

Management Report  
for  
City of Prior Lake, Minnesota  
December 31, 2020

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PRINCIPALS

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To the City Council and Management  
City of Prior Lake, Minnesota

We have prepared this management report in conjunction with our audit of the City of Prior Lake, 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 17, 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, *GOVERNMENT AUDITING STANDARDS*, AND TITLE 2 U.S. CODE OF FEDERAL REGULATIONS (CFR) PART 200, *UNIFORM ADMINISTRATIVE REQUIREMENTS, COST PRINCIPLES, AND AUDIT REQUIREMENTS FOR FEDERAL AWARDS (UNIFORM GUIDANCE)***

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, *Government Auditing Standards*, the Uniform Guidance, 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 that the Schedule of Expenditures of Federal Awards is fairly stated, in all material respects, in relation to the basic financial statements.
- The results of our tests indicate that the City has complied, in all material respects, with the types of compliance requirements that could have a direct and material effect on each of its major federal programs.
- We reported no deficiencies in the City's internal controls over compliance that we considered to be material weaknesses with the types of compliance requirements that could have a direct and material effect on each of its major federal programs.
- 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:

- **Depreciation** – Management's estimates of depreciation expense are based on the estimated useful lives of the assets.
- **Compensated Absences** – Estimates for compensated absences payable are based on current sick and vacation leave balances.
- **Total Other Post-Employment Benefits (OPEB) and Net Pension Liabilities** – The City has recorded liabilities and activity for pension benefits and OPEB. These obligations are calculated using actuarial methodologies described in Governmental Accounting Standards Board Statement Nos. 68 and 75. These actuarial calculations include significant assumptions, including projected changes, healthcare insurance costs, investment returns, retirement ages, proportionate share, and employee turnover.
- **Assets Held for Resale** – Management's estimates of the assets are 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 OPEB and 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 17, 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 and OPEB-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 supplemental information and the Schedule of Expenditures of Federal Awards accompanying the financial statements, which are 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 and other information sections, which accompany the financial statements, but are 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.



## GOVERNMENTAL FUNDS OVERVIEW

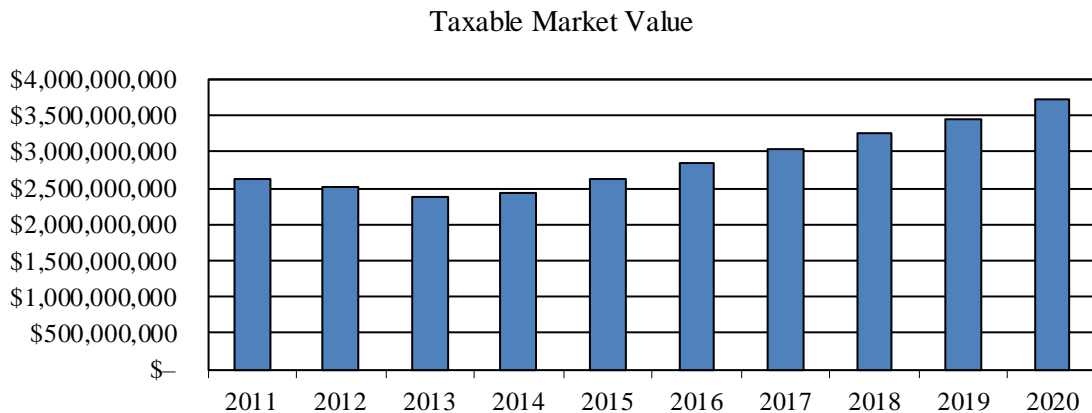
This section of the report provides you with an overview of the financial trends and activities of the City's governmental funds, which includes the General, special revenue, debt service, and capital project funds. These funds are used to account for the basic services the City provides to all of its 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.

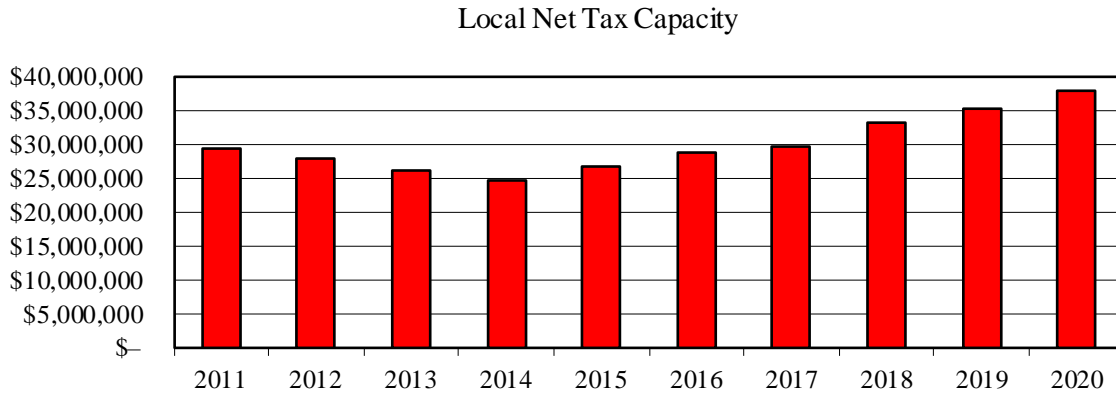
The total tax capacity value of property in Minnesota cities increased about 6.5 percent for the 2020 levy year. The tax capacity values used for levying property taxes are based on the assessed market values for the previous fiscal year (e.g., tax capacity values for taxes levied in 2020 were based 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 5.7 percent for taxes payable in 2019 and 7.7 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 6.1 percent and 7.9 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:

