance unless they have been employed for ten years, at which time they receive half of their accumulated sick leave at three-quarters of their normal wage rate.

Deferred Inflows and Deferred Outflows of Resources

In addition to assets, the statement of net position reports a separate section for deferred outflows of resources. Deferred outflows of resources represent consumption of net position that applies to a future period or periods. These items will not be recognized as an outflow of resources until the applicable future period. Deferred outflows of resources consist of pension activity.

In addition to liabilities, the statement of net position and governmental funds balance sheet report a separate section for deferred inflows of resources. Deferred inflows of resources represent acquisitions of net position that applies to a future period or periods. These items will not be recognized as an inflow of resources until the applicable future period. Deferred inflows of resources consist primarily of property taxes, special assessments and federal grant funds in the governmental fund balance sheet.

Receivables and Payables

Receivables and payables are not aggregated in these financial statements. The City expects all receivables to be collected within one year. Included in accounts receivable at December 31, 2016 is an allowance for doubtful accounts totaling \$10,000 for the general fund. Included in utility accounts receivable at December 31, 2016 are allowances for doubtful accounts totaling approximately \$3,000, \$4,000, \$4,000 and \$757,000 for the water, wastewater, sanitation and ambulance funds, respectively.

(2) Deposits and Investments

The City follows the practice of aggregating the cash assets of various funds to maximize cash management efficiency and returns. Various restrictions on deposits and investments are imposed by statutes. These restrictions are summarized below:

Deposits - The City's cash deposits are made in qualified public depositories as defined by SDCL 4-6A-1, 9-22-6, 9-22-6.1 and 9-22-6.2, and may be in the form of demand or time deposits. Qualified depositories are required by SDCL 4-6A-3 to maintain at all times, segregated from their other assets, eligible collateral having a value equal to at least 100 percent of the public deposit accounts which exceed deposit insurance such as the FDIC and NCUA. In lieu of pledging eligible securities, a qualified public depository may furnish irrevocable standby letters of credit issued by Federal Home Loan Banks accompanied by written evidence of that bank's public debt rating, which may not be less than "AA" or a qualified public depository may furnish a corporate surety bond of a corporation duly authorized to do business in South Dakota.

CITY OF STURGIS

**NOTES TO FINANCIAL STATEMENTS (CONTINUED)
DECEMBER 31, 2016**

(2) Deposits and Investments (Continued)

Investments - In general, SDCL 4-5-6 permits City funds to be invested only in (a) securities of the United States and securities guaranteed by the United States Government either directly or indirectly; or (b) repurchase agreements fully collateralized by securities described in (a) above; or in shares of an open-end, no-load fund administered by an investment company whose investments are in securities described in (a) above and repurchase agreements described in (b) above. Also, SDCL 4-5-9 requires investments to be in the physical custody of the political subdivision or may be deposited in a safekeeping account with any bank or trust company designated by the political subdivision as its fiscal agent.

The City categorizes its fair value measurements within the fair value hierarchy established by generally accepted accounting principles. The hierarchy is based on the valuation inputs used to measure the fair value of the asset. Level 1 inputs are quoted prices in active markets for identical assets; Level 2 inputs are significant other observable inputs; Level 3 inputs are significant unobservable inputs.

As of December 31, 2016, the City had the following investments:

Investments	Credit Rating	Maturity	Fair Value
Treasury Money Market	N/A	N/A	\$ 55,724
Negotiable Certificates of Deposits	N/A	1-5 Years	982,737
			\$ 1,038,461

Money markets and negotiable certificates of deposit are measured as level 2 recurring fair value measurements according to the fair value hierarchy.

State law allows income from deposits and investments to be credited to either the general fund or the fund making the investment. The City’s policy is to credit all income from deposits and investments to the General Fund, including investment income generated by the Perpetual Maintenance Fund, which must be credited to the General Fund, and used only for maintenance for the municipal cemetery, as required by SDCL 9-32-18. USGAAP, on the other hand, requires income from deposits and investments to be reported in the fund whose assets generated that income except where legal or contractual requirements require investment income to be credited to a fund other than the one associated with the assets. Where the governing board has discretion to credit investment income to a fund other than the fund that provided the resources for investment, a transfer to the designated fund is reported. Accordingly, in the fund financial statements, interfund transfers of investment earnings are reported, while in the government-wide financial statements, they have been eliminated, except for the net amounts transferred between governmental activities and business-type activities. Liquor Fund interest income consists of monies received from Build America Bonds, not income generated from bank account balances.

CITY OF STURGIS

**NOTES TO FINANCIAL STATEMENTS (CONTINUED)
DECEMBER 31, 2016**

(2) Deposits and Investments (Continued)

Interest Rate Risk:

The City limits interest rate risk by structuring the portfolio to meet the cash requirements of ongoing operations, thereby mitigating the need to liquidate securities at a loss prior to maturity.

Credit Risk:

State law limits eligible investments for the City as discussed above. The City will further reduce credit risk by limiting the portfolio to interest bearing checking accounts, savings accounts, US Treasury bills, bonds, notes, US Government Agencies, certificates of deposit, certificates of deposit purchased through CDARS, money market mutual funds, repurchase agreements fully collateralized by allowable securities, and local government investment pool (SD FIT).

Custodial Credit Risk:

Custodial credit risk is the risk that, in the event of a depository failure, the City’s deposits may not be returned to it. The City will minimize custodial credit risk for deposits by requiring the financial institution to submit a copy of their collateralization report to the finance officer to determine whether the financial institution is in compliance with SDCL 4-6A and 51A-10-9. As of December 31, 2016, the City’s deposits in financial institutions collateralized by securities held by the pledging financial institution were as follows:

	<u>Bank Balance</u>
Insured - FDIC	\$ 522,449
Uninsured, collateralized in accordance with SDCL 4-6A-3	3,164,684
Total Deposits	\$ 3,687,133

Concentration Risk:

The City will minimize concentration of credit risk by diversifying the investment portfolio so that the impact of potential losses from any one type of security or issuer will be minimized. Investments issued or explicitly guaranteed by the U.S. government and investments in mutual funds, external investment pools, and other pooled investments are excluded from this requirement. More than five percent of the City’s certificates of deposit are in: American Express (9.7 percent), Capital One Bank (12.1 percent), GE Capital (24.6 percent), Goldman Sachs (24.1 percent), and Discover Bank (24.6 percent).

(3) Property Taxes

Property taxes are levied on or before October 1 and payable in two installments before April 30 and October 31 of the following year. They attach as an enforceable lien on property as of January 1 of each year. The county bills and collects the taxes and remits them to the City.

CITY OF STURGIS

**NOTES TO FINANCIAL STATEMENTS (CONTINUED)
DECEMBER 31, 2016**

(3) Property Taxes (Continued)

The City is permitted by several state statutes to levy the following amounts of taxes per \$1,000 of taxable valuation on taxable real property in the City:

General Fund	\$27
Bond Redemption Funds	Amounts Required by Bond Agreements
Judgment Fund (Upon Judgment Being Made)	\$10

State statute allows the tax rates to be raised by special election of the voters.

(4) Changes in Capital Assets

A summary of changes in capital assets for year ending December 31 is as follows:

	Balance 12/31/2015	Additions	Transfers/ Deletions	Balance 12/31/2016
<i>Governmental Activities:</i>				
Capital Assets, not being Depreciated:				
Land	\$ 2,793,024	\$ 130,791	\$ -	\$ 2,923,815
Construction Work in Progress	585,476	2,629,355	(2,832,290)	382,541
Total Capital Assets, not being Depreciated	3,378,500	2,760,146	(2,832,290)	3,306,356
Capital Assets, being Depreciated:				
Buildings	12,797,855	424,753	166,822	13,389,430
Improvements Other Than Buildings	30,268,822	293,548	2,166,985	32,729,355
Machinery and Equipment	4,613,855	133,976	(31,219)	4,716,612
Total Capital Assets, being Depreciated	47,680,532	852,277	2,302,588	50,835,397
Less Accumulated Depreciation for:				
Buildings	4,393,434	288,880	-	4,682,314
Improvements Other Than Buildings	8,143,398	661,901	-	8,805,299
Machinery and Equipment	2,633,611	216,495	(5,099)	2,845,007
Total Accumulated Depreciation	15,170,443	1,167,276	(5,099)	16,332,620
Total Governmental Activities Capital Assets, being Depreciated, Net	32,510,089	(314,999)	2,307,687	34,502,777
Total Governmental Capital Assets, Net	\$ 35,888,589	\$ 2,445,147	\$ (524,603)	\$ 37,809,133

