

Management Report  
for  
City of Prior Lake, Minnesota  
December 31, 2021

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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, 2021. 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 9, 2022

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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, 2021. 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, 2021:

- 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.

### **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, 2021.

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 accounting 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 9, 2022.

## **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 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.

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## GOVERNMENTAL FUNDS OVERVIEW

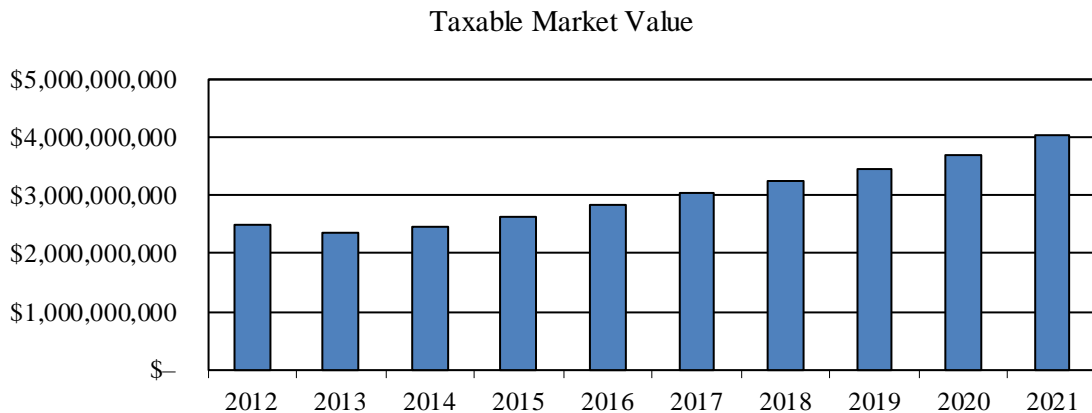
This section of the report provides you with an overview of the financial trends and activities of the City's governmental funds, which includes the General, special revenue, debt service, and capital project funds. These funds are used to account for the basic services the City provides to all of its 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 2020 fiscal year, local ad valorem property tax levies provided 40.9 percent of the total governmental fund revenues for cities over 2,500 in population, and 36.5 percent for cities under 2,500 in population. Total property taxes levied by all Minnesota cities for taxes payable in 2021 increased 4.0 percent compared to the prior year, and 5.9 percent for taxes payable in 2022.

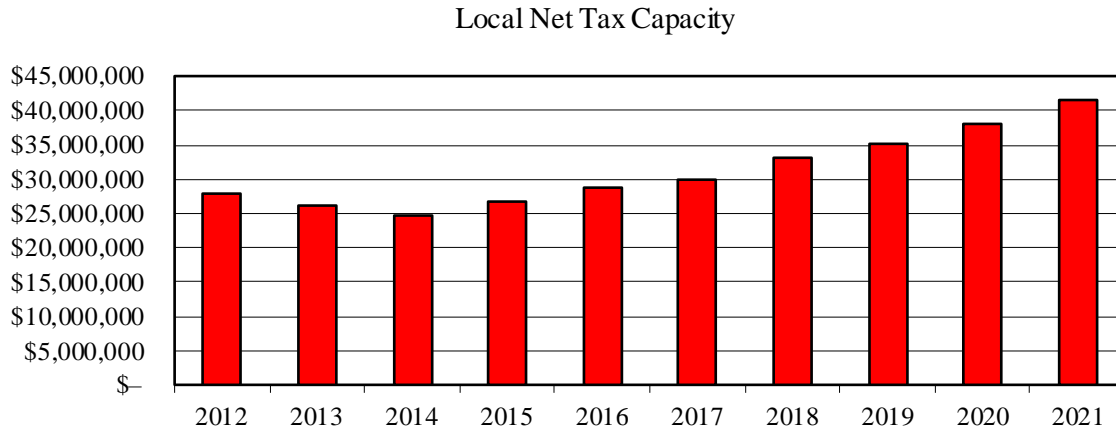
The total tax capacity value of property in Minnesota cities increased about 6.3 percent for the 2021 levy year. The tax capacity values used for levying property taxes are based on the assessed market values for the previous fiscal year (e.g., tax capacity values for taxes levied in 2021 were based on assessed market values as of January 1, 2020), 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 7.7 percent for taxes payable in 2020 and 9.2 percent for taxes payable in 2021. 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 7.9 percent and 9.7 percent for taxes payable in 2020 and 2021, 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		
	2019	2020	2021
<b>Average tax rate</b>			
City	33.0	32.5	30.3
County	33.8	32.7	31.0
School	31.7	29.9	29.1
Special taxing	<u>7.8</u>	<u>7.3</u>	<u>7.7</u>
Total	<u><u>106.3</u></u>	<u><u>102.4</u></u>	<u><u>98.1</u></u>

