

Management Report
for
City of Victoria, Minnesota
December 31, 2020

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PRINCIPALS

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To the City Council and Management
City of Victoria, Minnesota

We have prepared this management report in conjunction with our audit of the City of Victoria, Minnesota's (the City) financial statements for the year ended December 31, 2020. We have organized this report into the following sections:

- Audit Summary
- Governmental Funds Overview
- Enterprise Funds Overview
- Government-Wide Financial Statements
- Legislative Updates
- Accounting and Auditing Updates

We would be pleased to further discuss any of the information contained in this report or any other concerns that you would like us to address. We would also like to express our thanks for the courtesy and assistance extended to us during the course of our audit.

The purpose of this report is solely to provide those charged with governance of the City, management, and those who have responsibility for oversight of the financial reporting process comments resulting from our audit process and information relevant to city finances in Minnesota. Accordingly, this report is not suitable for any other purpose.

Malloy, Montague, Karnowski, Radosevich & Co., P.A.

Minneapolis, Minnesota
May 18, 2021

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AUDIT SUMMARY

The following is a summary of our audit work, key conclusions, and other information that we consider important or that is required to be communicated to the City Council, administration, or those charged with governance of the City.

OUR RESPONSIBILITY UNDER AUDITING STANDARDS GENERALLY ACCEPTED IN THE UNITED STATES OF AMERICA AND *GOVERNMENT AUDITING STANDARDS*

We have audited the financial statements of the governmental activities, the business-type activities, each major fund, and the aggregate remaining fund information of the City as of and for the year ended December 31, 2020. Professional standards require that we provide you with information about our responsibilities under auditing standards generally accepted in the United States of America and *Government Auditing Standards*, as well as certain information related to the planned scope and timing of our audit. We have communicated such information to you verbally and in our audit engagement letter. Professional standards also require that we communicate the following information related to our audit.

PLANNED SCOPE AND TIMING OF THE AUDIT

We performed the audit according to the planned scope and timing previously discussed and coordinated in order to obtain sufficient audit evidence and complete an effective audit.

AUDIT OPINION AND FINDINGS

Based on our audit of the City's financial statements for the year ended December 31, 2020:

- We have issued an unmodified opinion on the City's basic financial statements.
- We reported no deficiencies in the City's internal control over financial reporting that we considered to be material weaknesses.
- The results of our testing disclosed no instances of noncompliance required to be reported under *Government Auditing Standards*.
- We reported no findings based on our testing of the City's compliance with Minnesota laws and regulations.

OTHER OBSERVATIONS AND RECOMMENDATIONS

Electronic Funds Transfers Fraud

As the use of electronic funds transfers and payment methods has become more prevalent, we have seen increases in both the incidences of fraud related to these transactions and the dollar amounts involved. Operational changes related to the COVID-19 pandemic, including greater reliance on technology and more employees working remotely, have tended to increase risk in this area. We urge cities to carefully review controls over these transactions, and consider best practices to address these risks, such as:

- Ensuring segregation of duties over these transactions by involving more than one employee in the process.
- Requiring multi-factor authentication of requests for electronic payments from new vendors or for changes in wiring instructions for existing vendors. It is recommended that changes for existing vendors be verified through trusted contact information used previously for that vendor, not as provided in the change request, to verify the accuracy of the change.
- Educate employees on the controls in place to protect the organization's financial assets and ensure management is supportive and accepting of the processes in place. Attempted fraudulent transactions are often initiated using the profile of a supervisor. Employees must be comfortable questioning unusual transactions or requests, and instructed not to circumvent internal control procedures regardless of whom they believe initiated the transaction.
- Recommended cyber security measures, such as limiting network access and requiring robust passwords that are changed regularly, should be implemented and followed by all city employees, not just those directly involved with financial transactions.
- Review insurance policies to understand the coverage provided for financial losses due to cybersecurity risks and evaluate whether they provide adequate coverage based on management's assessment of these risks.

Uniform Guidance Written Controls and Micro-Purchase Threshold

Federal Uniform Guidance requires that nonfederal entities must have and use documented procurement procedures consistent with 2CFR § 200.317-320 for the acquisition of property or services required under a federal award or subaward. Effective August 31, 2020, the federal micro-purchase threshold, which is the threshold that allows for procurements without soliciting competitive price or rate quotations given certain conditions, was increased from \$3,500 to \$10,000 in the Federal Acquisition Regulations (FAR).

Effective November 12, 2020, the Uniform Guidance was also revised to allow nonfederal entities to establish a micro-purchase threshold higher than the \$10,000 threshold established in the FAR under certain circumstances. The nonfederal entity may self-certify a micro-purchase threshold up to \$50,000 if the requirements in 2CFR § 200.320(a)(1)(iv) are followed. Requirements include an *annual* self-certification and clear documentation of the justification to support the increase in the threshold. Acceptable reasons for justification must meet *one* of the following criteria:

- A qualification as a low-risk auditee, in accordance with the criteria in §200.520 for the most recent audit,
- An annual internal institutional risk assessment to identify, mitigate, and manage financial risks, or,
- A higher threshold consistent with state law.

This flexibility would allow Minnesota local governments to increase and align their federal procurement procedures, specifically the micro-purchase threshold, with state law, which allows for procurements below \$25,000 to be made without competitive price or rate quotations.

We recommend that the City review its current federal procurement policy. If the micro-purchase threshold in your currently adopted policy is below the allowable FAR limit of \$10,000, you would need to make a one-time amendment to the policy to adopt the \$10,000 FAR limit before using it. If you prefer to increase your federal micro-purchase threshold to \$25,000 to align it with state law, in addition to amending your federal procurement policy, you would need to annually certify the higher threshold and the justification for using the higher threshold.

SIGNIFICANT ACCOUNTING POLICIES

Management is responsible for the selection and use of appropriate accounting policies. The significant accounting policies used by the City are described in Note 1 of the notes to basic financial statements. No new accounting policies were adopted and the application of existing policies was not changed during the year ended December 31, 2020.

We noted no transactions entered into by the City during the year for which there is a lack of authoritative guidance or consensus. All significant transactions have been recognized in the financial statements in the proper period.

ACCOUNTING ESTIMATES AND MANAGEMENT JUDGMENTS

Accounting estimates are an integral part of the financial statements prepared by management and are based on management's knowledge and experience about past and current events and assumptions about future events. Certain accounting estimates are particularly sensitive because of their significance to the financial statements and because of the possibility that future events affecting them may differ significantly from those expected. The most sensitive estimates affecting the financial statements were:

- The City has recorded liabilities and activity for pension benefits. These obligations are calculated using actuarial methodologies described in Governmental Accounting Standards Board Statement No. 68. These actuarial calculations include significant assumptions, including projected changes, healthcare insurance costs, investment returns, retirement ages, proportionate share, and employee turnover.
- The depreciation of capital assets involves estimates pertaining to useful lives.
- Compensated absences – Management's estimate is based on current rates of pay and unused compensated absence balances.
- Value of assets held for resale – Management's estimate of these assets is based on net realizable value (lower of cost or acquisition value).

We evaluated the key factors and assumptions used by management to develop these estimates in determining that they are reasonable in relation to the basic financial statements taken as a whole.

Certain financial statement disclosures are particularly sensitive because of their significance to financial statement users. The disclosures included in the notes to the basic financial statements related to pension benefits are particularly sensitive, due to the materiality of the liabilities, and the large and complex estimates involved in determining the disclosures.

The financial statement disclosures are neutral, consistent, and clear.

DIFFICULTIES ENCOUNTERED IN PERFORMING THE AUDIT

We encountered no significant difficulties in dealing with management in performing and completing our audit.

CORRECTED AND UNCORRECTED MISSTATEMENTS

Professional standards require us to accumulate all known and likely misstatements identified during the audit, other than those that are clearly trivial, and communicate them to the appropriate level of management. There were no misstatements detected as a result of audit procedures that were material, either individually or in the aggregate, to each opinion unit's financial statements taken as a whole.

DISAGREEMENTS WITH MANAGEMENT

For purposes of this report, a disagreement with management is a financial accounting, reporting, or auditing matter, whether or not resolved to our satisfaction, that could be significant to the financial statements or the auditor's report. We are pleased to report that no such disagreements arose during the course of our audit.

MANAGEMENT REPRESENTATIONS

We have requested certain representations from management that are included in the management representation letter dated May 18, 2021.

MANAGEMENT CONSULTATIONS WITH OTHER INDEPENDENT ACCOUNTANTS

In some cases, management may decide to consult with other accountants about auditing and accounting matters, similar to obtaining a "second opinion" on certain situations. If a consultation involves application of an accounting principle to the City's financial statements or a determination of the type of auditor's opinion that may be expressed on those statements, our professional standards require the consulting accountant to check with us to determine that the consultant has all the relevant facts. To our knowledge, there were no such consultations with other accountants.

OTHER AUDIT FINDINGS OR ISSUES

We generally discuss a variety of matters, including the application of accounting principles and auditing standards with management each year prior to retention as the City's auditors. However, these discussions occurred in the normal course of our professional relationship and our responses were not a condition to our retention.