Depreciation expense was charged to functions as follows:

Public Works	\$ 533,903
Culture and Recreation	273,455
General Government	256,630
Public Safety	103,288
Total Depreciation Expense - Governmental	\$ 1,167,276

CITY OF STURGIS

**NOTES TO FINANCIAL STATEMENTS (CONTINUED)
DECEMBER 31, 2016**

(4) Changes in Capital Assets (Continued)

	Balance 12/31/2015	Additions	Transfers/ Deletions	Balance 12/31/2016
<i>Business-Type Activities:</i>				
Capital Assets, not being Depreciated:				
Land	\$ 738,681	\$ -	\$ -	\$ 738,681
Construction Work in Progress	20,937	2,056,311	(498,483)	1,578,765
Total Capital Assets, not being Depreciated	759,618	2,056,311	(498,483)	2,317,446
Capital Assets, being Depreciated:				
Buildings	2,123,285	-	-	2,123,285
Improvements Other Than Buildings	27,756,603	215,182	498,483	28,470,268
Machinery and Equipment	4,926,425	96,611	(36,351)	4,986,685
Total Capital Assets, being Depreciated	34,806,313	311,793	462,132	35,580,238
Less Accumulated Depreciation for:				
Buildings	551,626	60,635	-	612,261
Improvements Other Than Buildings	8,466,262	568,940	-	9,035,202
Machinery and Equipment	3,649,695	217,183	(26,966)	3,839,912
Total Accumulated Depreciation	12,667,583	846,758	(26,966)	13,487,375
Total Business-Type Activities Capital Assets, being Depreciated, Net	22,138,730	(534,965)	(489,098)	22,092,863
Total Business-Type Capital Assets, Net	\$ 22,898,348	\$ 1,521,346	\$ (9,385)	\$ 24,410,309

Depreciation expense was charged to functions as follows:

Ambulance	\$ 92,323
Wastewater	257,119
Water	372,402
Sanitation	93,982
Liquor	30,932
Total Depreciation Expense - Business-Type	\$ 846,758

CITY OF STURGIS

**NOTES TO FINANCIAL STATEMENTS (CONTINUED)
DECEMBER 31, 2016**

(5) Long-Term Debt

The following is a summary of the long-term debt transactions for the year ending December 31:

	Balance 12/31/2015	Additions	Deletions	Balance 12/31/2016	Due Within One Year
Primary Government:					
Governmental Activities:					
2008 Revenue Bonds	\$ 3,320,000	\$ -	\$ 500,000	\$ 2,820,000	\$ 520,000
Tax Increment Financing Obligations	57,583	1,548,801	57,583	1,548,801	-
2nd Street Plaza	1,128,596	-	131,175	997,421	45,492
Compensated Absences	208,782	203,763	195,680	216,865	216,865
Total Governmental Activities	4,714,961	1,752,564	884,438	5,583,087	782,357
Business-Type Activities:					
2010 GO Crossover Refunding Bonds	775,000	-	175,000	600,000	165,000
2010 Sales Tax Revenue Bond	749,936	-	10,982	738,954	10,840
2009 Drinking Water Revenue Bond	302,753	-	54,952	247,801	56,198
2009 Clean Water Revenue Bond	229,552	-	13,170	216,382	13,570
2011 Drinking Water Revenue Bond	3,152,871	-	41,359	3,111,512	42,743
2012 Drinking Water Revenue Bond	1,902,257	-	79,560	1,822,697	81,974
Pioneer Bank Loan	-	712,501	-	712,501	-
Compensated Absences	84,147	105,730	103,201	86,676	86,676
Total Business-Type Activities	7,196,516	818,231	478,224	7,536,523	457,001
Total Primary Government	\$ 11,911,477	\$ 2,570,795	\$ 1,362,662	\$ 13,119,610	\$ 1,239,358

The City has restricted reserves of \$625,765, \$24,588, and \$8,849 at December 31, 2016, in accordance with debt covenants.

The City has pledged future sales tax revenue and revenues of the Water and Wastewater Funds for the retirement of debt issues associated with those funds through the maturity dates listed below. All debt secured by pledged revenues funded capital projects and improvements. The current principal balance plus interest at the stated applicable rate over the life of the debt represents the amount of future revenue pledged. Below is a comparison of principal and interest payments and total pledged revenue for the current year.

	Water Fund	Wastewater Fund	Sales Tax Revenue
Current Year Principal and Interest	\$ 359,489	\$ 201,867	\$ 653,246
Pledged Revenue	1,810,586	1,231,674	3,615,800

CITY OF STURGIS

**NOTES TO FINANCIAL STATEMENTS (CONTINUED)
DECEMBER 31, 2016**

(5) Long-Term Debt (Continued)

Debt payable at December 31, 2016, is comprised of the following:

General Obligation

General Obligation Crossover Refunding Bonds, Series 2010A for \$2,210,000, matures in June 2021, interest at 2.25 to 3.65 percent, due in semi-annual installments of \$30,000 to \$155,000. Financed through Water and Wastewater Funds. \$ 600,000

Revenue Bonds

Sales Tax Refunding Bonds, 2008 Series for \$6,470,000, mature in March 2020, interest at 3.30 to 3.80 percent, due in variable annual installments. Sales tax revenues pledged and financed through the Capital Improvement Fund. 2,820,000

Sales Tax Revenue Bonds, Series 2010 (Build America Bonds - Direct Pay), for \$811,000, mature in July 2050, interest at a fixed 4.00 percent, due in annual installments of \$40,980. Sales tax revenues pledged and financed through the Liquor Fund. The City will receive a credit from the Federal government for 35 percent of the interest paid on the bonds. 738,954

Drinking Water Revenue Borrower Bond, 2009 Series for \$547,576, mature in January 2021, interest at a fixed 2.25 percent, due in quarterly installments of \$15,325. Water revenues pledged and financed through the Water Fund. 247,801

Clean Water Revenue Borrower Bond, 2009 Series for \$298,617, mature in October 2030, interest at a fixed 3.00 percent, due in quarterly installments of \$4,977. Wastewater revenues pledged and financed through the Wastewater Fund. 216,382

Drinking Water Revenue Borrower Bond, 2011 Series for \$3,200,000, matures in September 2054, interest at a fixed 3.25 percent due in monthly installments of \$11,936. Water revenues pledged and financed through the Water Fund. 3,111,512

Drinking Water Revenue Borrower Bond, Series 2012 for \$2,035,893, mature in July 2034, interest at a fixed 3.00 percent, due in quarterly installments of \$33,935. Water revenues pledged and financed through the Water Fund. 1,822,697

Note Payable

Note Payable to First Interstate Bank, matures with a balloon payment in 2019, interest at a fixed 3.75 percent, due in monthly installments of \$7,116. Financed through Capital Improvement Fund. 997,421

Note Payable to Pioneer Bank for \$3,052,000, matures with a balloon payment in 2036, interest at a fixed 3.85 percent, due in monthly installments of \$19,186. Financed through Wastewater Fund. 712,501

Tax Increment Financing Obligations

TIF #12 maximum borrowings of \$1,900,000, including interest not to exceed 10 percent per annum, due in varying installments within 30 days of property tax collections from the County. Financed through TIF Debt Service Funds. 1,548,801

Total Bonds, Contract Payable, and TIF Obligations **12,816,069**

CITY OF STURGIS

NOTES TO FINANCIAL STATEMENTS (CONTINUED)
DECEMBER 31, 2016

(5) Long-Term Debt (Continued)

Compensated Absences:

General Fund	216,865
Liquor Fund	1,258
Water Fund	26,249
Wastewater Fund	25,378
Sanitation Fund	28,139
Ambulance Fund	5,652
Total Compensated Absences	303,541

Total Long-Term Debt **\$ 13,119,610**

The annual requirements to amortize long-term debt outstanding as of December 31, 2016, except for compensated absences are as follows:

	General Obligation		Revenue Bonds		TIF Obligations	
	Interest	Principal	Interest	Principal	Interest	Principal
2017	\$ 18,337	\$ 165,000	\$ 290,722	\$ 725,325	\$ 46,620	\$ -
2018	13,574	130,000	265,877	751,287	126,315	-
2019	9,219	135,000	239,684	772,483	190,575	-
2020	4,613	140,000	200,128	1,428,865	129,875	124,960
2021	548	30,000	171,341	181,034	158,698	160,397
2022-2026	-	-	722,264	927,038	437,587	1,263,444
2027-2031	-	-	615,088	1,052,519	-	-
2032-2036	-	-	455,512	773,682	-	-
2037-2041	-	-	356,113	564,947	-	-
2042-2046	-	-	251,376	669,674	-	-
2047-2051	-	-	127,104	737,057	-	-
2052-2054	-	-	17,363	373,435	-	-
Total	\$ 46,291	\$ 600,000	\$ 3,712,572	\$ 8,957,346	\$ 1,089,670	\$ 1,548,801

Note Payable		Total	
Interest	Principal	Interest	Principal
\$ 39,905	\$ 45,492	\$ 395,584	\$ 935,817
38,169	47,228	443,935	928,515
24,416	904,701	463,894	1,812,184
-	-	334,616	1,693,825
-	-	330,587	371,431
-	-	1,159,851	2,190,482
-	-	615,088	1,052,519
-	712,501	455,512	1,486,183
-	-	356,113	564,947
-	-	251,376	669,674
-	-	127,104	737,057
-	-	17,363	373,435
\$ 102,490	\$ 1,709,922	\$ 4,951,023	\$ 12,816,069

CITY OF STURGIS

**NOTES TO FINANCIAL STATEMENTS (CONTINUED)
DECEMBER 31, 2016**

(5) Long-Term Debt (Concluded)

Tax Increment Financing Obligations

Tax increment financing is a method of financing improvements and development in an area which has been determined to be blighted according to the criteria set forth in SDCL 11-9. In some instances, the City pledges future tax revenues generated by the tax increment district to acquire public improvements within the established Tax Increment District which were constructed by a private developer.

It is a specific condition of the developer’s agreement and a condition of the City’s obligation that all sums payable shall be limited to the proceeds of the positive tax increment. It is also specifically agreed that the City has made no representation that the proceeds from such funds shall be sufficient to retire the indebtedness incurred by the developer to construct the public improvements.

During the year ended December 31, 2016, property tax revenues were \$155,927 for TIF #9. Interest expenditures, excluding corresponding accruals, related to TIF obligations totaled \$98,545 for the year ended December 31, 2016.

(6) Individual Fund Interfund Receivable and Payable Balances

Interfund receivable and payable balances at December 31, 2016, are as follows:

Fund	Interfund Receivables	Interfund Payables
<i>Major Funds:</i>		
Sanitation Fund	\$ 249,414	\$ -
Ambulance Fund	-	521,072
Water Fund	270,526	-
Wastewater Fund	151,194	-
Liquor Fund	-	241,522
General Fund	399,031	-
TIF Fund	-	29,003
Capital Improvement Fund	-	278,568
Total Interfund Receivable and Payable Balances	\$ 1,070,165	\$ 1,070,165

The General Fund, Sanitation Fund, Wastewater Fund, and Water Fund lent money to the Capital Improvement Fund in order to fund current year construction and also lent money to the Ambulance, Liquor and TIF Funds to help maintain a positive cash balance at year end. The balances will be repaid within the next year.

CITY OF STURGIS

**NOTES TO FINANCIAL STATEMENTS (CONTINUED)
DECEMBER 31, 2016**

(6) Individual Fund Interfund Receivable and Payable Balances (Continued)

Interfund advances balances at December 31, 2016, are as follows:

Fund	Interfund Advance To	Interfund Advance From
<i>Major Funds:</i>		
General Fund	\$ 1,230,420	\$ -
Revolving Loan Fund	559,669	-
Water Fund	1,444,294	-
TIF Funds	-	2,264,714
Wastewater Fund	-	159,669
Capital Improvements Fund	-	810,000
Total Interfund Receivable and Payable Balances	\$ 3,234,383	\$ 3,234,383

The Wastewater Fund continued making payments to the Revolving Loan Fund for assistance in lagoon repairs and will be repaid through 2024. The General Fund and Revolving Loan Fund advanced monies to the Capital Improvement Fund to assist with costs for HD Rally Point. The balance will be repaid through 2025. The General Fund and Water Fund advanced monies to the TIF Funds to assist in funding for TIF #11. The balance will be repaid through 2033 and bears interest at 4.00 percent. The General Fund advanced monies to the TIF Funds to assist in funding for TIF #13. The balance will be repaid through 2025 and bears interest at 5.00 percent.

(7) Interfund Transfers

	Transfers In	Transfers Out
<i>Major Funds:</i>		
General Fund	\$ 110,000	\$ 40,053
Wastewater Fund	-	100,000
Sanitation Fund	12,000	10,000
Water Fund	28,053	-
Total Transfers	\$ 150,053	\$ 150,053

Transfers between the funds were made to cover general operational costs of the City, to repair the Community Center roof, to purchase a pickup in the water fund and to transfer interest income to the General Fund in accordance with the City's policy.

(8) Pension Plan

All employees, working more than 20 hours per week during the year, participate in the SDRS, a cost sharing, multiple employer defined benefit pension plan administered by SDRS to provide retirement benefits for employees of the State of South Dakota and its political subdivisions. The SDRS provides retirement, disability, and survivors' benefits. The right to receive retirement benefits vests after three years of credited service. Authority for establishing, administering and amending plan provisions are found in SDCL 3-12. The SDRS issues a publicly available financial report that includes financial statements and required supplementary information. That report may be obtained at <http://www.sdrs.sd.gov/publications/> or by writing to the SDRS, P.O. Box 1098, Pierre, SD 57501-1098 or by calling (605) 773-3731.

CITY OF STURGIS

**NOTES TO FINANCIAL STATEMENTS (CONTINUED)
DECEMBER 31, 2016**

(8) Pension Plan (Continued)

Benefits Provided:

SDRS has three different classes of employees, Class A, Class B public safety and Class B judicial. Class A retirement benefits are determined as 1.7 percent prior to 2008 and 1.55 percent thereafter of the employee’s final 3-year average compensation times the employee’s years of service. Employees with 3 years of service are eligible to retire at age 55. Class B public safety benefits are determined as 2.4 percent for service prior to 2008 and 2.0 percent thereafter of employee final average compensation. Class B judicial benefits are determined as 3.733 percent for service prior to 2008 and 3.333 percent thereafter of employee final average compensation. All Class B employees with 3 years of service are eligible to retire at age 45. Employees are eligible for service-related disability benefits regardless of length of service. Three years of service is required for nonservice-related disability eligibility. Disability benefits are determined in the same manner as retirement benefits but are payable immediately without an actuarial reduction. Death benefits are a percent of the employee’s final average salary.

The annual increase in the amount of the SDRS benefits payable on each July 1st is indexed to the consumer price index (CPI) based on SDRS funded status:

- If the SDRS market value funded ratio is 100% or more - 3.1% COLA
- If the SDRS market value funded ratio is 80.0% to 99.9%, index with the CPI
 - 90.0% to 99.9% funded - 2.1% minimum and 2.8% maximum COLA
 - 80.0% to 89.9% funded - 2.1% minimum and 2.4% maximum COLA
- If the SDRS market value funded ratio is less than 80% - 2.1% COLA

All benefits except those depending on the Member’s Accumulated Contributions are annually increased by the Cost-of-Living Adjustment.

Contributions:

Per SDCL 3-12, contribution requirements of the active employees and the participating employers are established and may be amended by the SDRS Board. Covered employees are required by state statute to contribute the following percentages of their salary to the plan; Class A Members, 6.0 percent of salary; Class B Judicial Members, 9.0 percent of salary; and Class B Public Safety Members, 8.0 percent of salary. State statute also requires the employer to contribute an amount equal to the employee’s contribution. State statute also requires the employer to make an additional contribution in the amount of 6.2 percent for any compensation exceeding the maximum taxable amount for social security for general employees only. The City’s share of contributions to the SDRS for the fiscal years ended December 31, 2016, 2015, and 2014 were **\$327,324**, \$328,185, and \$284,199, respectively, equal to the required contributions each year.