<b>Rates Expressed as a Percentage of Net Tax Capacity</b>			
	City of Prior Lake		
	2018	2019	2020
<b>Average tax rate</b>			
City	33.0	33.0	32.5
County	35.1	33.8	32.7
School	33.0	31.7	29.9
Special taxing	8.7	7.8	7.3
Total	<u>109.8</u>	<u>106.3</u>	<u>102.4</u>

The City’s portion of the tax rate has been consistent over the past three years.

## 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:

<b>Governmental Funds Change in Fund Balance</b>			
	Fund Balance as of December 31,		Change
	<u>2020</u>	<u>2019</u>	
Fund balances of governmental funds			
Total by classification			
Nonspendable	\$ 70,006	\$ -	\$ 70,006
Restricted	7,321,154	4,088,161	3,232,993
Assigned	9,416,770	11,295,634	(1,878,864)
Unassigned	<u>9,783,378</u>	<u>7,578,463</u>	<u>2,204,915</u>
Total governmental funds	<u>\$ 26,591,308</u>	<u>\$ 22,962,258</u>	<u>\$ 3,629,050</u>
Total by fund			
General	\$ 10,114,088	\$ 7,903,175	\$ 2,210,913
Debt Service	2,834,191	3,003,467	(169,276)
Construction	493,808	261,269	232,539
Special revenue nonmajor funds	3,622,398	3,394,539	227,859
Capital projects nonmajor funds	<u>9,526,823</u>	<u>8,399,808</u>	<u>1,127,015</u>
Total governmental funds	<u>\$ 26,591,308</u>	<u>\$ 22,962,258</u>	<u>\$ 3,629,050</u>

In total, the fund balances of the City's governmental funds increased by \$3,629,050 during the year ended December 31, 2020. The overall increase in fund balances relates to increase in the General Fund balance and nonmajor capital project funds, including increases to the Trunk Reserve, Water Storage, and Revolving Park Equipment Funds. The increases to restricted fund balance and decline in assigned fund balance mostly relates to reclassifications of special revenue fund balances.

## GOVERNMENTAL FUNDS REVENUE AND EXPENDITURES

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.

<b>Governmental Funds Revenue per Capita</b>							
With State-Wide Averages by Population Class							
Year	State-Wide			City of Prior Lake			
	December 31, 2019			2018	2019	2020	
Population	2,500-10,000	10,000-20,000	20,000-100,000	26,207	26,849	27,222	
Property taxes	\$ 514	\$ 489	\$ 512	\$ 460	\$ 475	\$ 498	
Tax increments	30	28	44	29	29	29	
Franchise and other taxes	45	50	50	24	24	25	
Special assessments	54	38	53	51	40	34	
Licenses and permits	40	35	51	38	37	33	
Intergovernmental revenues	342	297	201	71	154	178	
Charges for services	135	108	115	168	125	85	
Other	89	78	79	28	54	39	
Total revenue	<u>\$ 1,249</u>	<u>\$ 1,123</u>	<u>\$ 1,105</u>	<u>\$ 869</u>	<u>\$ 938</u>	<u>\$ 921</u>	

In total, the City's governmental fund revenues for 2020 were \$25,056,822, a decrease of \$118,097 (0.5 percent) from the prior year. On a per capita basis, the City received \$921 in governmental fund revenue for 2020, a decrease of \$17 from the prior year. Charges for services revenues decreased \$40 per capita, due to decreased services provided, as a result of COVID-19. In general, the City has generated less governmental fund revenue per capita than the state-wide averages spread across all categories.

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.