OTHER MATTERS

We applied certain limited procedures to the management's discussion and analysis (MD&A) and the pension related required supplementary information (RSI) that supplements the basic financial statements. Our procedures 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 did not audit the RSI and do not express an opinion or provide any assurance on the RSI.

We were engaged to report on the supplementary information accompanying the financial statements, which is not RSI. With respect to this supplementary information, we made certain inquiries of management and evaluated the form, content, and methods of preparing the information to determine that the information complies with accounting principles generally accepted in the United States of America, the method of preparing it has not changed from the prior period, and the information is appropriate and complete in relation to our audit of the financial statements. We compared and reconciled the supplementary information to the underlying accounting records used to prepare the financial statements or to the financial statements themselves.

We were not engaged to report on the introductory section and statistical section, which accompany the financial statements, but is not RSI. Such information 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.

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GOVERNMENTAL FUNDS OVERVIEW

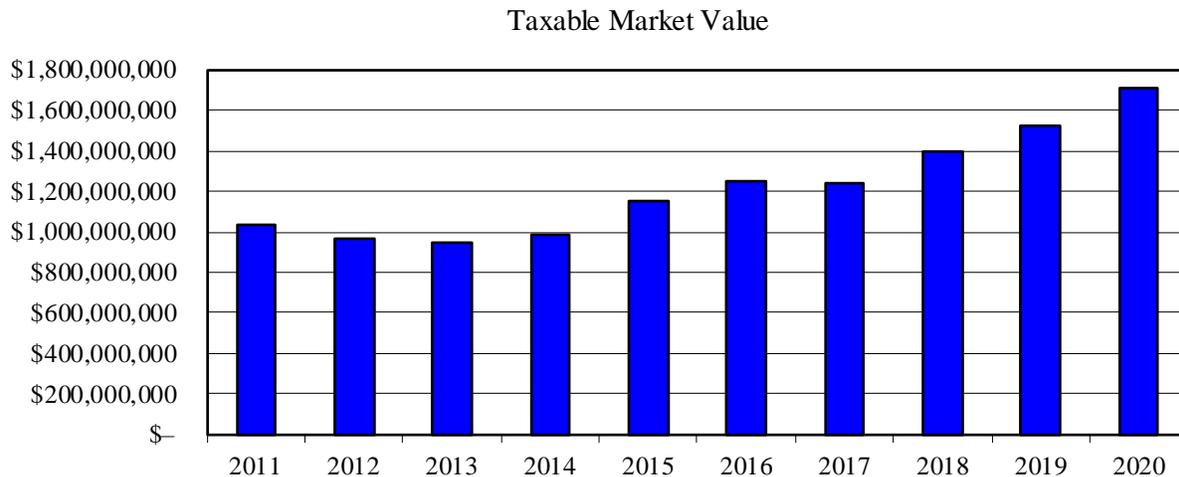
This section of the report provides you with an overview of the financial trends and activities of the City's governmental funds, which includes the General, special revenue, debt service, and capital project funds. These funds are used to account for the basic services the City provides to all of its citizens, which are financed primarily with property taxes. The governmental fund information in the City's financial statements focuses on budgetary compliance and the sufficiency of each governmental fund's current assets to finance its current liabilities.

PROPERTY TAXES

Minnesota cities rely heavily on local property tax levies to support their governmental fund activities. For the 2019 fiscal year, local ad valorem property tax levies provided 40.8 percent of the total governmental fund revenues for cities over 2,500 in population, and 37.6 percent for cities under 2,500 in population. Total property taxes levied by all Minnesota cities for taxes payable in 2020 increased 6.1 percent from the prior year.

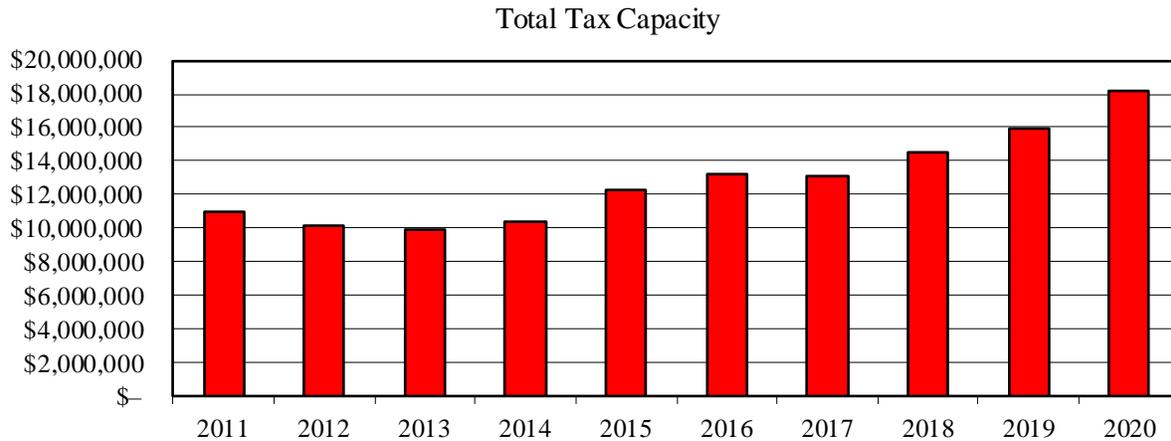
The total tax capacity value of property in Minnesota cities increased about 6.5 percent for the 2020 levy year. The tax capacity values used for levying property taxes are based on the assessed market values for the previous fiscal year (e.g., tax capacity values for taxes levied in 2020 were based on assessed market values as of January 1, 2019), so the trend of change in these tax capacity values lags somewhat behind the housing market and economy in general.

The City's taxable market value increased 9.4 percent for taxes payable in 2019 and 11.7 percent for taxes payable in 2020. The following graph shows the City's changes in taxable market value over the past 10 years:



Tax capacity is considered the actual base available for taxation. It is calculated by applying the state’s property classification system to each property’s market value. Each property classification, such as commercial or residential, has a different calculation and uses different rates. Consequently, a city’s total tax capacity will change at a different rate than its total market value, as tax capacity is affected by the proportion of its tax base that is in each property classification from year-to-year, as well as legislative changes to tax rates. The City’s tax capacity increased 9.6 percent and 14.0 percent for taxes payable in 2019 and 2020, respectively.

The following graph shows the City’s change in tax capacities over the past 10 years:



The following table presents the average tax rates applied to city residents for each of the last three levy years:

Rates Expressed as a Percentage of Net Tax Capacity			
	City of Victoria		
	2018	2019	2020
Average tax rate			
City	32.8	32.4	32.1
County	37.4	36.5	36.9
School (ISD No. 112)	33.8	33.6	33.0
Special taxing entities	4.7	4.5	2.4
Total	<u>108.7</u>	<u>107.0</u>	<u>104.4</u>

The total average tax rate decreased from the prior year. A slight increase in the county portion was offset by decreases in the city, school, and special taxing authority rates.

GOVERNMENTAL FUND BALANCES

The following table summarizes the changes in the fund balances of the City's governmental funds during the year ended December 31, 2020, presented both by fund balance classification and by major fund:

Governmental Funds Change in Fund Balance			
	Fund Balance as of December 31,		Change
	<u>2020</u>	<u>2019</u>	
Fund balances of governmental funds			
Total by classification			
Nonspendable	\$ 590,341	\$ 395,117	\$ 195,224
Restricted	4,568,593	6,394,681	(1,826,088)
Committed	3,405,769	3,462,585	(56,816)
Assigned	6,123,966	4,148,633	1,975,333
Unassigned	<u>1,047,635</u>	<u>1,020,792</u>	<u>26,843</u>
Total governmental funds	<u>\$ 15,736,304</u>	<u>\$ 15,421,808</u>	<u>\$ 314,496</u>
Total by fund			
General	\$ 3,176,681	\$ 3,167,494	\$ 9,187
Victoria Recreation Center	1,071,147	1,038,806	32,341
Debt Service	3,324,774	4,129,502	(804,728)
Tax Increment District No. 5	(299,255)	(299,907)	652
Tax Increment District No. 6	(117,992)	(100,397)	(17,595)
Marsh Lake Road Improvements	186,161	-	186,161
Park	964,152	929,617	34,535
Nonmajor	<u>7,430,636</u>	<u>6,556,693</u>	<u>873,943</u>
Total governmental funds	<u>\$ 15,736,304</u>	<u>\$ 15,421,808</u>	<u>\$ 314,496</u>

In total, the fund balances of the City's governmental funds increased by \$314,496 during the year ended December 31, 2020. The increase was largely due to assigned fund balance in the nonmajor funds, resulting from transfers from the General Fund for future capital equipment and improvements. This increase was offset by a decrease in restricted funds, mainly due to the spend down of prior year bond proceeds, and due to the City refunding outstanding bonds in 2020.

GOVERNMENTAL FUND REVENUES

The following table presents the per capita revenue of the City's governmental funds for the past three years, along with state-wide averages.