Pension Assets, Pension Expense, and Deferred Outflows of Resources and Deferred Inflows of Resources to Pensions:

At June 30, 2016, SDRS is 96.89 percent funded and accordingly has a net pension liability. The proportionate shares of the components of the net pension liability of South Dakota Retirement System, for the City as of June 30, 2016 are as follows:

	Governmental Activities	Business-Type Activities	Total
Proportionate Share of Net Position Restricted for Pension Benefits	\$ 17,537,973	\$ 9,027,149	\$ 26,565,122
Less: Proportionate Share of Total Pension Liability	(18,101,456)	(9,317,185)	(27,418,641)
Proportionate Share of Net Pension Liability	\$ (563,483)	\$ (290,036)	\$ (853,519)

CITY OF STURGIS

**NOTES TO FINANCIAL STATEMENTS (CONTINUED)
DECEMBER 31, 2016**

(8) Pension Plan (Continued)

At December 31, 2016, the City reported a liability of \$853,519 for its proportionate share of the net pension liability. The net pension liability was measured as of June 30, 2016, and the total pension liability used to calculate the net pension liability was based on a projection of the City’s share of contributions to the pension plan relative to the contributions of all participating entities. At June 30, 2016, the City’s proportion was 0.2526772 percent, which is an increase of .004 percent from its proportion measured as of June 30, 2015.

For the year ended December 31, 2016, the City recognized pension expense of \$567,331. At December 31, 2016, the City reported deferred outflows of resources related to pensions from the following sources:

	Deferred Outflows of Resources	Deferred Inflows of Resources
Difference between Expected and Actual Experience	\$ 297,129	\$ -
Changes in Assumption	511,217	-
Net Difference between Projected and Actual Earnings on Pension Plan Investments	949,401	-
Changes in Proportion and Difference between City Contributions and Proportionate Share of Contributions	-	-
City Contributions Subsequent to the Measurement Date	161,141	-
Total	\$ 1,918,888	\$ -

Deferred outflow of resources includes \$161,141 resulting from City contributions subsequent to the measurement date will be recognized as a reduction of the net pension liability in the year ending December 31, 2016. Other amounts reported as deferred outflows of resources and deferred inflows of resources related to pensions will be recognized in pension expense (revenue) as follows:

2017	\$ 474,297
2018	286,902
2019	601,161
2020	395,387
	\$ 1,757,747

Actuarial Assumptions:

The total pension asset in the June 30, 2016 actuarial valuation was determined using the following actuarial assumptions, applied to all periods included in the measurement:

Inflation	3.25 percent
Salary Increases	5.83 percent at entry to 3.87 percent after 30 years of service
Investment Rate of Return	7.25 percent through 2017 and 7.50 percent thereafter, net of pension plan investment expense

Mortality rates were based on the RP-2000 Employee Mortality Table for males and females, as appropriate.

The actuarial assumptions used in the June 30, 2016 valuation were based on the results of an actuarial experience study for the period July 1, 2005 through June 30, 2011. The mortality assumptions were revised based on an extension of the experience study including mortality experience through June 30, 2013.

CITY OF STURGIS

**NOTES TO FINANCIAL STATEMENTS (CONTINUED)
DECEMBER 31, 2016**

(8) Pension Plan (Concluded)

Investment portfolio management is the statutory responsibility of the South Dakota Investment Council (SDIC), which may utilize the services of external money managers for management of a portion of the portfolio. SDIC is governed by the Prudent Man Rule (i.e., the council should use the same degree of care as a prudent man). Current SDIC investment policies dictate limits on the percentage of assets invested in various types of vehicles (equities, fixed income securities, real estate, cash, private equity, etc.). The long-term expected rate of return on pension plan investments was determined using a method in which best-estimate ranges of expected future real rates of return (expected returns, net of pension plan investment expense and inflation) are developed for each major asset class. These ranges are combined to produce the long-term expected rate of return by weighing the expected future real rates of return by the target asset allocation percentage and by adding expected inflation. Best estimates of real rates of return for each major asset class included in the pension plan’s target asset allocation as of June 30, 2015 (see the discussion of the pension plan’s investment policy) are summarized in the following table using geometric means:

<u>Asset Class</u>	<u>Target Allocation</u>	<u>Long-Term Expected Real Rate of Return</u>
Global Equity	58.0%	4.8%
Fixed Income	30.0%	1.8%
Real Estate	10.0%	4.6%
Cash	2.0%	0.7%
	<u>100.0%</u>	

Discount Rate:

The discount rate used to measure the total pension asset was 7.25 percent through 2017 and 7.50 percent thereafter. The projection of cash flows used to determine the discount rate assumed that employee contributions will be made at the current contribution rate and that matching employer contributions will be made at rates equal to the member rate. Based on these assumptions, the pension plan’s fiduciary net position was projected to be available to make all future benefit payments of current plan members. Therefore, the long-term expected rate of return on pension plan investments was applied to all periods of projected benefit payments to determine the total pension asset.

Sensitivity of Asset to Changes in the Discount Rate:

The following presents the City’s proportionate share of net pension asset calculated using the discount rate of 7.25 percent through 2017 and 7.50 percent thereafter, as well as what the District’s proportionate share of the net pension asset would be if it were calculated using a discount rate that is 1-percentage point lower (6.25/6.50 percent) or 1-percentage point higher (8.25/8.50 percent) than the current rate:

	<u>1% Decrease</u>	<u>Current Discount Rate</u>	<u>1% Increase</u>
City’s Proportionate Share of the Net Pension Liability	\$ (4,776,280)	\$ (853,519)	\$ 2,345,914

Pension Plan Fiduciary Net Position:

Detailed information about the plan’s fiduciary net position is available in the separately issued SDRS financial report.

(9) Risk Management

The City is exposed to various risks of loss related to torts; theft of, damage to, and destruction of assets; errors and omissions; injuries to employees; and natural disasters. During the year ended December 31, 2016, the City managed its risks as follows:

Employee Health Insurance:

The City purchases health insurance for its employees from a commercial insurance carrier. Settled claims resulting from these risks have not exceeded the liability coverage during the past four years.

CITY OF STURGIS

**NOTES TO FINANCIAL STATEMENTS (CONTINUED)
DECEMBER 31, 2016**

(9) Risk Management (Continued)

Liability Insurance:

The City joined the South Dakota Public Assurance Alliance (SDPAA), a public entity risk pool currently operating as a common risk management and insurance program for South Dakota local government entities. The objective of the SDPAA is to administer and provide risk management services and risk sharing facilities to the members and to defend and protect the members against liability, to advise members on loss control guidelines and procedures, and provide them with risk management services, loss control and risk reduction information and to obtain lower costs for that coverage. The City's responsibility is to promptly report to and cooperate with the SDPAA to resolve any incident which could result in a claim being made by or against the City. The City pays an annual premium to the pool to provide coverage for general liability, vehicle coverage, wrongful acts, and errors and omissions of public officials.

The agreement with the SDPAA provides that the above coverage will be provided to a \$2,000,000 limit. Member premiums are used by the pool for payment of claims and to pay for reinsurance for claims in excess of \$250,000 for property coverage and \$500,000 for liability coverage to the upper limit. The City carries a \$1,000 deductible for the wrongful acts coverage and auto coverage.

As of December 31, 2016, the City has a fully vested balance in the cumulative reserve fund of \$135,844. Access to this balance is restricted by SDPAA.

The City does not carry additional insurance to cover claims in excess of the upper limit. Settled claims resulting from the risks have not exceeded the liability coverage during the past four years.

Property and Building Insurance:

The City purchases property and building insurance from a commercial insurance carrier. Settled claims resulting from these risks have not exceeded the liability coverage during the past four years.

Worker's Compensation:

The City joined the South Dakota Municipal League Worker's Compensation Fund (the Fund), a public entity risk pool currently operating as a common risk management and insurance program for South Dakota local government entities. The objective of the Fund is to formulate, develop, and administer, on behalf of the member organizations, a program of worker's compensation coverage, to obtain lower costs for that coverage, and to develop a comprehensive loss control program. The City's responsibility is to initiate and maintain a safety program to give its employees safe and sanitary working conditions and to promptly report to and cooperate with the Fund to resolve any worker's compensation claims. The City pays an annual premium to provide worker's compensation coverage for its employees under a retrospectively rated policy, and the premiums are accrued based on the ultimate cost of the experience to date of the Fund members. Coverage limits are set by state statute. The pool pays the first \$650,000 of any claim per individual. The pool has reinsurance which covers up to \$2,000,000 per individual per incident. The City does not carry additional insurance to cover claims in excess of the upper limit. Settled claims resulting from these risks have never exceeded the liability coverage over the past four years.