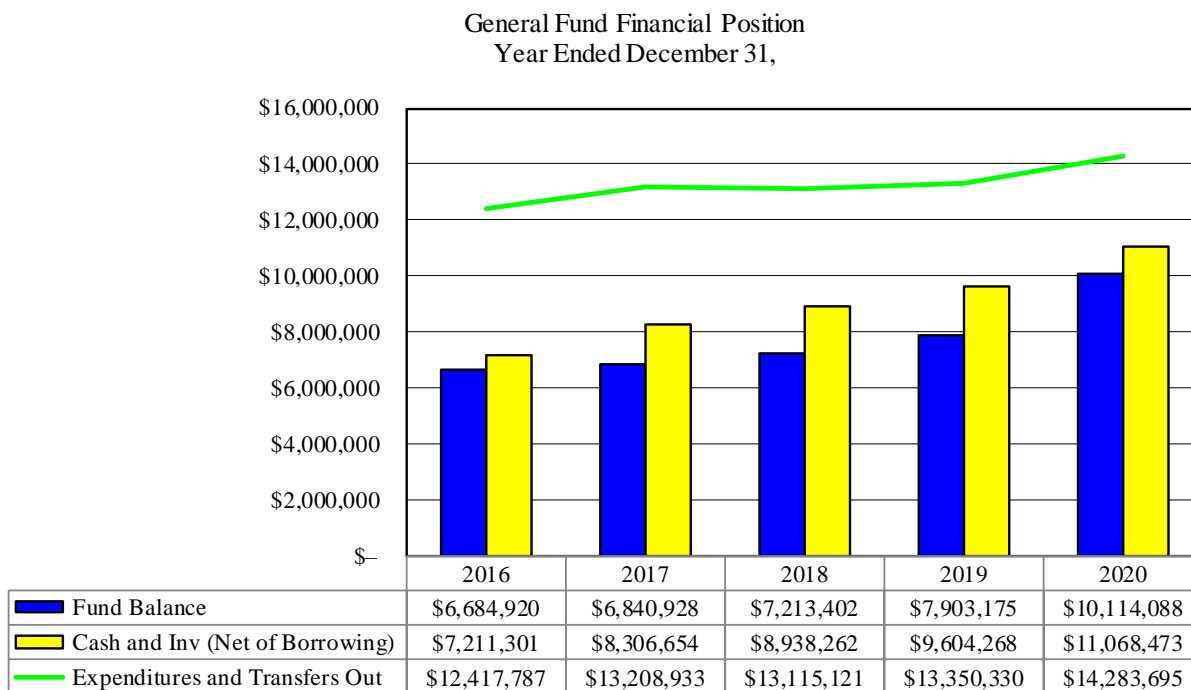
The City’s expenditures per capita of its governmental funds for the past three years, together with comparative state-wide averages, are presented in the following table:

<b>Governmental Funds Expenditures per Capita</b> With State-Wide Averages by Population Class							
Year	State-Wide			City of Prior Lake			
	December 31, 2019			2018	2019	2020	
Population	2,500–10,000	10,000–20,000	20,000–100,000	26,207	26,849	27,222	
<b>Current</b>							
General government	\$ 152	\$ 128	\$ 107	\$ 105	\$ 112	121	
Public safety	300	282	306	222	230	246	
Streets and highways	146	149	119	72	73	73	
Culture and recreation	103	124	106	73	72	60	
All other	74	75	97	6	7	6	
	<u>775</u>	<u>758</u>	<u>735</u>	<u>478</u>	<u>494</u>	<u>506</u>	
Capital outlay and construction	438	376	355	345	375	161	
<b>Debt service</b>							
Principal	168	182	88	151	156	154	
Interest and fiscal charges	43	41	28	39	46	41	
	<u>211</u>	<u>223</u>	<u>116</u>	<u>190</u>	<u>202</u>	<u>195</u>	
Total expenditures	<u>\$ 1,424</u>	<u>\$ 1,357</u>	<u>\$ 1,206</u>	<u>\$ 1,013</u>	<u>\$ 1,071</u>	<u>\$ 862</u>	

Total expenditures in the City’s governmental funds for 2020 were \$23,508,010, a decrease of \$5,253,020 (18.3 percent) from the prior year. On a per capita basis, the City expended a total of \$862 in 2020. Capital outlay expenditures decreased \$214 per capita from the prior year, due to less construction related expenditures in 2020.

## 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 and transfers out to reflect the change in the size of the General Fund operation over the same period.