We have included the most recent comparative state-wide averages available from the Office of the State Auditor to provide a benchmark for interpreting the City's data. The amounts received from the typical major sources of governmental fund revenue will naturally vary between cities based on factors, such as a city's stage of development, location, size and density of its population, property values, services it provides, and other attributes. It will also differ from year-to-year, due to the effect of inflation and changes in its operation. Also, certain data in these tables may be classified differently than how they appear in the City's financial statements in order to be more comparable to the state-wide information, particularly in separating capital expenditures from current expenditures.

We have designed this section of our management report using per capita data in order to better identify unique or unusual trends and activities of the City. We intend for this type of comparative and trend information to complement, rather than duplicate, information in the MD&A. An inherent difficulty in presenting per capita information is the accuracy of the population count, which for most years is based on estimates.

Governmental Funds Revenue per Capita						
With State-Wide Averages by Population Class						
Year	State-Wide			City of Victoria		
	December 31, 2019			2018	2019	2020
	2,500–10,000	10,000–20,000	20,000–100,000	10,144	10,476	10,808
Property taxes	\$ 514	\$ 489	\$ 512	\$ 479	\$ 497	\$ 547
Tax increments	30	28	44	26	38	39
Franchise and other taxes	45	50	50	35	37	36
Special assessments	54	38	53	65	42	39
Licenses and permits	40	35	51	67	63	65
Intergovernmental revenues	342	297	201	16	16	89
Charges for services	135	108	115	140	143	115
Other	89	78	79	59	77	51
Total revenue	\$ 1,249	\$ 1,123	\$ 1,105	\$ 887	\$ 913	\$ 981

The City's governmental fund revenues for 2020 were \$10,602,577, an increase of \$1,021,927 (10.7 percent) from the prior year. The City's per capita governmental funds revenue for 2020 was \$981, an increase of \$68, from the prior year, including the effect of a change in estimated population. The largest changes occurred with increases in intergovernmental revenues and property taxes offset by decreases in charges for services and other revenue. Intergovernmental revenues increased by \$73 per capita, due to the recognition of the City's portion of coronavirus relief funds (CRF). Property taxes increased in the current year, mainly due to the increased property tax levy. These increases were offset by the decrease in charges for service of \$28 per capita, mainly due to the closure of the Victoria Recreation Center at times during 2020, due to the COVID-19 pandemic. The remaining decrease in other revenues is due to funds received from developers for tree replacement in the prior year, and due to a less favorable investment market and lower available interest rates in the current year.

GOVERNMENTAL FUND EXPENDITURES

The expenditures of governmental funds will also vary from state-wide averages and from year-to-year, based on the City's circumstances. Expenditures are classified into three types as follows:

- **Current** – These are typically the general operating type expenditures occurring on an annual basis, and are primarily funded by general sources, such as taxes and intergovernmental revenues.
- **Capital Outlay and Construction** – These expenditures do not occur on a consistent basis, more typically fluctuating significantly from year-to-year. Many of these expenditures are project-oriented, and are often funded by specific sources that have benefited from the expenditure, such as special assessment improvement projects.
- **Debt Service** – Although the expenditures for debt service may be relatively consistent over the term of the respective debt, the funding source is the important factor. Some debt may be repaid through specific sources, such as special assessments or redevelopment funding, while other debt may be repaid with general property taxes.

The City's expenditures per capita of its governmental funds for the past three years, together with comparative state-wide averages, are presented in the following table:

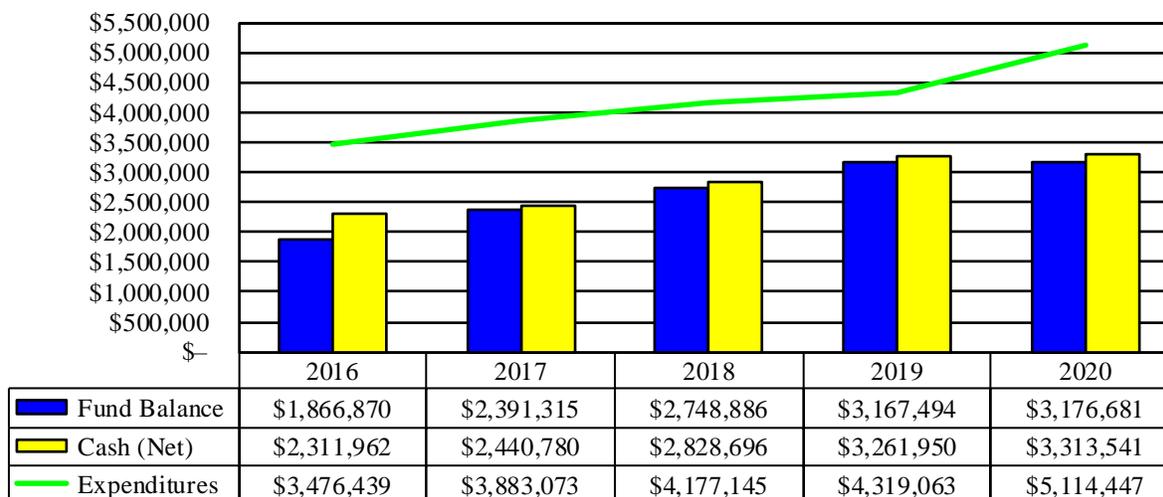
Governmental Funds Expenditures per Capita With State-Wide Averages by Population Class						
Year	State-Wide			City of Victoria		
	December 31, 2019			2018	2019	2020
Population	2,500–10,000	10,000–20,000	20,000–100,000	10,144	10,476	10,808
Current						
General government	\$ 152	\$ 128	\$ 107	\$ 153	\$ 151	\$ 171
Public safety	300	282	306	122	122	129
Streets and highways	146	149	119	91	85	71
Culture and recreation	103	124	106	108	98	96
All other	74	75	97	–	1	2
Total current	<u>775</u>	<u>758</u>	<u>735</u>	<u>474</u>	<u>457</u>	<u>469</u>
Capital outlay and construction	438	376	355	381	118	573
Debt service						
Principal	168	182	88	190	196	180
Interest and fiscal charges	43	41	28	55	50	50
Total debt service	<u>211</u>	<u>223</u>	<u>116</u>	<u>245</u>	<u>246</u>	<u>230</u>
Total expenditures	<u>\$ 1,424</u>	<u>\$ 1,357</u>	<u>\$ 1,206</u>	<u>\$ 1,100</u>	<u>\$ 821</u>	<u>\$ 1,272</u>

Total expenditures in the City's governmental funds for 2020 were \$13,744,741, an increase of \$5,148,630 (59.9 percent). The City's per capita governmental funds total expenditures increased \$451. This increase was mainly in capital outlay and construction, which increased \$455 per capita, due to the Marsh Lake Road street improvement project and construction of Wasserman Lake Preserve.

GENERAL FUND

The City's General Fund accounts for the financial activity of the basic services provided to the community. The primary services included within this fund are the administration of the municipal operation, police and fire protection, building inspection, streets and highway maintenance, and culture and recreation. The graph below illustrates the change in the General Fund financial position over the last five years. We have also included a line representing annual expenditures to reflect the change in the size of the General Fund operation over the same period.

General Fund Financial Position
Year Ended December 31,



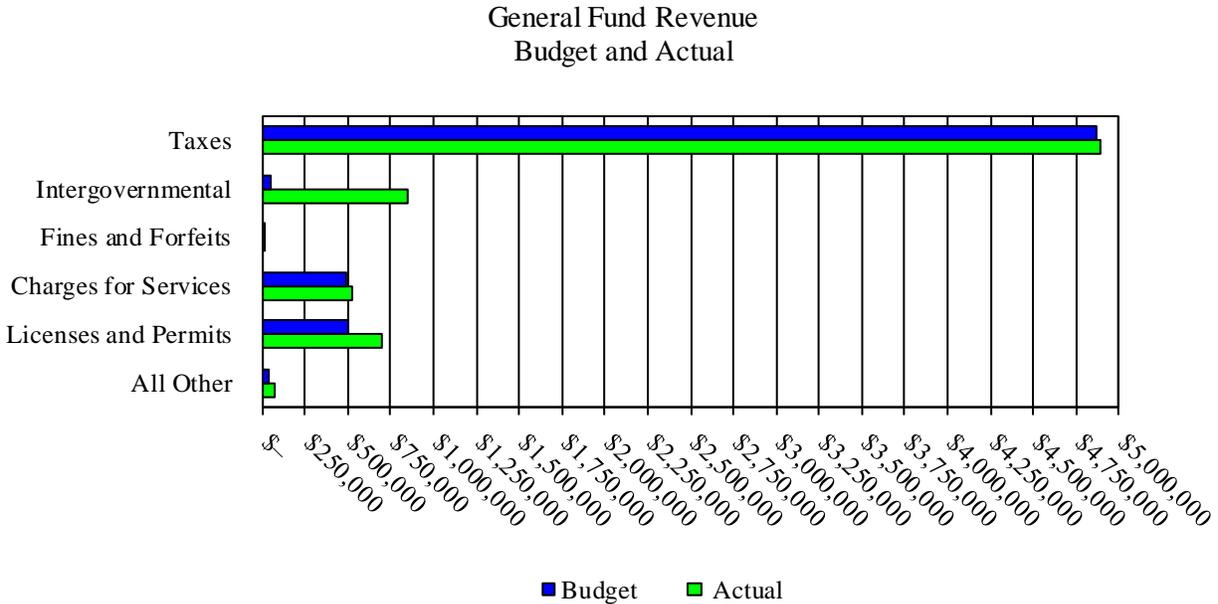
The City's General Fund cash and investment balance (net of borrowing) at December 31, 2020 was \$3,313,541, an increase of \$51,591 from the previous year. Total fund balance at December 31, 2020 was \$3,176,681, an increase of \$9,187 from the prior year.