The City’s portion of the tax rate declined in 2021, after being fairly consistent the past several 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, 2021, 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>2021</u>	<u>2020</u>	
Fund balances of governmental funds			
Total by classification			
Nonspendable	\$ -	\$ 70,006	\$ (70,006)
Restricted	8,086,463	7,321,154	765,309
Assigned	12,173,968	9,416,770	2,757,198
Unassigned	<u>9,857,197</u>	<u>9,783,378</u>	<u>73,819</u>
Total governmental funds	<u>\$ 30,117,628</u>	<u>\$ 26,591,308</u>	<u>\$ 3,526,320</u>
Total by fund			
General	\$ 10,430,617	\$ 10,114,088	\$ 316,529
Debt Service	2,583,668	2,834,191	(250,523)
Construction	1,483,757	493,808	989,949
Special revenue nonmajor funds	4,526,053	3,622,398	903,655
Capital projects nonmajor funds	<u>11,093,533</u>	<u>9,526,823</u>	<u>1,566,710</u>
Total governmental funds	<u>\$ 30,117,628</u>	<u>\$ 26,591,308</u>	<u>\$ 3,526,320</u>

In total, the fund balances of the City's governmental funds increased by \$3,526,320 during the year ended December 31, 2021. The overall increase in fund balances relates mostly to increases in the balances within the construction fund, nonmajor special revenue funds, and nonmajor capital project funds. These increases are mostly reflected in assigned and restricted fund balances for future capital improvements.

## 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, 2020			2019	2020	2021	
Population	2,500–10,000	10,000–20,000	20,000–100,000	26,849	27,222	27,917	
Property taxes	\$ 540	\$ 517	\$ 537	\$ 475	\$ 498	\$ 514	
Tax increments	34	33	44	29	29	28	
Franchise and other taxes	49	60	46	24	25	24	
Special assessments	54	39	54	40	34	30	
Licenses and permits	36	39	46	37	33	36	
Intergovernmental revenues	474	367	273	154	178	104	
Charges for services	113	89	91	125	85	175	
Other	83	69	69	53	39	30	
<b>Total revenue</b>	<b>\$ 1,383</b>	<b>\$ 1,213</b>	<b>\$ 1,160</b>	<b>\$ 937</b>	<b>\$ 921</b>	<b>\$ 941</b>	

In total, the City’s governmental fund revenues for 2021 were \$26,263,562, an increase of \$1,206,740 (4.8 percent) from the prior year. On a per capita basis, the City received \$941 in governmental fund revenue for 2021, an increase of \$20 from the prior year. Charges for services revenues increased \$90 per capita, due to increased development fees and development-related charges for services. Intergovernmental revenue declined \$74 per capital, mostly due to COVID-related stimulus grants and aids received in the prior year.

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:

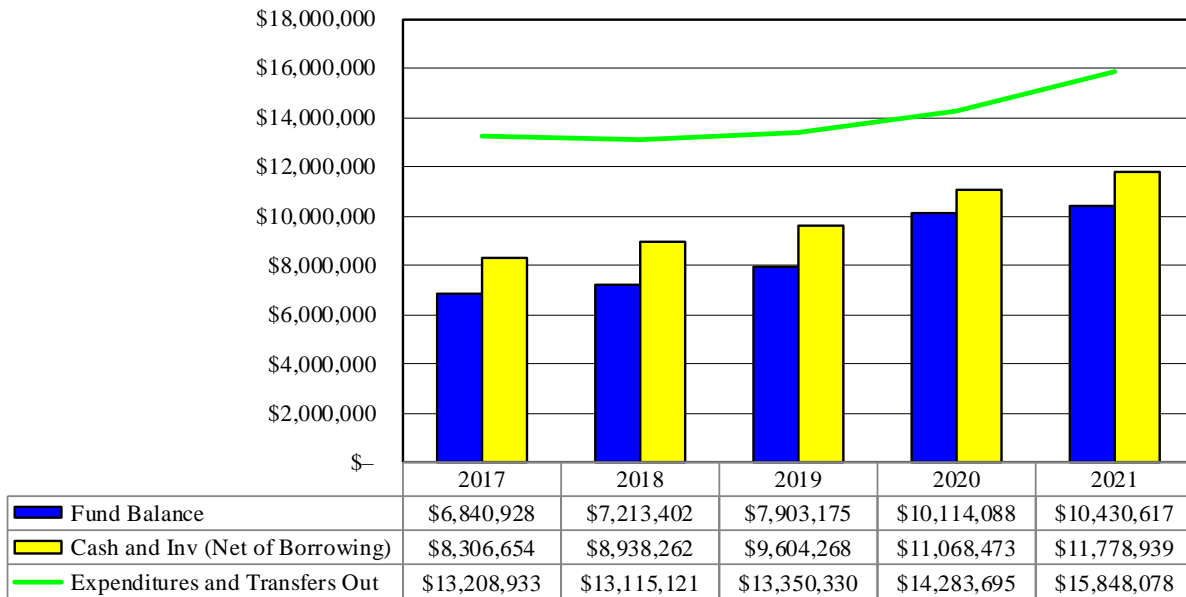
<b>Governmental Funds Expenditures per Capita</b> With State-Wide Averages by Population Class							
Year	State-Wide			City of Prior Lake			
	December 31, 2020			2019	2020	2021	
Population	2,500–10,000	10,000–20,000	20,000–100,000	26,849	27,222	27,917	
<b>Current</b>							
General government	\$ 176	\$ 140	\$ 118	\$ 112	\$ 121	\$ 117	
Public safety	315	288	320	230	246	261	
Streets and highways	146	122	112	73	73	75	
Culture and recreation	100	112	95	72	60	72	
All other	95	108	104	7	6	8	
	832	770	749	494	506	533	
Capital outlay and construction	586	429	331	375	161	325	
<b>Debt service</b>							
Principal	172	149	91	156	154	150	
Interest and fiscal charges	45	42	33	46	41	43	
	217	191	124	202	195	193	
Total expenditures	\$ 1,635	\$ 1,390	\$ 1,204	\$ 1,071	\$ 862	\$ 1,051	