Unemployment Benefits:

The City provides coverage for unemployment benefits by paying into the Unemployment Compensation Fund established by state law and managed by the State of South Dakota.

CITY OF STURGIS

**NOTES TO FINANCIAL STATEMENTS (CONCLUDED)
DECEMBER 31, 2016**

(10) Notes Receivable

Notes receivable are revolving loans the City makes to promote urban development. The following is a summary of the notes receivable at December 31, 2016:

Governmental:

<u>Loan</u>	<u>Collateral</u>	<u>Rate</u>	<u>Maturity</u>	<u>Balance</u>
Fickbohm	None	0%	January 1, 2017	\$ 2,979
Jenter	None	0%	January 1, 2017	4,939
Knuckle Brewery	Real Estate	3%	August 5, 2024	19,822
Sturgis ATV	Real Estate	3%	August 5, 2024	19,809
Jake's Garage	Real Estate	3%	December 5, 2024	20,581
Dakota Hardware	Real Estate, Inventory, Equipment	2%	November 1, 2024	80,932
Baldwin	Real Estate	3%	February 5, 2025	21,206
Dominos	Real Estate	3%	June 1, 2025	21,520
X-Treme Bikes	Inventory, Equipment, Cash	3%	April 1, 2026	93,913
Discovery Kids	Equipment, Cash	3%	August 1, 2026	195,284
				\$ 480,985

(11) Due from Other Governments

The following represent receivables due from other governments at December 31, 2016:

Due from State Government:

Local Government Highway and Bridge	\$ 25,077
Alcohol Reversion	10,609
Fuel Tax	16,434
Starline Park	14,603
Total Due from State Government	66,723

Due from Federal Government:

Aiport Repairs	116,713
Total Due from Other Governments	\$ 183,436

(12) Operating Leases

The City leases buildings under non-cancelable operating leases. Rent expense under these leases was \$200,000 for the year ended December 31, 2016.

Future minimum lease payments under the terms of these non-cancelable operating leases are as follows for the years ending December 31:

2017	\$ 200,000
2018	200,000
2019	160,000
2020	160,000
	\$ 720,000

REQUIRED SUPPLEMENTARY INFORMATION

CITY OF STURGIS

BUDGETARY COMPARISON SCHEDULE - BUDGETARY BASIS
GENERAL FUND
FOR THE YEAR ENDED DECEMBER 31, 2016

	<u>Original Budget</u>	<u>Final Budget</u>	<u>Actual - Budgetary Basis</u>	<u>Variance</u>
Revenue				
<i>Taxes:</i>				
311 General Property Taxes	\$ 2,729,578	\$ 2,729,578	\$ 2,782,087	\$ 52,509
313 General Sales and Use Taxes	1,981,412	1,981,412	1,974,389	(7,023)
315 Amusement Taxes	900	900	816	(84)
319 Penalties and Interest on Delinquent Taxes	14,000	14,000	8,637	(5,363)
320 Licenses and Permits	650,670	650,670	701,532	50,862
<i>Intergovernmental Revenue:</i>				
331 Federal Grants	-	-	271,242	271,242
334 State Grants	-	-	23,879	23,879
335 Bank Franchise Tax	9,200	9,200	9,383	183
335 Liquor Tax Reversion	41,750	41,750	43,218	1,468
335 Motor Vehicle Licenses	75,705	75,705	89,135	13,430
335.1 Local Government Highway and Bridge Fund	145,370	145,370	139,375	(5,995)
338 County Highway and Bridge Reserve Tax (25%)	5,855	5,855	5,855	-
338 Port of Entry	5,000	5,000	12,981	7,981
339 County Payments in Lieu of Taxes	6,100	6,100	5,643	(457)
<i>Charges for Goods and Services:</i>				
341 General Government	1,387,091	1,387,091	1,426,532	39,441
342 Public Safety	42,135	42,135	58,066	15,931
345 Health	490	490	5,799	5,309
346 Culture and Recreation	277,470	277,470	252,426	(25,044)
349 Other	-	-	15,426	15,426
<i>Fines and Forfeits:</i>				
351 Court Fines and Costs	7,000	7,000	5,558	(1,442)
<i>Miscellaneous Revenue:</i>				
361 Earnings on Deposits and Investments	179,000	179,000	146,755	(32,245)
362 Rentals/Airport Hangar Lease	17,700	17,700	17,069	(631)
367 Contributions and Donations - Private Sources	11,525	11,525	13,820	2,295
369 Other	2,300	2,300	9,404	7,104
Total Revenue	7,590,251	7,590,251	8,019,027	428,776

CITY OF STURGIS

BUDGETARY COMPARISON SCHEDULE - BUDGETARY BASIS (CONTINUED)
GENERAL FUND
FOR THE YEAR ENDED DECEMBER 31, 2016

	<u>Original Budget</u>	<u>Final Budget</u>	<u>Actual - Budgetary Basis</u>	<u>Variance</u>
Expenditures				
<i>General Government:</i>				
411 Legislative	320,504	346,504	220,584	125,920
414 Financial Administration	1,128,923	1,140,496	1,103,633	36,863
419 Other	1,489,531	1,943,318	1,812,729	130,589
<i>Public Safety:</i>				
421 Police	2,032,583	2,221,381	2,165,409	55,972
422 Fire	145,048	145,048	129,118	15,930
<i>Public Works:</i>				
431 Highway and Streets	894,194	894,194	799,621	94,573
435 Airport	46,773	76,773	72,594	4,179
437 Cemeteries	117,002	117,002	94,703	22,299
<i>Culture and Recreation:</i>				
451 Recreation	733,163	733,163	728,785	4,378
452 Parks	676,644	650,828	624,082	26,746
455 Library	350,163	350,163	322,830	27,333
456 Auditorium	47,837	47,837	38,829	9,008
Total Expenditures	7,982,365	8,666,707	8,112,917	553,790
Excess of Revenue Over (Under) Expenditures	(392,114)	(1,076,456)	(93,890)	982,566
Other Financing Sources (Uses)				
391.01 Transfers In	110,000	853,725	110,000	(743,725)
391.04 Compensation for Loss or Damage to Capital Assets	-	-	74,058	74,058
511 Transfers Out	(12,000)	(12,000)	(40,053)	(28,053)
Total Other Financing Sources	98,000	841,725	144,005	(697,720)
Net Change in Fund Balance	(294,114)	(234,731)	50,115	284,846
Fund Balance, December 31, 2015	2,700,171	2,700,171	2,700,171	-
Fund Balance, December 31, 2016	\$ 2,406,057	\$ 2,465,440	\$ 2,750,286	\$ 284,846

The accompanying supplementary notes are an integral part of the required supplementary information.

CITY OF STURGIS

BUDGETARY COMPARISON SCHEDULE - BUDGETARY BASIS
CAPITAL IMPROVEMENT FUND
FOR THE YEAR ENDED DECEMBER 31, 2016

	<u>Original Budget</u>	<u>Final Budget</u>	<u>Actual - Budgetary Basis</u>	<u>Variance</u>
Revenue				
<i>Taxes:</i>				
313 General Sales and Use Taxes	\$ 1,320,992	\$ 1,320,992	\$ 1,316,259	\$ (4,733)
<i>Miscellaneous Revenue:</i>				
341 Rally Property Leases	300,000	300,000	220,273	(79,727)
367 Contributions and Donations	-	-	7,500	7,500
Total Revenue	1,620,992	1,620,992	1,544,032	(76,960)
Expenditures				
<i>General Government:</i>				
419 Other	230,000	8,890	8,890	-
<i>Public Works:</i>				
431 Highway and Streets	-	33,781	14,349	19,432
<i>Culture and Recreation:</i>				
451 Recreation	-	22,977	22,977	-
452 Parks	-	15,648	-	15,648
456 Auditorium	-	13,400	13,400	-
470 Debt Service	698,212	928,213	785,207	143,006
900 Capital Outlay	692,729	1,562,033	1,459,880	102,153
Total Expenditures	1,620,941	2,584,942	2,304,703	280,239
Net Change in Fund Balance	51	(963,950)	(760,671)	203,279
Fund Balance, December 31, 2015	456,002	456,002	456,002	-
Fund Balance, December 31, 2016	\$ 456,053	\$ (507,948)	\$ (304,669)	\$ 203,279

The accompanying supplementary notes are an integral part of the required supplementary information.