As the graph illustrates, the City has generally been able to maintain healthy cash and fund balance levels as the volume of financial activity has grown. This is an important factor because a government, like any organization, requires a certain amount of equity to operate. A healthy financial position allows the City to avoid volatility in tax rates; helps minimize the impact of state funding changes; allows for the adequate and consistent funding of services, repairs, and unexpected costs; and is a factor in determining the City's bond rating and resulting interest costs. Maintaining an adequate fund balance has become increasingly important given the fluctuations in state funding for cities in recent years.

A trend that is typical to Minnesota local governments, especially the General Fund of cities, is the unusual cash flow experienced throughout the year. The City's General Fund cash disbursements are made fairly evenly during the year, other than the impact of seasonal services, such as snowplowing, street maintenance, and park activities. Cash receipts of the General Fund are quite a different story. Taxes comprise about 69.4 percent of the fund's total annual revenue. Approximately half of these revenues are received by the City in July and the rest in December. Consequently, the City needs to have adequate cash reserves to finance its everyday operations between these payments.

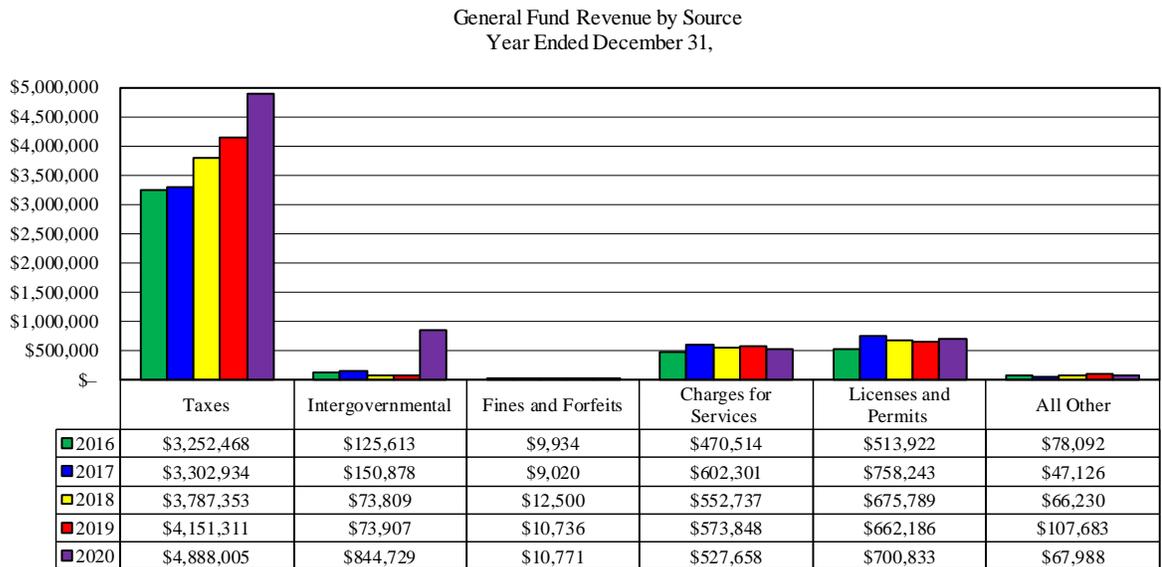
Current city policy allows the fund balance in the General Fund to grow to 30 percent of the subsequent year's budgeted expenditures. At December 31, 2020, the unassigned fund balance for the General Fund was 30 percent of the subsequent year's budgeted expenditures. The City should review the level of fund balance on an ongoing basis to determine the optimal level for efficient operations.

The following graph reflects the City's General Fund revenue sources for 2020 compared to budget:



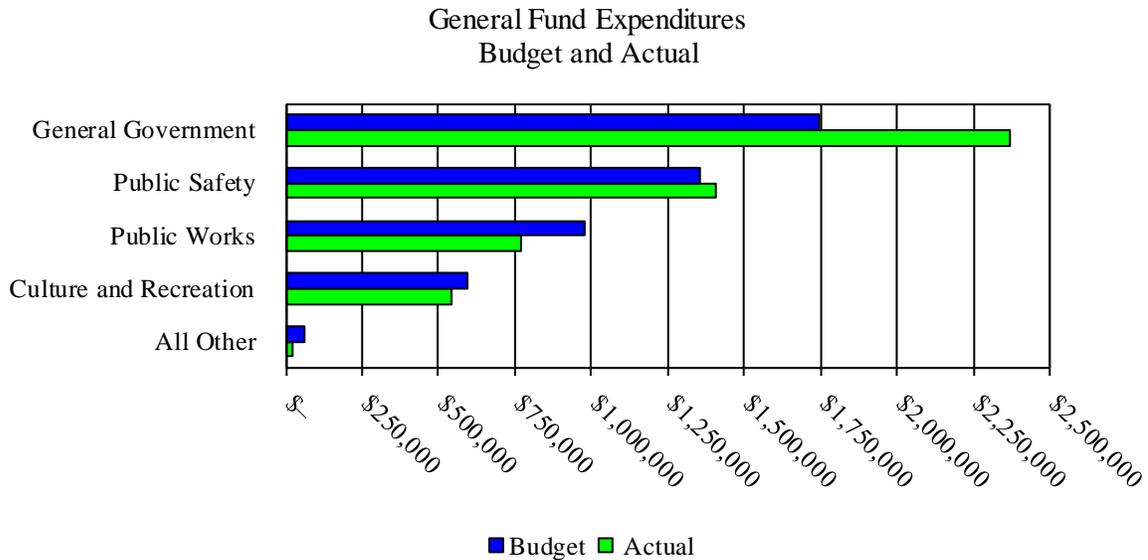
Total General Fund revenues for 2020 were \$7,039,984, an increase of \$1,460,313 from the previous year, and were \$1,090,984 (18.3 percent) over budget. Revenues were more than projected in each category as presented above, with the largest variances in the intergovernmental and licenses and permits categories. Intergovernmental revenues were \$798,457 over budget, due to receipt of CRF. Licenses and permits revenues were \$199,884 over budget, due to more than anticipated building activity.

The following graph presents the City's General Fund revenues by source for the last five years. The graph reflects the City's reliance on property taxes and other local sources of revenue.



The increase in General Fund revenues was mainly in intergovernmental and taxes. Intergovernmental revenues increased \$770,822, due to receipt of CRF as previously mentioned. The increase in taxes of \$736,694 is a result of an increase in the property tax levy approved by the City Council for 2020.

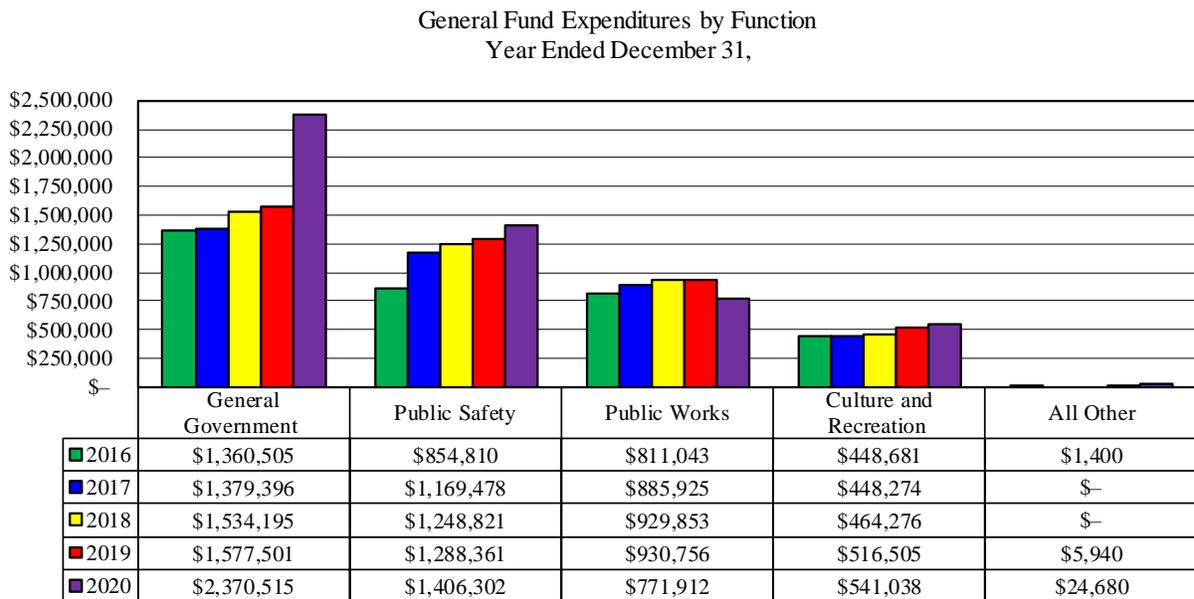
The following graph illustrates the components of General Fund spending for 2020 compared to budget:



General Fund expenditures for 2020 were \$5,114,447, an increase of \$795,384 from the previous year, and were \$377,527 (8.0 percent) over budget. General government expenditures were \$624,534 over budget, mainly due to furniture and equipment purchases and renovations at City Hall funded by CRF. This variance was offset by expenditures under budget in public works by \$208,317, mainly in the streets and highways department.