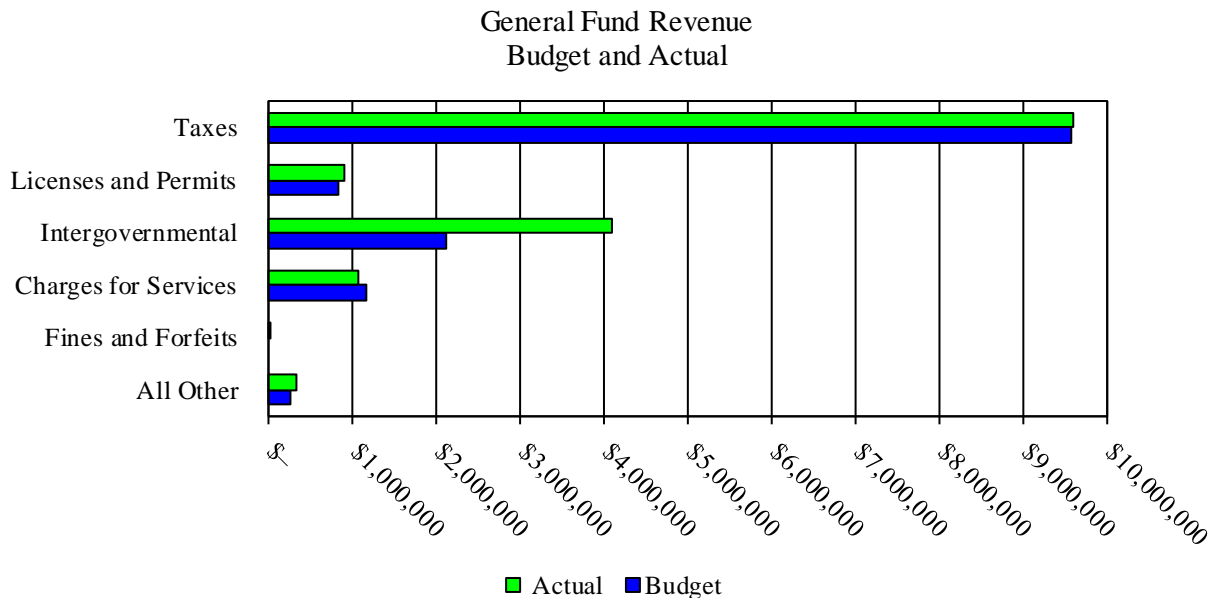


The City's General Fund cash and investments balance increased \$1,464,205 during the current year. Total fund balance increased \$2,210,913 from the prior year.

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.

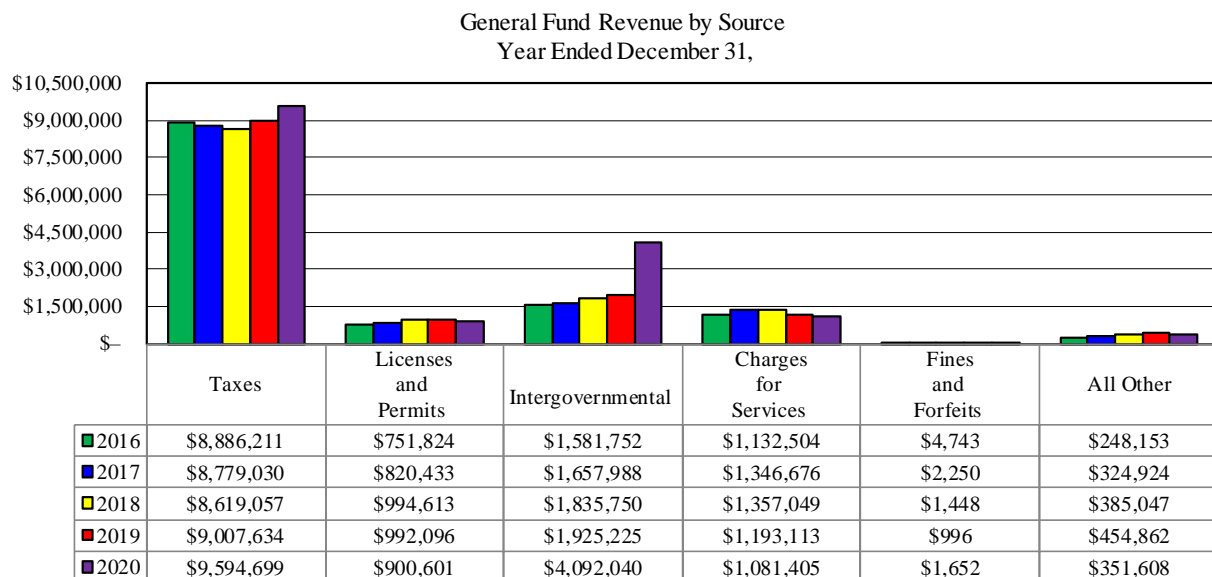
The City has formally adopted a fund balance policy regarding the minimum unrestricted fund balance for the General Fund. The policy establishes that the City will strive to maintain an unrestricted General Fund balance (which includes committed, assigned, and unassigned classifications) between 40.0 percent and 50.0 percent of the subsequent year's General Fund budgeted expenditures. At December 31, 2020, the unrestricted fund balance of the General Fund was 66.6 percent of the subsequent year's budgeted expenditures and transfers out.