CITY OF STURGIS

**BUDGETARY COMPARISON SCHEDULE - BUDGETARY BASIS
REVOLVING LOAN FUND
FOR THE YEAR ENDED DECEMBER 31, 2016**

	<u>Original Budget</u>	<u>Final Budget</u>	<u>Actual - Budgetary Basis</u>	<u>Variance</u>
Revenue				
<i>Miscellaneous Revenue:</i>				
361 Investment Earnings	\$ 9,766	\$ 9,766	\$ 9,754	\$ (12)
Total Revenue	9,766	9,766	9,754	(12)
Expenditures				
419 Other	31,821	31,821	1,000	30,821
Excess of Expenditures Over (Under) Revenue	(22,055)	(22,055)	8,754	30,809
Other Financing Sources				
391 Transfers In	22,903	22,903	-	(22,903)
Net Change in Fund Balance	848	848	8,754	7,906
Fund Balance, December 31, 2015	1,303,856	1,303,856	1,303,856	-
Fund Balance, December 31, 2016	\$ 1,304,704	\$ 1,304,704	\$ 1,312,610	\$ 7,906

The accompanying supplementary notes are an integral part of the required supplementary information.

CITY OF STURGIS

**SCHEDULE OF THE CITY'S PROPORTIONATE SHARE OF THE NET PENSION ASSET (LIABILITY)
DECEMBER 31, 2016**

	<u>2016</u>	<u>2015</u>
City's Proportion of the Net Pension Asset (Liability)	0.25267720%	0.24867220%
City's Proportionate Share of Net Pension Asset (Liability)	\$ (853,519)	\$ 1,054,689
City's Covered Payroll (Plan's Fiscal Year)	\$ 4,639,694	\$ 4,346,273
City's Proportionate Share of the Net Pension Asset (Liability) as a Percentage of its Covered Payroll	-18.40%	24.27%
Plan Fiduciary Net Position as a Percentage of the Total Pension Asset (Liability)	96.89%	104.10%

CITY OF STURGIS

**SCHEDULE OF THE CITY'S CONTRIBUTIONS
DECEMBER 31, 2016**

	<u>2016</u>	<u>2015</u>
Contractually Required Contribution	\$ 293,505	\$ 291,141
Contributions in Relation to the Contractually Required Contribution	293,505	291,141
Contribution Deficiency (Excess)	<u>\$ -</u>	<u>\$ -</u>
City's Covered Payroll	\$ 4,705,530	\$ 4,686,344
Contributions as a Percentage of Covered Payroll	6.2%	6.2%

CITY OF STURGIS

**NOTES TO REQUIRED SUPPLEMENTARY INFORMATION
DECEMBER 31, 2016**

(1) Budgets and Budgetary Accounting

The City follows these procedures in establishing the budgetary data reflected in the financial statements:

1. At the first regular board meeting in September of each year or within ten days thereafter, the governing board introduces the annual appropriation ordinance for the ensuing fiscal year.
2. After adoption by the governing board, the operating budget is legally binding and actual disbursements for each purpose cannot exceed the amounts budgeted, except as indicated in item number 4.
3. A line item for contingencies may be included in the annual budget. Such line item may not exceed 5 percent of the total municipal budget and may be transferred by resolution of the governing board to any other budget category that is deemed insufficient during the year.
4. If it is determined during the year that sufficient amounts have not been budgeted, State statute allows the adoption of supplemental budgets.
5. Unexpended appropriations lapse at year end unless encumbered by resolution of the governing board.
6. The City did not encumber any amounts at December 31, 2016.
7. Formal budgetary integration is employed as a management control device during the year for the general fund and major special revenue funds.
8. Budgets for the general fund and major special revenue funds are adopted on a basis consistent with accounting principles generally accepted in the United States (USGAAP).

OTHER SUPPLEMENTARY INFORMATION

CITY OF STURGIS

COMBINING BALANCE SHEET
NONMAJOR GOVERNMENTAL FUNDS
DECEMBER 31, 2016

	Special Sales Tax <u>Fund</u>	Library <u>Fund</u>	BID <u>Fund</u>	Alice W. Dunn <u>Fund</u>	Perpetual Maintenance <u>Fund</u>	Total Nonmajor Governmental <u>Funds</u>
Assets						
104 Interest Bearing Accounts	\$ 104,311	\$ 74,733	\$ 16,644	\$ 79,097	\$ 175,403	\$ 450,188
105 Savings Certificates	-	-	-	427,535	-	427,535
108 Sales Tax Receivable	15,355	-	-	-	-	15,355
115 Accounts Receivable	-	-	54	-	-	54
121 Special Assessments Receivable	-	-	24,106	-	-	24,106
151 Investment Held for Sale	608,100	-	-	-	-	608,100
Total Assets	\$ 727,766	\$ 74,733	\$ 40,804	\$ 506,632	\$ 175,403	\$ 1,525,338
Liabilities, Deferred Inflows of Resources, and Fund Balances						
<i>Liabilities</i>						
216 Accounts Payable	\$ 1,379	\$ -	\$ 8,207	\$ -	\$ -	\$ 9,586
217 Accrued Taxes Payable	-	-	-	-	7	7
Total Liabilities	1,379	-	8,207	-	7	9,593
<i>Deferred Inflows of Resources</i>						
246 Unavailable Revenue - Special Assessments	-	-	24,106	-	-	24,106
<i>Fund Balances</i>						
263.51 Nonspendable - Perpetual Care Cemetery	-	-	-	-	50,000	50,000
263.99 Nonspendable - Library Trust	-	-	-	327,535	-	327,535
264.03 Restricted - Perpetual Care Cemetery	-	-	-	-	125,396	125,396
264.04 Restricted - BBB Tax	726,387	-	-	-	-	726,387
264.05 Restricted - Library Purposes	-	74,733	-	179,097	-	253,830
264.09 Restricted - BID Tax	-	-	8,491	-	-	8,491
267 Unassigned	-	-	-	-	-	-
Total Fund Balances	726,387	74,733	8,491	506,632	175,396	1,491,639
Total Liabilities, Deferred Inflows of Resources, and Fund Balances	\$ 727,766	\$ 74,733	\$ 40,804	\$ 506,632	\$ 175,403	\$ 1,525,338

CITY OF STURGIS

**COMBINING STATEMENT OF REVENUES, EXPENDITURES, AND CHANGES IN FUND BALANCES
NONMAJOR GOVERNMENTAL FUNDS
FOR THE YEAR ENDED DECEMBER 31, 2016**

	<u>Special Sales Tax Fund</u>	<u>Library Fund</u>	<u>BID Fund</u>	<u>Alice W. Dunn Fund</u>	<u>Perpetual Maintenance Fund</u>	<u>Total Nonmajor Governmental Funds</u>
Revenue:						
313 General Sales and Use Taxes	\$ 325,152	\$ -	\$ -	\$ -	\$ -	\$ 325,152
319 Penalties and Interest on Delinquent Taxes	-	-	182	-	-	182
341 Charges for Goods and Services - General Government	-	-	36,500	-	-	36,500
361 Investment Earnings	-	27	-	4,811	87	4,925
363 Special Assessments	-	-	25,212	-	-	25,212
369 Other	-	5,134	-	-	6,210	11,344
Total Revenue	325,152	5,161	61,894	4,811	6,297	403,315
Expenditures:						
419 General Government - Other	7,086	-	52,749	-	-	59,835
455 Library	-	1,420	-	-	-	1,420
460 Conservation and Development	272,209	-	-	-	-	272,209
Total Expenditures	279,295	1,420	52,749	-	-	333,464
Net Change in Fund Balances	45,857	3,741	9,145	4,811	6,297	69,851
Fund Balance, December 31, 2015	680,530	70,992	(654)	501,821	169,099	1,421,788
Fund Balance, December 31, 2016	\$ 726,387	\$ 74,733	\$ 8,491	\$ 506,632	\$ 175,396	\$ 1,491,639

CITY OF STURGIS

**SCHEDULE OF RALLY ACTIVITIES (UNAUDITED)
FOR THE YEAR ENDED DECEMBER 31, 2016**

Revenue

Taxes:

313 Sales Tax	\$ 506,721
320 Licenses and Permits	408,020

Charges for Goods and Services:

341 General Government	1,439,572
346 Culture & Recreation	16,353
344 Special Sanitation Fee	164,239

Total Revenue	2,534,905
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Expenditures

General Government:

419 Other	(1,549,554)
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Total Expenditures	(1,549,554)
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Excess of Revenue over Expenditures	\$ 985,351
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OTHER REPORTS



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INDEPENDENT AUDITOR'S REPORT ON INTERNAL CONTROL OVER FINANCIAL REPORTING AND ON COMPLIANCE AND OTHER MATTERS BASED ON AN AUDIT OF FINANCIAL STATEMENTS PERFORMED IN ACCORDANCE WITH *GOVERNMENT AUDITING STANDARDS*

City Council
City of Sturgis
Sturgis, South Dakota

We have audited, in accordance with the auditing standards generally accepted in the United States of America and the standards applicable to financial audits contained in *Government Auditing Standards* issued by the Comptroller General of the United States, the financial statements of the governmental activities, the business-type activities, each major fund, and the aggregate remaining fund information of **CITY OF STURGIS** (the City) as of and for the year ended December 31, 2016, and the related notes to the financial statements, which collectively comprise the City's basic financial statements, and have issued our report thereon dated September 7, 2017. Our report was modified for a qualified opinion on the liquor fund.

Internal Control over Financial Reporting

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.

Our consideration of internal control was for the limited purpose described in the preceding paragraph and was not designed to identify all deficiencies in internal control that might be material weaknesses or significant deficiencies and therefore, material weaknesses or significant deficiencies may exist that were not identified. However, as described in the accompanying Schedule of Findings, we identified certain deficiencies in internal control that we consider to be material weaknesses and significant deficiencies.

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 City's financial statements will not be prevented, or detected and corrected, on a timely basis. We consider the deficiencies described in the accompanying Schedule of Findings as #2016-001, #2016-002, #2016-003 and #2016-004 to be material weaknesses.

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. We consider the deficiencies described in the accompanying Schedule of Findings as #2016-005 and #2016-006 to be significant deficiencies.

Compliance and Other Matters

As part of obtaining reasonable assurance about whether the City's financial statements are free from material misstatement, we performed tests of its compliance with certain provisions of laws, regulations, contracts, and grant agreements, 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, and accordingly, we do not express such an opinion. The results of our tests disclosed no instances of noncompliance or other matters that are required to be reported under *Government Auditing Standards*.

City Council

City's Response to Findings

The City's response to the findings identified in our audit is described in the Schedule of Findings. The City's response was not subjected to the auditing procedures applied in the audit of the financial statements and, accordingly, we express no opinion on the response.

Purpose of this Report

The purpose of this report is solely to describe the scope of our testing of internal control and compliance and the results of that testing, and not to provide an opinion on the effectiveness of the City's internal control or on compliance. This report is an integral part of an audit performed in accordance with *Government Auditing Standards* in considering the City's internal control and compliance. Accordingly, this communication is not suitable for any other purpose. As required by South Dakota Codified Law 4-11-11, this report is a matter of public record and its distribution is not limited.



KETEL THORSTENSON, LLP
Certified Public Accountants

September 7, 2017

CITY OF STURGIS

SCHEDULE OF FINDINGS FOR THE YEAR ENDED DECEMBER 31, 2016

MATERIAL WEAKNESSES

2016-001 FINDING: Financial Statement Preparation

Condition and Cause: As in prior years, we were requested to draft the audited financial statements and related footnote disclosures as part of our regular audit services. Ultimately, it is management's responsibility to provide for the preparation of the City's statements and footnotes, and the responsibility of the auditor to determine the fairness of presentation of those statements. From a practical standpoint, we do both for the City at the same time in connection with our audit. This is not unusual for us to do with municipalities of your size.

Criteria and Effect: This deficiency could result in a material misstatement to the financial statements that could have been prevented or detected by the City's management.

Repeat Finding from Prior Year: Yes, prior year finding 2015-001.

Recommendation: As in prior years, we have instructed management to review a draft of the auditor prepared financials in detail for their accuracy; we have answered any questions they might have, and have encouraged research of any accounting guidance in connection with the adequacy and appropriateness of classification and disclosure in the City's statements. We are satisfied that the appropriate steps have been taken to provide the City with the completed financial statements. It is the responsibility of management and those charged with governance to make the decision whether to accept the degree of risk associated with this condition because of cost or other considerations.

Response/Corrective Action Plan: The City agrees with the above finding. See Corrective Action Plan.

2016-002 FINDING: Audit Adjustments

Condition and Cause: During the course of our engagement, we proposed material audit adjustments that were approved and recorded. Adjustments included adjustments to TIF #12 construction in progress and long term debt activity, recording retainage on construction in progress, adjustments for pension activity, increasing the ambulance allowance for doubtful accounts, adjustments to debt service expense activity related to TIF #9 closing, adjusting equity balances to actual, and reclassification of capital improvement expenditures. Additionally, we proposed several reclassification entries with no effect on net income. Furthermore, other entries were proposed as a part of the audit, but were not recorded due to the overall insignificance on the financial statements.

Criteria and Effect: These adjustments would not have been identified as a result of the City's existing internal controls, and therefore, could have resulted in a material misstatement of the City's financial statements.

Repeat Finding from Prior Year: Yes, prior year finding 2015-002.

Recommendation: We recommend that management consider the following:

- a. The City should consider obtaining external accounting assistance, prior to the audit, to ensure accuracy of general ledger information. Specifically, the City should consider assistance with the recording of capital assets, long term debt and pension activity.
- b. Capital assets should be reviewed to make sure all additions and disposals are properly reflected, including the activity within TIF Funds. During the course of the year, the City should reconcile capital assets, at a minimum, on a quarterly basis.
- c. The Ambulance Fund receivables should be analyzed for collectability and adjusted on a regular basis.

Response/Corrective Action Plan: The City agrees with the above finding. See Corrective Action Plan.

CITY OF STURGIS

**SCHEDULE OF FINDINGS (CONTINUED)
FOR THE YEAR ENDED DECEMBER 31, 2016**

MATERIAL WEAKNESSES (CONTINUED)

2016-003 FINDING: Liquor Store Internal Controls, Qualification of Audit Opinion

Condition and Cause: There is an overall lack of segregation of duties involving the Liquor Store Manager's ability to order inventory, receive inventory, pick up inventory offsite, adjust inventory costs, and perform inventory counts. The gross margins calculated per the general ledger did not agree to those expected based on historical averages. During the inventory observations, 67 items were counted. Within the sample, there were 21 items with variances between the quantity per the inventory listings and the amounts observed. Per discussion with Management, we also noted significant inventory was discovered which had not been accounted for by the City in the past. Management was unable to quantify aggregate total of this inventory amount along with the effect on prior periods.

Criteria and Effect: A lack of segregation of duties could lead to misstatements to the financial statements and misappropriation of liquor inventory. Additionally, detailed gross margins analysis should be performed periodically to ensure accuracy and completeness for accounting of inventory transactions. Employees performing the count should be very detail-oriented and specific, in order to count each item correctly. This includes testing the items counted to ensure they are accurately uploaded in the system.

Repeat Finding from Prior Year: Yes, prior year finding 2015-003.

Recommendation: Individuals other than the Liquor Store Manager should be receiving inventory and performing inventory counts. A separate individual should review cost adjustments and gross margins for reasonableness. We recommend liquor store management use greater precaution when performing the inventory count and management have the ability to obtain average cost details for all items.

Response/Corrective Action Plan: The City agrees with the above finding. See Corrective Action Plan.

2016-004 FINDING: Internal Controls

Condition and Cause: The Finance Officer has access to the general ledger, prepares and posts journal entries, has access to the check stock, is a check signer, and reconciles the bank statement. After presentation of the prior year audit, the City Manager began reviewing bank reconciliations.

Criteria and Effect: Proper segregation of duties results in adequate internal control over the safeguard of assets and the reliability of financial records and reporting. Without proper segregation of duties, an intentional or unintentional error could go undetected resulting in a misappropriation of assets or inaccurate records.

Repeat Finding from Prior Year: Yes, prior year finding 2015-005.

Recommendation: The City Manager or Council Member should review processes or tasks completed by the Finance Officer to ensure accuracy.

Response/Corrective Action Plan: The City agrees with the above finding. See Corrective Action Plan.