The City also transferred out \$770,788 more than budgeted to other funds for capital projects and equipment, in accordance with its fund balance policy.

The following graph presents the City’s General Fund expenditures by function for the last five years:



The increase in General Fund expenditures was mainly in the general government function, due to furniture and equipment purchases and renovations at City Hall, as previously mentioned.

ENTERPRISE FUNDS OVERVIEW

The City maintains several enterprise funds to account for services the City provides that are financed primarily through fees charged to those utilizing the service. This section of the report provides you with an overview of the financial trends and activities of the City's enterprise funds, which include the Water Fund, Sewer Fund, and the Storm Water Management Fund.

ENTERPRISE FUNDS FINANCIAL POSITION

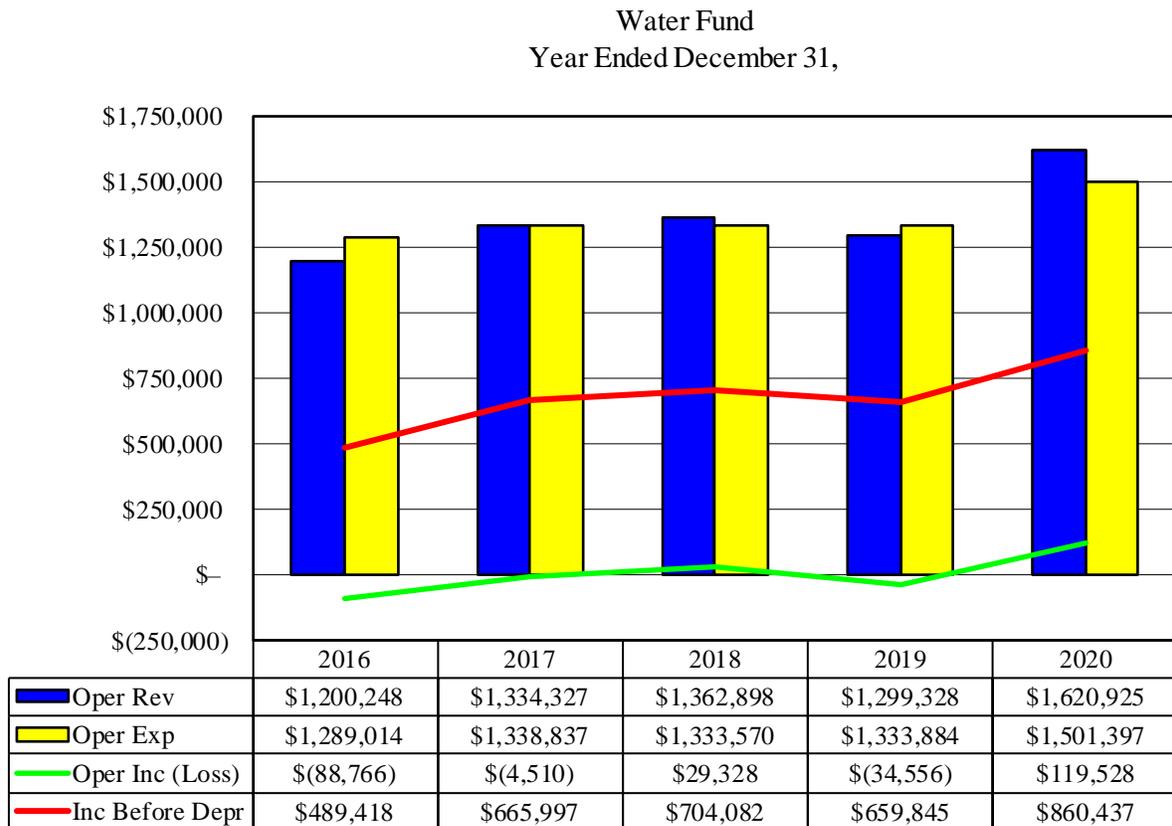
The following table summarizes the changes in the financial position of the City's enterprise funds during the year ended December 31, 2020, presented both by classification and by fund:

Enterprise Funds Change in Financial Position			
	Net Position as of December 31,		Change
	2020	2019	
Net position of enterprise funds			
Total by classification			
Net investment in capital assets	\$ 44,542,605	\$ 41,087,740	\$ 3,454,865
Unrestricted	<u>6,648,560</u>	<u>5,904,578</u>	<u>743,982</u>
Total enterprise funds	<u>\$ 51,191,165</u>	<u>\$ 46,992,318</u>	<u>\$ 4,198,847</u>
Total by fund			
Water	\$ 21,245,721	\$ 19,865,773	\$ 1,379,948
Sewer	16,305,846	14,462,855	1,842,991
Storm water management	<u>13,639,598</u>	<u>12,663,690</u>	<u>975,908</u>
Total enterprise funds	<u>\$ 51,191,165</u>	<u>\$ 46,992,318</u>	<u>\$ 4,198,847</u>

In total, the net position of the City's enterprise funds increased by \$4,198,847 during the year ended December 31, 2020. Net investment in capital assets increased \$3,454,865, due to continued investment in utility infrastructure and increased developer contributions.

WATER FUND

The following graph presents five years of comparative operating results for the City's Water Fund:



The Water Fund ended 2020 with a total net position of \$21,245,721, an increase of \$1,379,948 from the prior year. Of this, \$18,237,694 represents the investment in capital assets, leaving unrestricted net position of \$3,008,027.

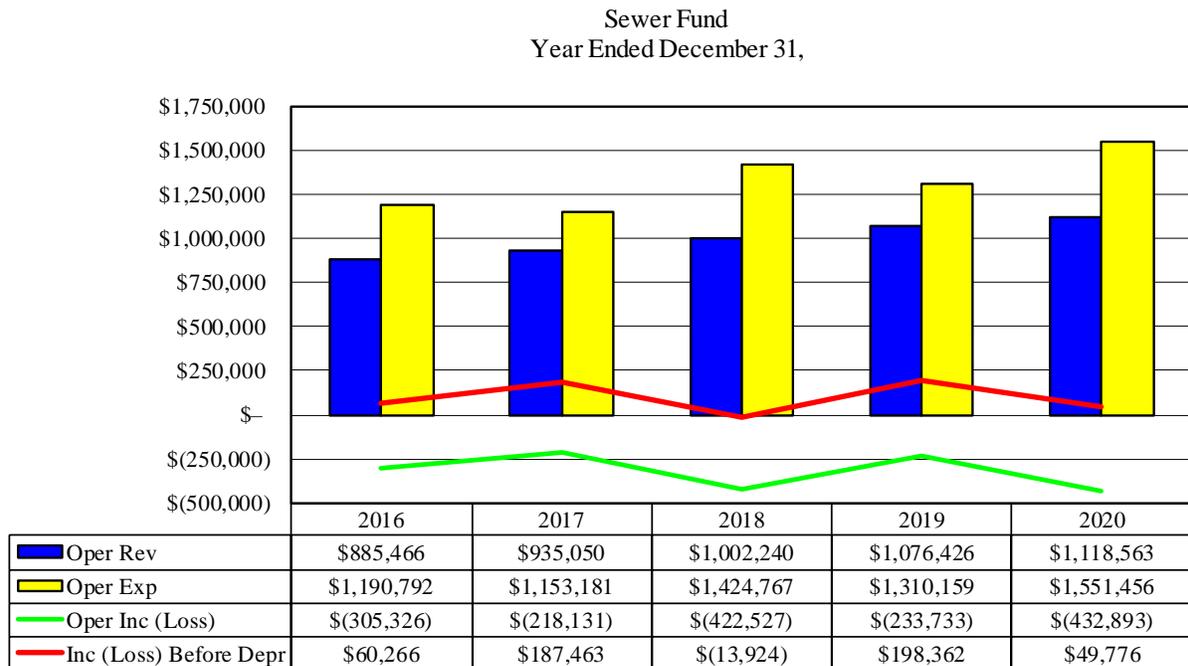
Operating revenue in the Water Fund increased \$321,597 (24.8 percent) from the prior year. This was due to an increase in water consumption and connections.