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



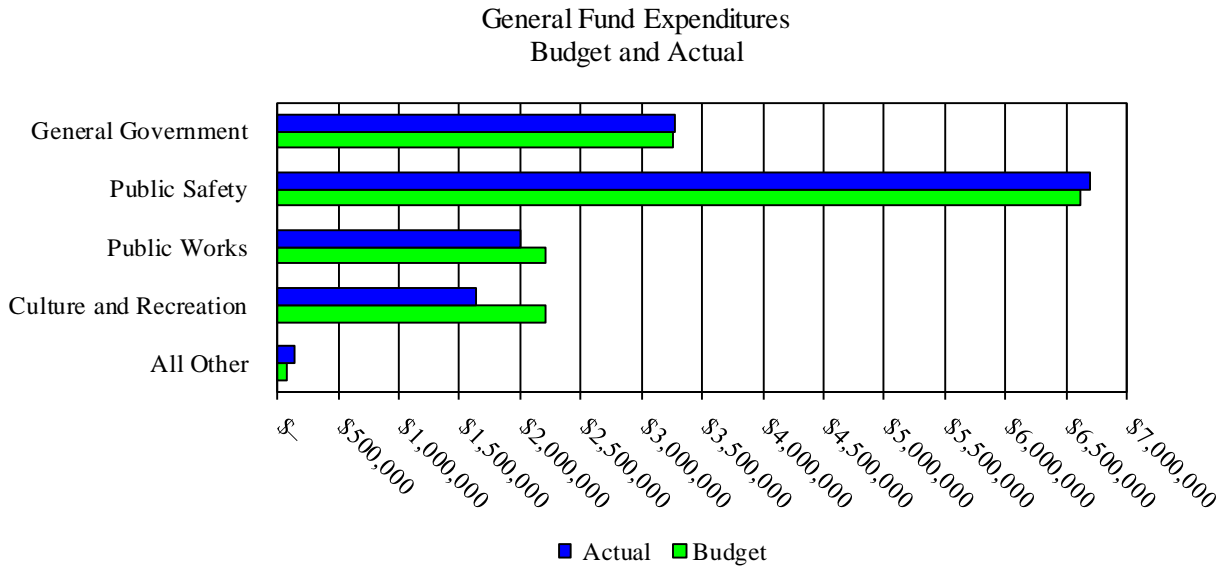
General Fund revenue for 2020 was \$16,022,005, which was \$2,036,507 (14.6 percent) more than budget, mainly due to the City receiving more intergovernmental aid in 2020 related to federal Coronavirus Aid, Relief, and Economic Security (CARES) Act funding. Investment income, included in “all other” in the graph above, also exceeded budgeted amounts by \$84,120 as earnings exceeded conservative projected amounts.

The following graph presents the City’s General Fund revenue by source for the last five years. The graph reflects the City’s increased reliance on property tax revenue in recent years.



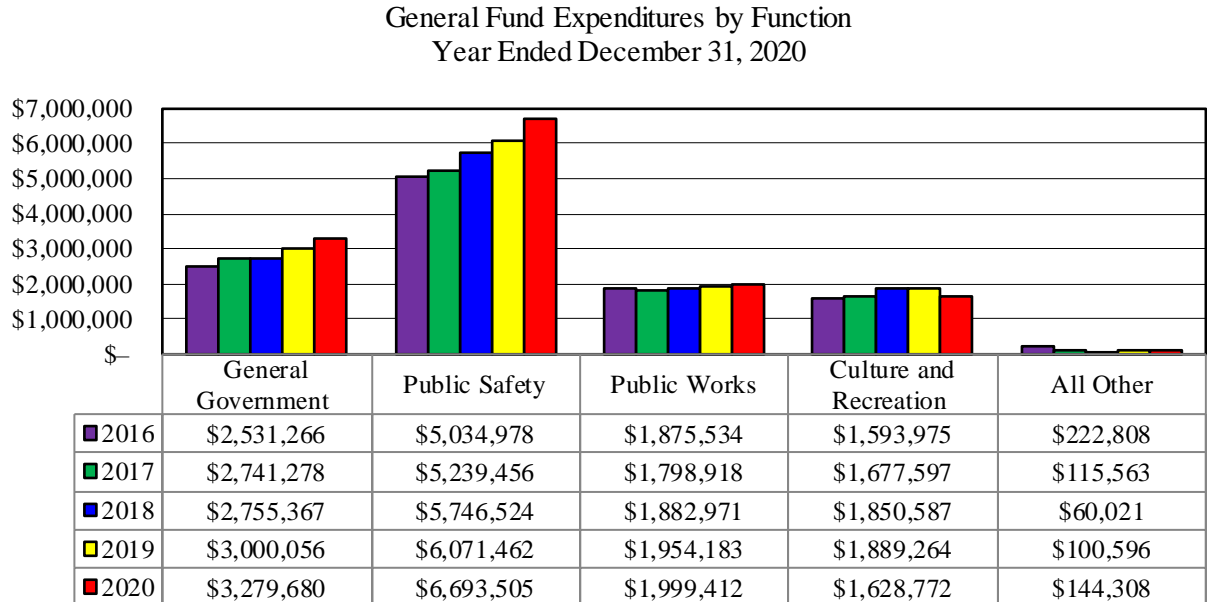
Total General Fund revenue for 2020 was \$2,448,079 (18.0 percent) higher than last year. Intergovernmental increased \$2,166,815, or 112.5 percent, related to federal CARES Act funding. Property taxes increased \$587,065 related to an increased levy.

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



Total General Fund expenditures for 2020 were \$13,745,677, which was \$631,515 (4.4 percent) under budget. Culture and recreation was under budget by \$585,401, mainly due to COVID-19 restrictions. Public works was also under budget by \$216,433. This amount includes amounts favorable to budget variances in a number of areas, including engineering, central garage, and streets.

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



Total General Fund expenditures for 2020 were \$730,116 (5.6 percent) greater than the previous year. Public safety expenditures increased \$622,043, due to wages and benefits for additional police officers, cost of living adjustments in the current year, and increased overtime costs. Expenditures were also higher in general government by \$279,624. This includes increases mainly for elections, personnel costs, and community development.