CITY OF STURGIS

**SCHEDULE OF FINDINGS (CONCLUDED)
FOR THE YEAR ENDED DECEMBER 31, 2016**

SIGNIFICANT DEFICIENCIES

2016-005 FINDING: Bank Reconciliations

Condition and Cause: During the course of the audit, we noted the bank reconciliation for the City's First Interstate checking account did not agree to the general ledger in the amount of \$1,403. The difference was the result of two entries posted in error to adjust the City's water deposit cash accounts, which are included in the City's First Interstate checking account. Additionally we noted the Library bank account did not agree to the general ledger in the amount of \$615.

Criteria and Effect: The First Interstate checking account should be reconciled to the general ledger on a monthly basis and no entries should be posted to the cash account after such reconciliation is completed. Without proper bank reconciliations, a misstatement to the financial statements could occur without being prevented or detected by the City's management.

Repeat Finding from Prior Year: No.

Recommendation: The City Manager or Council Member should review the bank reconciliations monthly, to ensure they are accurate and agree to the general ledger.

Response/Corrective Action Plan: The City agrees with the above finding. See Corrective Action Plan.

2016-006 FINDING: Certificates of Deposit

Condition and Cause: The City is invested in participating and negotiable certificates of deposit.

Criteria and Effect: South Dakota Codified Law 4-5-6 indicates the types of investments that the City may invest public funds. Based on 4-5-6, the City is in violation of State law.

Recommendation: We recommend that the City re-evaluate their investment policy and invest these funds in investments allowed by SDCL 4-5-6.

Response/Corrective Action Plan: See City's Corrective Action Plan.

MANAGEMENT RESPONSE



**SUMMARY SCHEDULE OF PRIOR AUDIT FINDINGS
DECEMBER 31, 2016**

The City of Sturgis respectfully submits the following summary schedule of prior audit findings from December 31, 2015 Schedule of Findings. The findings are numbered consistently with the numbers assigned in the 2015 Schedule of Findings.

2015-001 FINDING: Financial Statement Preparation

Status: It is more cost effective for the City to hire Ketel Thorstenson, LLP, a public accounting firm, to prepare the full disclosure financial statements as a part of the annual audit process. The City has designated a member of management to review the draft financial statements and accompanying notes to the financial statements.

Initial Year Report: Originally issued years ago.

Reasons for Recurrence and Corrective Action Plan: As the City has accepted the risk associated with the auditor's preparing of the financial statements, it will be repeated in 2016, see Corrective Action Plan.

2015-002 FINDING: Audit Adjustments

Status: The City made efforts to record all year-end entries, but several audit adjustments were made.

Initial Year Report: Originally issued years ago.

Reasons for Recurrence and Corrective Action Plan: The finding is altered based on specific audit adjustments each year, but is repeated in the Schedule of Findings. See Corrective Action Plan.

2015-003 FINDING: Liquor Store Internal Controls

Status: In 2016, the City implemented new liquor store software which caused pricing and quantity issues at year end. The City also had a deficiency in segregation of duties due to limited personnel.

Initial Year Report: Originally issued one year ago.

Reasons for Recurrence and Corrective Action Plan: Changes to inventory software and in personnel during year caused a repeat of prior year deficiencies. See Corrective Action Plan.

2015-004 FINDING: Budgetary Overdraft

Status: The City made efforts to ensure there were adequate appropriations and supplements made throughout the year. As such, no budgetary overdrafts occurred in the current year.

Initial Year Report: Originally issued one year ago.

2015-005 FINDING: Internal Controls

Status: During the course of the year, the Finance Officer had access to the general ledger, prepared and posted journal entries, had access to check stock, was a check signer and also reconciled the bank statement.

Initial Year Report: Originally issued years ago.

Reasons for Recurrence and Corrective Action Plan: In order to help mitigate the risk of segregation of duties, the City formed a new position of Senior Accountant during 2016 and began to transition some of these duties. However, the City has a small accounting staff and as such could not prevent reoccurrence of this finding in 2016. See Corrective Action Plan.



**SUMMARY SCHEDULE OF PRIOR AUDIT FINDINGS (CONTINUED)
DECEMBER 31, 2016**

2015-006 FINDING: Publishing Wages

Status: The City made efforts to ensure all wage increases were published during 2016.

Initial Year Report: Originally issued one year ago.



**CORRECTIVE ACTION PLAN
DECEMBER 31, 2016**

The City respectfully submits the following summary schedule of prior audit findings from December 31, 2016 Schedule of Findings. The findings are numbered consistently with the numbers assigned in the Schedule of Findings.

2016-001 FINDING: Financial Statement Preparation

Responsible Officials: Fay Bueno, Finance Officer

Corrective Action Plan: The City has accepted the risk associated with Finding #2016-001 regarding the preparation of the financial statements, and will continue to have the independent auditor prepare the annual financial statements. For future audits, Finance Officer Fay Bueno and the person in the newly formed position of Senior Accountant (4th quarter 2016) will continue to monitor the financial statement preparation and determine if any modification can be done to the procedure.

Anticipated Completion Date: Ongoing

2016-002 FINDING: Audit Adjustments

Responsible Officials: Fay Bueno, Finance Officer

Corrective Action Plan: The City will make every effort to make accurate accounting adjustments throughout the year. When recording a journal entry that is unfamiliar the Finance Officer or the Senior Accountant will inquire on how to make the correct entry. With the newly formed position of Senior Accountant (4th quarter of 2016) and the Finance Officer there will be more time to make sure that the accounting adjustment are made and are correct. Capital assets will be reviewed monthly by the Finance Officer and capitalized in a timely manner. The ambulance receivables are being analyzed and adjusted by the Senior Accountant on a monthly bases.

Anticipated Completion Date: Reviewing journal entries will be done monthly.

2016-003 FINDING: Liquor Store Internal Controls, Qualification of Audit Opinion

Responsible Officials: Fay Bueno, Finance Officer

Corrective Action Plan: Starting on May 1, 2016, the City had a full-time receiving clerk who receives inventory and adds it to the POS system. Receiving is done with an I-phone scanner and is not done manually which allows for fewer mistakes on the receiving end. The City purchased a new POS Systems from LPA Retail Systems with the software Counterpoint. The system was put into place on May 1, 2016. We connected the LPA software to the accounting software that the Finance Office uses January 1, 2017. Prior to that we used the reports from the POS system to provide us receiving, depositing and bill paying information. This system provides many reports and has provided us with the information we are needing to have an accurate inventory and sales. We have a team (three from Finance, one from Human Resource, the City Manager and one other staff from City Hall) that does the inventory twice a year, once in July and once in January. Starting in 2017 we will have four teams doing inventory and will do inventory over a two day period in order to have a more accurate inventory count. The Senior Accountant spot checks the inventory on a monthly basis and the Receiving Clerk will be doing spot checks on inventory on a weekly basis. Several Liquor Store internal control policies have been adopted since October of 2016.

Anticipated Completion Date: 2017



**CORRECTIVE ACTION PLAN (CONTINUED)
DECEMBER 31, 2016**

2016-004 FINDING: Internal Controls

Responsible Officials: Fay Bueno, Finance Officer

Corrective Action Plan: The Finance Officer will provide the City Manager with the reconciliation report, the bank statements and all manual journal entries made each month. The City Manager will review the papers. The newly formed position of Senior Accountant (4th quarter of 2016) will be doing the bank reconciliation and preparing the journal entries and the Finance Officer will review them. We will make sure that all check stock will be located upstairs and locked into a file cabinet and the only person that has a key to the file cabinet is the person who prints the checks and one alternate. We will make sure that all signature stamps are kept locked in a safe place with only the person for whom the stamp belongs to has a key. The other option is to not keep the signature stamp at City Hall when not in use.

Anticipated Completion Date: January 2017

2016-005 FINDING: Bank Reconciliations

Responsible Officials: Fay Bueno, Finance Officer

Corrective Action Plan: The Finance Officer and Senior Accountant will analysis the cash accounts for correct journalizing prior to audit.

Anticipated Completion Date: 2017

2016-006 FINDING: Certificates of Deposit

Responsible Officials: Fay Bueno, Finance Officer

Corrective Action Plan: As the Certificates of Deposit come due the City will re-evaluate the investment policy and determine if there is a better area to invest the City's money.

Anticipated Completion Date: As Certificates of Deposit's mature.