Water Fund operating expenses for 2020 increased \$167,513 (12.6 percent) from the previous year, mainly in personal services and professional services.

The Water Fund continued to recognize significant capital contributions in the current year, due to development within the City.

SEWER FUND

The following graph presents five years of comparative operating results for the City's Sewer Fund:



The Sewer Fund ended 2020 with a total net position of \$16,305,846, an increase of \$1,842,991 from the prior year. Of this, \$13,469,141 represents the investment in capital assets, leaving unrestricted net position of \$2,836,705.

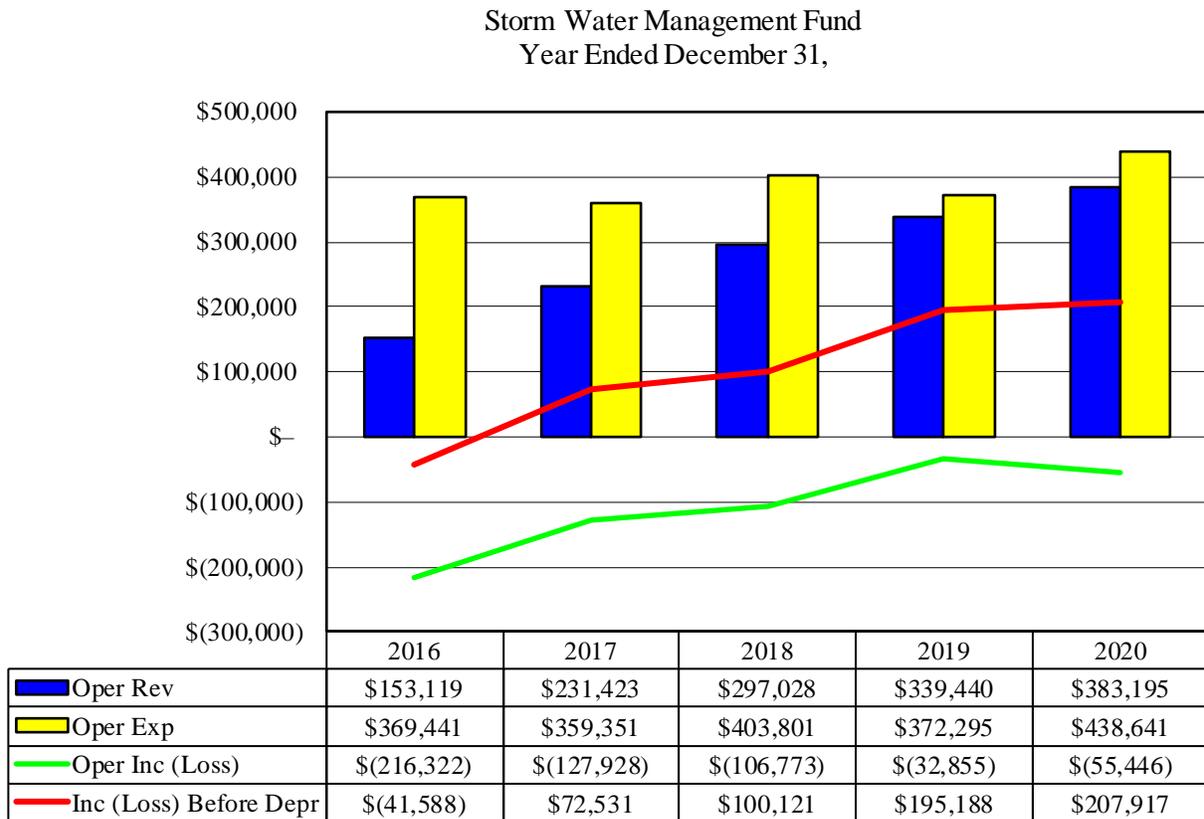
Operating revenue in the Sewer Fund increased \$42,137 (3.9 percent) from the prior year, due to an increase in consumption and rates in the current year.

Sewer Fund operating expenses for 2020 increased \$241,297 (18.4 percent) from the previous year. The largest operating expense of this fund is to Metropolitan Council Environmental Services (MCES) for sewer service charges. MCES disposal charges in 2020 increased \$70,360 from the prior year. This fund also had an increase in materials and supplies of \$91,449 in the current year, due to sewer repairs.

The Sewer Fund continued to recognize significant capital contributions in the current year, due to development within the City.

STORM WATER MANAGEMENT FUND

The following graph presents five years of comparative operating results for the City's Storm Water Management Fund:



The Storm Water Management Fund ended 2020 with a total net position of \$13,639,598, an increase of \$975,908 from the prior year. Of this, \$12,835,770 represents the investment in capital assets, leaving unrestricted net position of \$803,828.

Operating revenue in the Storm Water Management Fund increased \$43,755 (12.9 percent) from the prior year, due to an approved rate increase.

Storm Water Management Fund operating expenses for 2020 increased \$66,346 (17.8 percent) from the previous year, mainly in professional services.

The Storm Water Management Fund continued to recognize significant capital contributions in the current year, due to development within the City.

GOVERNMENT-WIDE FINANCIAL STATEMENTS

In addition to fund-based information, the current reporting model for governmental entities also requires the inclusion of two government-wide financial statements designed to present a clear picture of the City as a single, unified entity. These government-wide financial statements provide information on the total cost of delivering services, including capital assets and long-term liabilities.

STATEMENT OF NET POSITION

The Statement of Net Position essentially tells you what the City owns and owes at a given point in time, the last day of the fiscal year. Theoretically, net position represents the resources the City has leftover to use for providing services after its debts are settled. However, those resources are not always in spendable form, or there may be restrictions on how some of those resources can be used. Therefore, net position is divided into three components: net investment in capital assets, restricted, and unrestricted.

The following table presents the components of the City's net position as of December 31, 2020 and 2019, for governmental activities and business-type activities:

	As of December 31,		Change
	2020	2019	
Net position			
Governmental activities			
Net investment in capital assets	\$ 29,225,688	\$ 25,618,968	\$ 3,606,720
Restricted	5,732,775	6,661,562	(928,787)
Unrestricted	9,764,457	8,185,594	1,578,863
Total governmental activities	<u>44,722,920</u>	<u>40,466,124</u>	<u>4,256,796</u>
Business-type activities			
Net investment in capital assets	44,542,605	41,087,740	3,454,865
Unrestricted	6,648,560	5,904,578	743,982
Total business-type activities	<u>51,191,165</u>	<u>46,992,318</u>	<u>4,198,847</u>
Total net position	<u>\$ 95,914,085</u>	<u>\$ 87,458,442</u>	<u>\$ 8,455,643</u>

The City ended 2020 with a combined total net position of \$95,914,085, an increase of \$8,455,643 from the prior year. The increase in governmental activities net investment in capital assets is due to continued investment in infrastructure and increased developer contributions.

The business-type activities net position increased in the current year as previously discussed.

STATEMENT OF ACTIVITIES

The Statement of Activities tracks the City's yearly revenues and expenses, as well as any other transactions that increase or reduce total net position. These amounts represent the full cost of providing services. The Statement of Activities provides a more comprehensive measure than just the amount of cash that changed hands, as reflected in the fund-based financial statements. This statement includes the cost of supplies used, depreciation of long-lived capital assets, and other accrual-based expenses.

The following table presents the change in the net position of the City for the years ended December 31, 2020 and 2019:

	2020			2019
	Expenses	Program Revenues	Net Change	Net Change
Net (expense) revenue				
Governmental activities				
General government	\$ 1,928,824	\$ 5,898	\$ (1,922,926)	\$ (1,692,086)
Public safety	1,607,359	1,130,440	(476,919)	(331,605)
Public works	2,424,327	2,448,737	24,410	(627,997)
Culture and recreation	1,519,792	1,039,243	(480,549)	(161,844)
Economic development	243,915	–	(243,915)	(89,801)
Interest and fiscal charges	481,765	–	(481,765)	(464,025)
Business-type activities				
Water	1,589,830	2,923,996	1,334,166	1,093,744
Sewer	1,552,463	3,352,464	1,800,001	1,075,783
Storm water management	438,641	1,404,310	965,669	807,906
Total net (expense) revenue	<u>\$ 11,786,916</u>	<u>\$ 12,305,088</u>	518,172	(389,925)
General revenues				
Property taxes			5,893,840	5,200,776
Tax increments			439,348	401,035
Franchise taxes			393,737	390,426
Grants and contributions not restricted to specific programs			753,532	1,753
Other general revenues			123,380	137,763
Investment earnings			333,634	579,471
Total general revenues			<u>7,937,471</u>	<u>6,711,224</u>
Change in net position			<u>\$ 8,455,643</u>	<u>\$ 6,321,299</u>

One of the goals of this statement is to provide a side-by-side comparison to illustrate the difference in the way the City's governmental and business-type operations are financed. The table clearly illustrates the dependence of the City's governmental operations on general revenues, such as property taxes and unrestricted grants. It also shows that the City's business-type activities are generating sufficient program revenues (service charges and program-specific grants) to cover expenses. This is critical given the current downward pressures on the general revenue sources. The change in public works reflects the increase in capital infrastructure contributions received from new development in the current year. The increase in grants and contributions not restricted to specific programs is due to recognition of the City's portion of CRF.