## ENTERPRISE FUNDS OVERVIEW

The City maintains a number of 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, Sewer, and Water Quality Funds.

### 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 by both classification and by fund:

<b>Enterprise Funds Change in Financial Position</b>			
	Net Position as of December 31,		Change
	2020	2019	
Net position of enterprise funds			
Total by classification			
Investment in capital assets	\$ 69,058,053	\$ 68,398,856	\$ 659,197
Unrestricted	<u>9,784,086</u>	<u>7,137,595</u>	<u>2,646,491</u>
Total enterprise funds	<u>\$ 78,842,139</u>	<u>\$ 75,536,451</u>	<u>\$ 3,305,688</u>
Total by fund			
Water	\$ 46,737,472	\$ 45,354,364	\$ 1,383,108
Sewer	27,724,006	26,381,082	1,342,924
Water Quality	<u>4,380,661</u>	<u>3,801,005</u>	<u>579,656</u>
Total enterprise funds	<u>\$ 78,842,139</u>	<u>\$ 75,536,451</u>	<u>\$ 3,305,688</u>

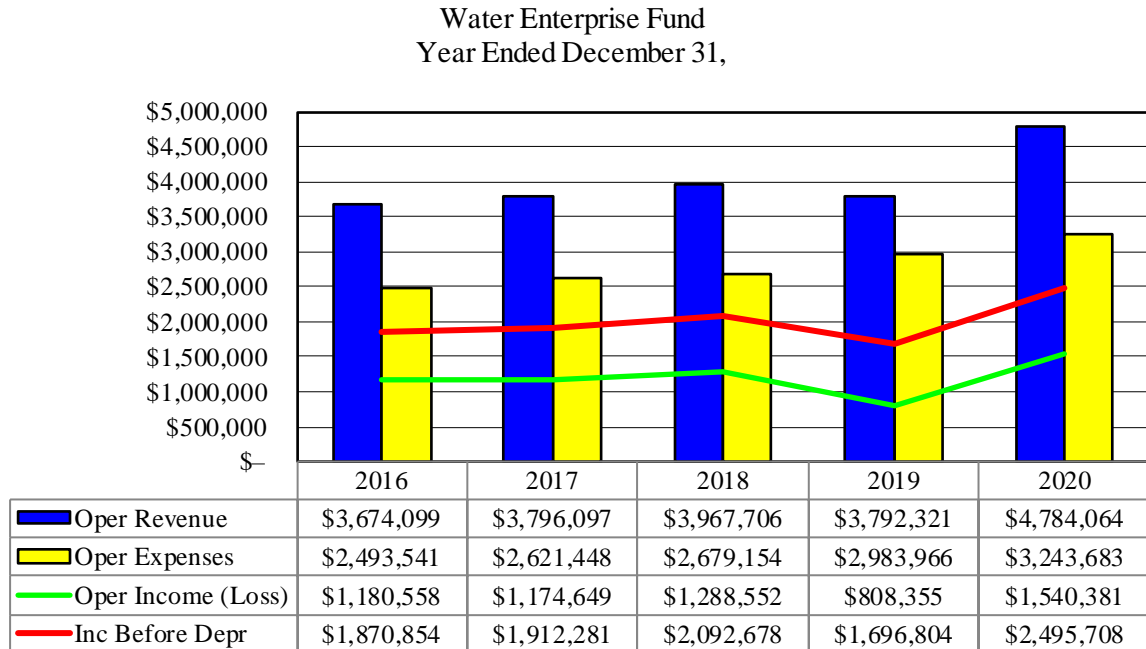
### INTERNAL SERVICE FUND

The City has established a Compensated Absences Internal Service Fund to finance the compensated absence obligations of the governmental funds of the City. At December 31, 2020, this fund had assets totaling \$505,830, while liabilities totaled \$948,808, leaving a deficit net position balance of (\$442,978). We recommend that the City continue to include the financing of these obligations as part of its long-range financial plans.

The City has also established an Insurance Internal Service Fund to account for risk management activities, including workers' compensation, volunteer accident, and property/casualty insurance. At December 31, 2020, this fund had assets totaling \$28,170 and no liabilities, leading to a net position balance of \$28,170.

## WATER ENTERPRISE FUND

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



The Water Fund ended 2020 with net position of \$46,737,472, an increase of \$1,383,108 from the prior year. Of this, \$41,436,018 represents the investment in capital assets, leaving \$5,301,454 in unrestricted net position. The Water Fund had transfers out totaling \$1,215,160 in 2020 to support other funds, pay debt service, and provide for construction projects.

Operating revenue in the Water Fund increased \$991,743 (26.2 percent) from the prior year. This increase was due to increased rates and increased usage in the current year.