LEGISLATIVE UPDATES

The 2020 legislative session, coming in the second half of the state's fiscal biennium, was expected to be a typical short session focused primarily on making relatively minor modifications to the biennial budget. Given a projected budget surplus of \$1.5 billion going into the session, consideration of a substantial capital investment and bonding bill was also a potential focus.

The start of the legislative session in February was followed by a series of significant events that changed the course of the session, including a world-wide health pandemic, the death of George Floyd while in police custody and the ensuing protests and unrest, and a hotly contested national election. On March 13, 2020, the Governor issued an executive order declaring a peacetime emergency, giving his administration the ability to quickly impose restrictions and measures aimed at mitigating the COVID-19 outbreak. By early May, the state's budget outlook had changed from a robust surplus to a projected deficit of \$2.4 billion. The legislative session ultimately encompassed an unprecedented seven special sessions, more than double the previous state record of three, with the final special session in mid-December.

In the end, a \$1.87 billion omnibus bonding bill was passed that included \$1.36 billion in general obligation state bonding for capital improvements, \$31.0 million in supplemental General Fund budget spending, and provisions for tax relief and economic assistance. The session also yielded a new Police Accountability Act, and a \$217.0 million economic relief package to help businesses negatively impacted by the pandemic. The following is a brief summary of legislative changes from the 2020 session or previous legislative sessions potentially impacting Minnesota cities.

Coronavirus Aid, Relief, and Economic Security (CARES) Act – The CARES Act provided federal economic relief to protect the American people from the public health and economic impacts of COVID-19. Minnesota received approximately \$2.2 billion in funding under the CARES Act.

When the first legislative special session ended without an agreement on the distribution of approximately \$841.5 million of federal Coronavirus Relief Fund (CRF) funding earmarked for Minnesota local governments, the Governor distributed the funds by executive order based on the framework of the legislative agreement debated during the first special session. This resulted in \$350.4 million being distributed directly to Minnesota cities with populations equal to or greater than 200. The funds were authorized for use for unbudgeted costs related to the COVID-19 pandemic, but not to replace lost revenues. In accordance with CARES Act provisions, the CRF funding was available to cover costs that; 1) were necessary expenditures incurred due to the public health emergency related to COVID-19; 2) were not accounted for in the entity's budget most recently approved as of March 27, 2020; and 3) were incurred during the period from March 1, 2020 through December 31, 2020 (the availability period end date was revised by the state to November 15, 2020 for Minnesota cities).

Emergency Small Business Assistance Program – The Legislature created a program to appropriate \$60.0 million of federal CRF funding to make grants available through the Minnesota Department of Employment and Economic Development for eligible small businesses impacted by COVID-19. Small businesses employing up to 50 full-time employees are eligible to receive grants of up to \$10,000. The allocation is split between the metro area and greater Minnesota, with specific allocations for businesses owned by minorities, veterans, and women. \$18.0 million of the allocation is earmarked for businesses with 6 or less employees.

Workers' Compensation Claims – COVID-19 Presumption – The Legislature adopted several new provisions to state unemployment statutes related to COVID-19, including a presumption that an employee who contracts COVID-19 has an "occupational disease" arising out of, and in the course of, employment if the employee works in one of the specified occupations and has a confirmed case of COVID-19. Covered occupations include nurses, healthcare workers, and workers required to provide childcare for first responders and healthcare workers under Executive Orders 20-02 and 20-19. The COVID-19 presumption provision sunsets on May 1, 2021.

Bonding Bill – The 2020 bonding bill provided financing for approximately \$1.36 billion of projects. Some of the more significant appropriations for local infrastructure included: \$105 million in undesignated grants for local road improvement and bridge replacement; \$100 million for water infrastructure and point source implementation grants; \$25 million for state match of federal grants for public facilities improvements, \$20 million for natural resource asset preservation, \$17 million for flood control mitigation, \$15 million for the Local Government Roads Wetlands Replacement Program; \$5 million for Metropolitan Council inflow and infiltration grants; and \$5 million for metropolitan regional parks and trails. The bill also included funding for a number of state initiatives, including: \$300 million in trunk highway bonds for the improvement of the state trunk highway system; \$145 million in appropriation bonds to fund the infrastructure and capital needs of the Minnesota Housing Finance Agency, Minnesota Pollution Control Agency, and Minnesota Public Television; \$30 million for state agency projects aimed at promoting racial equity, \$29.5 million for the state Emergency Operations Center; and \$16 million for the Minnesota Housing Finance Agency.

The bill provides authority for eligible local governments to own and operate childcare facilities, and permits local governments to enter into management agreements with licensed childcare providers to operate in publicly-owned facilities. It also makes cities, counties, school districts, and joint powers boards located outside of the seven-county metro area eligible to apply for grants through the Greater Minnesota Childcare Facility Capital Grant Program.

The bill also included a provision extending the equal pay certificate of compliance requirement to contracts by any public entity, including political subdivisions, using state general obligation bond proceeds for all or part of a capital project. Local governments will be responsible for requiring that bids include proper certification on applicable projects, which applies to projects for goods or services valued at more than \$1 million utilizing appropriated bond proceeds on or after January 1, 2022.

Elections – A number of measures were passed to help ensure the safe and secure conduct of the 2020 state primary and general elections, including; allowing for the processing of absentee ballots to begin 14 days prior to the date of the election, extending the period during which absentee ballots could be processed for 2 days following the election, accepting electronic filings for affidavits of candidacy or nominating petitions, and specifying that municipalities were to use schools as polling places only when no other public or private location was reasonably available. Funds from the federal Help America Vote Act were made available to modernizing, securing, and improving election facilities, a portion of which was made available for grants to local governments to fund activities prescribed by this program.

Minors Operating Lawn Care Equipment – Effective May 28, 2020, Minnesota Statutes lowered the age for employment operating lawn care equipment to age 16. Minors aged 16 and 17 must be trained in the safe operation of the equipment and wear appropriate personal protective equipment when operating the lawn care equipment. The exception under this statute applies only to minors directly employed by golf courses, resorts, rental property owners, or municipalities to perform lawn care on golf courses, resort grounds, rental property, or municipal grounds.

Open Meeting Law Exception – The interactive television provision of the Minnesota Open Meeting Law was amended to allow for participation in meetings by interactive electronic means, such as Skype or Zoom, without requiring that an elected official be advised to do so by a healthcare professional for personal or family medical reasons. This allowance is available only when a national security or peacetime emergency has been declared and may be used up to 60 days after the emergency declaration has been lifted. Whenever public meetings are held via interactive electronic means of this type, votes must be conducted by roll call and be recorded in the minutes.

Expanded Authority for Electronic Signatures During COVID-19 – Effective May 17, 2020, cities are allowed to accept certain documents, signatures, or filings electronically, by mail, or facsimile during the COVID-19 pandemic, including; planning and zoning applications and permits; land use documents; documents requiring the signature of licensed architects, engineers, land surveyors, geoscientists, or interior designers; applications for birth or death certificates; or recording notary commissions. This accommodation expires January 16, 2021, or 60 days following the termination of the peacetime public health emergency.

Solid Waste Recycling Exemption – The requirement that not more than 15 percent of mixed municipal solid waste received by recycling or composting facilities be disposed of, rather than recycled or composted, is suspended as long as the need for the exception is triggered by operational changes implemented to address the COVID-19 pandemic.

Pension Changes – Effective January 1, 2021, the maximum lump-sum pension amount for volunteer firefighters is increased from \$10,000 to \$15,000 per year of service. Municipalities are permitted to split state fire aid received between its career firefighters and its affiliated volunteer firefighters, but only if the amount allocated to the career firefighters is approved by the membership of the volunteer firefighter relief association. Any aid allocated to career firefighters must be used to pay the Public Employees Retirement Association (PERA) employer contributions on their behalf within 18 months of the transfer or be returned to the relief association.

Police Accountability Act – The Legislature passed the Police Accountability Act, which enacted a number of changes to laws governing police conduct, training, and oversight. Among the more significant changes adopted were:

- Defined and authorized “public safety peer counseling” and “critical incident stress management,” and classifies information shared in these settings as private data.
- Established an Independent Use of Force Investigations Unit within the Bureau of Criminal Apprehension to investigate all officer-involved deaths in the state, as well as criminal sexual assault allegations against peace officers, effective August 1, 2020.
- Authorized statutory or home rule charter cities to offer incentives to encourage a person hired as a peace officer to be a resident of the city.
- Limited the use of certain restraint methods by peace officer unless the use of deadly force is authorized in a given situation.
- Established and modified provisions related to law enforcement use of deadly force.
- Defined and prohibited “warrior-style” training for peace officers.
- Established a 15-member “Ensuring Police Excellence and Improving Community Relations Advisory Council” under the Police Officer Standards and Training (POST) Board, to assist the POST Board in maintaining policies and regulating peace officers in a manner that ensures the protection of civil and human rights.
- Established a duty for peace officers to intercede when another officer is using excessive force and report incidents of excessive force to supervisors.