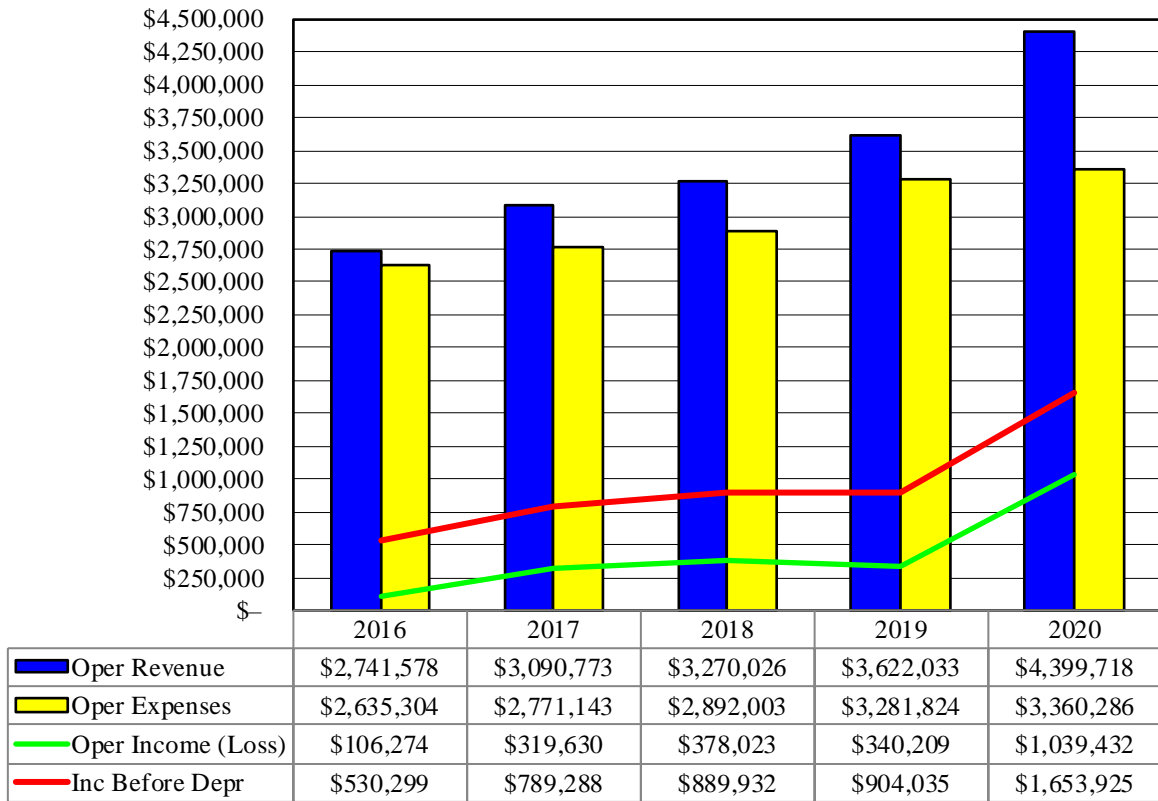
Water Fund operating expenses for 2020 increased \$259,717 (8.7 percent) from the previous year. This increase was mainly for repairs and maintenance.

State and federal grants, interest revenue and expenses, miscellaneous income, and loss on sale of capital assets, which are not included in the graph above, totaled \$168,192 in 2020. After including these revenues and expenses, the Water Fund reflected income before contributions and transfers of \$1,708,573.

**SEWER ENTERPRISE FUND**

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

Sewer Enterprise Fund  
Year Ended December 31,



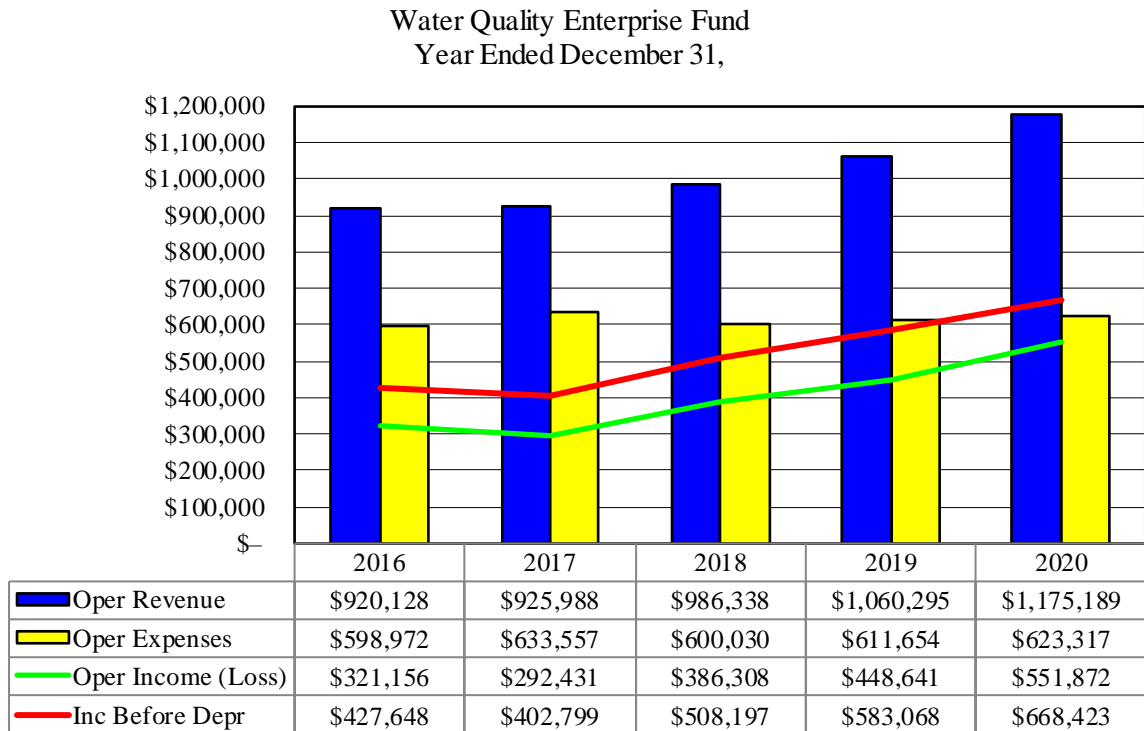
The Sewer Fund ended 2020 with net position of \$27,724,006, an increase of \$1,342,924 from the prior year. Of this, \$25,024,608 represents the City’s investment in capital assets, leaving \$2,699,398 in unrestricted net position. The Sewer Fund had transfers out totaling \$632,110 in 2020 to support other funds, pay debt service, and provide for construction projects.