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ACCOUNTING AND AUDITING UPDATES

The following is a summary of Governmental Accounting Standards Board (GASB) standards expected to be implemented in the next few years. Due to the COVID-19 pandemic, the GASB has delayed the original implementation dates of these and other standards as described below.

GASB Statement No. 87, *Leases*

A lease is a contract that transfers control of the right to use another entity's nonfinancial asset as specified in the contract for a period of time in an exchange or exchange-like transaction. Examples of nonfinancial assets include buildings, land, vehicles, and equipment. Any contract that meets this definition should be accounted for under the leases guidance, unless specifically excluded in this statement.

Governments enter into leases for many types of assets. Under the previous guidance, leases were classified as either capital or operating depending on whether the lease met any of the four tests. In many cases, the previous guidance resulted in reporting lease transactions differently than similar nonlease financing transactions.

The goal of this statement is to better meet the information needs of users by improving accounting and financial reporting for leases by governments. It establishes a single model for lease accounting based on the principle that leases are financings of the right to use an underlying asset. This statement increases the usefulness of financial statements by requiring recognition of certain lease assets and liabilities for leases that previously were classified as operating leases and recognized as inflows of resources or outflows of resources based on the payment provisions of the contract.

Under this statement, a lessee is required to recognize a lease liability and an intangible right to use lease asset, and a lessor is required to recognize a lease receivable and a deferred inflow of resources, thereby enhancing the relevance and consistency of information about governments' leasing activities.

To reduce the cost of implementation, this statement includes an exception for short-term leases, defined as a lease that, at the commencement of the lease term, has a maximum possible term under the lease contract of 12 months (or less), including any options to extend, regardless of their probability of being exercised. Lessees and lessors should recognize short-term lease payments as outflows of resources or inflows of resources, respectively, based on the payment provisions of the lease contract. The requirements of this statement are effective for reporting periods beginning after June 15, 2021.

GASB Statement No. 91, *Conduit Debt Obligations*

The primary objectives of this statement are to provide a single method of reporting conduit debt obligations by issuers and eliminate diversity in practice associated with (1) commitments extended by issuers, (2) arrangements associated with conduit debt obligations, and (3) related note disclosures. This statement achieves those objectives by clarifying the existing definition of a conduit debt obligation; establishing that a conduit debt obligation is not a liability of the issuer; establishing standards for accounting and financial reporting of additional commitments and voluntary commitments extended by issuers and arrangements associated with conduit debt obligations; and improving required note disclosures.

A conduit debt obligation is defined as a debt instrument having all of the following characteristics:

- There are at least three parties involved: (1) an issuer, (2) a third party obligor, and (3) a debt holder or a debt trustee.
- The issuer and the third party obligor are not within the same financial reporting entity.
- The debt obligation is not a parity bond of the issuer, nor is it cross-collateralized with other debt of the issuer.
- The third party obligor or its agent, not the issuer, ultimately receives the proceeds from the debt issuance.
- The third party obligor, not the issuer, is primarily obligated for the payment of all amounts associated with the debt obligation (debt service payments).

This statement also addresses arrangements, often characterized as leases, that are associated with conduit debt obligations. In those arrangements, capital assets are constructed or acquired with the proceeds of a conduit debt obligation and used by third party obligors in the course of their activities.

This statement requires issuers to disclose general information about their conduit debt obligations, organized by type of commitment, including the aggregate outstanding principal amount of the issuers' conduit debt obligations and a description of each type of commitment. Issuers that recognize liabilities related to supporting the debt service of conduit debt obligations also should disclose information about the amount recognized and how the liabilities changed during the reporting period.

The requirements of this statement are effective for reporting periods beginning after December 15, 2021. Earlier application is encouraged.

GASB Statement No. 92, *Omnibus 2020*

The objectives of this statement are to enhance comparability in accounting and financial reporting and to improve the consistency of authoritative literature by addressing practice issues that have been identified during implementation and application of certain GASB Statements. This statement addresses a variety of topics and includes specific provisions about the following:

- The effective date of Statement No. 87, *Leases*, and Implementation Guide No. 2019-3, *Leases*, for interim financial reports
- Reporting of intra-entity transfers of assets between a primary government employer and a component unit defined benefit pension plan or defined benefit other post-employment benefit (OPEB) plan
- The applicability of Statements No. 73, *Accounting and Financial Reporting for Pensions and Related Assets That Are Not within the Scope of GASB Statement 68*, and *Amendments to Certain Provisions of GASB Statements 67 and 68*, as amended, and No. 74, *Financial Reporting for Postemployment Benefit Plans Other Than Pension Plans*, as amended, to reporting assets accumulated for post-employment benefits
- The applicability of certain requirements of Statement No. 84, *Fiduciary Activities*, to post-employment benefit arrangements
- Measurement of liabilities (and assets, if any) related to asset retirement obligations in a government acquisition
- Reporting by public entity risk pools for amounts that are recoverable from reinsurers or excess insurers
- Reference to nonrecurring fair value measurements of assets or liabilities in authoritative literature
- Terminology used to refer to derivative instruments

The requirements of this statement are effective for fiscal years beginning after June 15, 2021. Earlier application is encouraged.

GASB Statement No. 96, *Subscription-Based Information Technology Arrangements*

This statement provides guidance on the accounting and financial reporting for subscription-based information technology arrangements (SBITAs) for government end users (governments). This statement (1) defines a SBITA; (2) establishes that a SBITA results in a right-to-use subscription asset—an intangible asset—and a corresponding subscription liability; (3) provides the capitalization criteria for outlays other than subscription payments, including implementation costs of a SBITA; and (4) requires note disclosures regarding a SBITA. To the extent relevant, the standards for SBITAs are based on the standards established in Statement No. 87, *Leases*, as amended.

An SBITA is defined as a contract that conveys control of the right to use another party's (an SBITA vendor's) information technology (IT) software, alone or in combination with tangible capital assets (the underlying IT assets), as specified in the contract for a period of time in an exchange or exchange-like transaction. Under this statement, a government generally should recognize a right-to-use subscription asset—an intangible asset—and a corresponding subscription liability.

This statement provides an exception for short-term SBITAs with a maximum possible term under the SBITA contract of 12 months, including any options to extend, regardless of their probability of being exercised. Subscription payments for short-term SBITAs should be recognized as outflows of resources.

This statement requires a government to disclose descriptive information about its SBITAs other than short-term SBITAs, such as the amount of the subscription asset, accumulated amortization, other payments not included in the measurement of a subscription liability, principal and interest requirements for the subscription liability, and other essential information.

The requirements of this statement are effective for fiscal years beginning after June 15, 2022, and all reporting periods thereafter.

GASB Statement No. 97, Certain Component Unit Criteria, and Accounting and Financial Reporting for Internal Revenue Code Section 457 Deferred Compensation Plans—an Amendment of GASB Statement No. 14 and No. 84, and a Supersession of GASB Statement No. 32

The primary objectives of this statement are to (1) increase consistency and comparability related to the reporting of fiduciary component units in circumstances in which a potential component unit does not have a governing board and the primary government performs the duties that a governing board typically would perform; (2) mitigate costs associated with the reporting of certain defined contribution pension plans, defined contribution OPEB plans, and employee benefit plans other than pension plans or OPEB plans (other employee benefit plans) as fiduciary component units in fiduciary fund financial statements; and (3) enhance the relevance, consistency, and comparability of the accounting and financial reporting for Internal Revenue Code Section 457 deferred compensation plans (Section 457 plans) that meet the definition of a pension plan and for benefits provided through those plans.

The requirements of this statement that (1) exempt primary governments that perform the duties that a government board typically performs from treating the absence of a governing board the same as the appointment of a voting majority of a governing board in determining whether they are financially accountable for defined contribution pension plans, defined contribution OPEB plans, or other employee benefit plans, and (2) limit the applicability of the financial burden criterion in paragraph 7 of Statement 84 to defined benefit pension plans and defined benefit OPEB plans that are administered through trusts that meet the criteria in paragraph 3 of Statement 67 or paragraph 3 of Statement 74, respectively, are effective immediately.

The requirements of this statement that are related to the accounting and financial reporting for Section 457 plans are effective for fiscal years beginning after June 15, 2021. For purposes of determining whether a primary government is financially accountable for a potential component unit, the requirements of this statement that provide that for all other arrangements, the absence of a governing board be treated the same as the appointment of a voting majority of a governing board if the primary government performs the duties that a governing board typically would perform, are effective for reporting periods beginning after June 15, 2021. Earlier application of those requirements is encouraged and permitted by requirement as specified within this statement.