Operating revenue in the Sewer Fund increased \$777,685 (21.5 percent) from the prior year, mainly related to increased usage and rates in 2020. Sewer Fund operating expenses for 2020 increased \$78,462 (2.4 percent) from the previous year. These increases were mainly for disposal charges.

State and federal grants, interest revenue and expenses, and miscellaneous revenues, which are not included in the graph above, totaled \$45,796 in 2020. After including these revenues and expenses, the Sewer Fund reflected income before contributions and transfers of \$1,085,228.

## WATER QUALITY ENTERPRISE FUND

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



The Water Quality Fund ended 2020 with net position of \$4,380,661, an increase of \$579,656 from the prior year. Of this, \$2,597,427 represents the investment in capital assets, leaving \$1,783,234 in unrestricted net position.

Operating revenue in the Water Quality Fund increased \$114,894 (10.8 percent) from the prior year, due to an increase in the rates in 2020. Water Quality Fund operating expenses for 2020 increased \$11,663 (1.9 percent) from the previous year.

## 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	\$ 118,120,401	\$ 112,279,178	\$ 5,841,223
Restricted	10,865,279	7,988,232	2,877,047
Unrestricted	11,944,650	11,418,431	526,219
Total governmental activities	<u>140,930,330</u>	<u>131,685,841</u>	<u>9,244,489</u>
Business-type activities			
Net investment in capital assets	69,058,053	68,398,856	659,197
Unrestricted	9,784,086	7,137,595	2,646,491
Total business-type activities	<u>78,842,139</u>	<u>75,536,451</u>	<u>3,305,688</u>
Total net position	<u>\$ 219,772,469</u>	<u>\$ 207,222,292</u>	<u>\$ 12,550,177</u>

The City's total net position at December 31, 2020 was \$12,550,177 higher than the total net position reported at the previous year-end. The increase in the net investment in capital assets balance was mostly due to capital outlay and capital contribution activity during fiscal 2020.

The increase in restricted net position in governmental activities is related to reclassifications of special revenue fund balances in the current year. Increases in unrestricted fund balance in the business-type activities relates to positive operating results in these funds in the current year.

At the end of the current fiscal year, the City is able to present positive balances in all categories of net position, both for the government as a whole, as well as for its separate governmental and business-type activities. The same situation held true for the prior year.

## 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	\$ 3,831,010	\$ 493,819	\$ (3,337,191)	\$ (2,927,283)
Public safety	7,025,367	3,153,992	(3,871,375)	(3,348,722)
Public works	6,024,512	6,084,890	60,378	2,686,022
Culture and recreation	2,127,013	435,197	(1,691,816)	(1,879,877)
Economic development	964,213	14,936	(949,277)	(915,082)
Interest on long-term debt	896,377	–	(896,377)	(1,038,292)
Business-type activities				
Water	3,281,173	5,692,694	2,411,521	1,059,788
Sewer	3,397,772	5,302,169	1,904,397	609,146
Water quality	623,317	1,212,230	588,913	466,628
Total net (expense) revenue	<u>\$ 28,170,754</u>	<u>\$ 22,389,927</u>	(5,780,827)	(5,287,672)
General revenues				
Taxes			15,066,374	14,176,838
Unrestricted grants and contributions			1,951,940	12,867
Investment income			1,089,194	1,385,288
Miscellaneous			184,583	144,924
Gain on sale of assets			38,913	–
Total general revenues			<u>18,331,004</u>	<u>15,719,917</u>
Change in net position			<u>\$ 12,550,177</u>	<u>\$ 10,432,245</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.

## 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 for 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 employment age for 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.