Total expenditures in the City’s governmental funds for 2021 were \$29,331,443, an increase of \$5,823,433 (24.8 percent) from the prior year. On a per capita basis, the City expended a total of \$1,051 in 2021. Capital outlay expenditures increased \$164 per capita from the prior year, due to more construction-related expenditures in 2021.

## 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.

General Fund Financial Position  
Year Ended December 31,

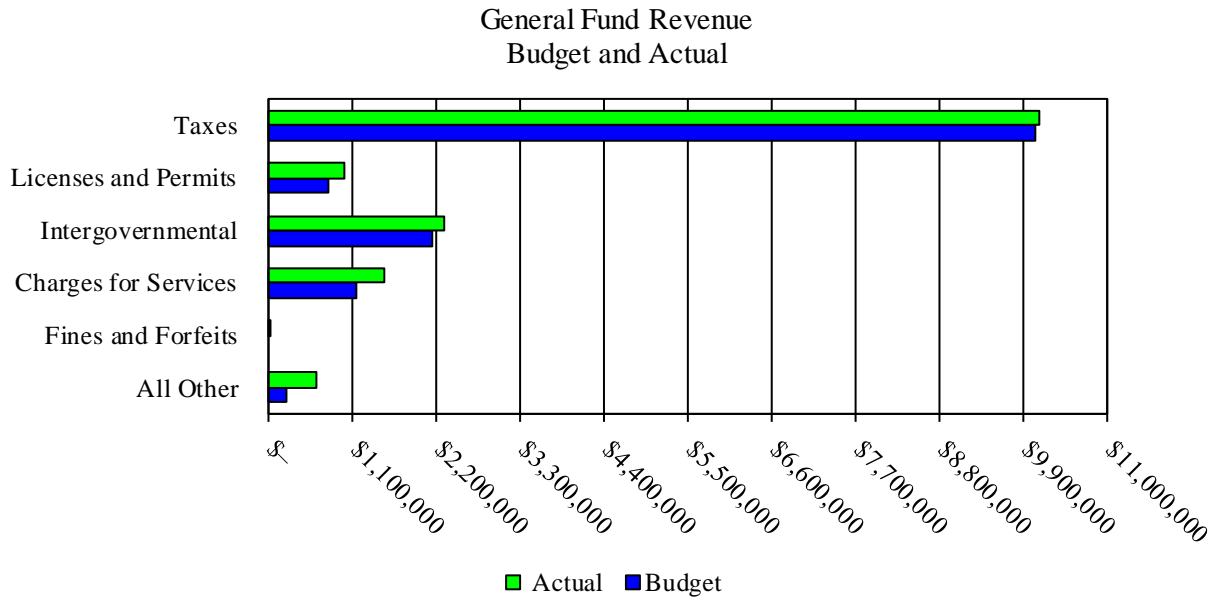


The City's General Fund cash and investments balance increased \$710,466 during the current year. Total fund balance increased \$316,529 from the prior year.

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.

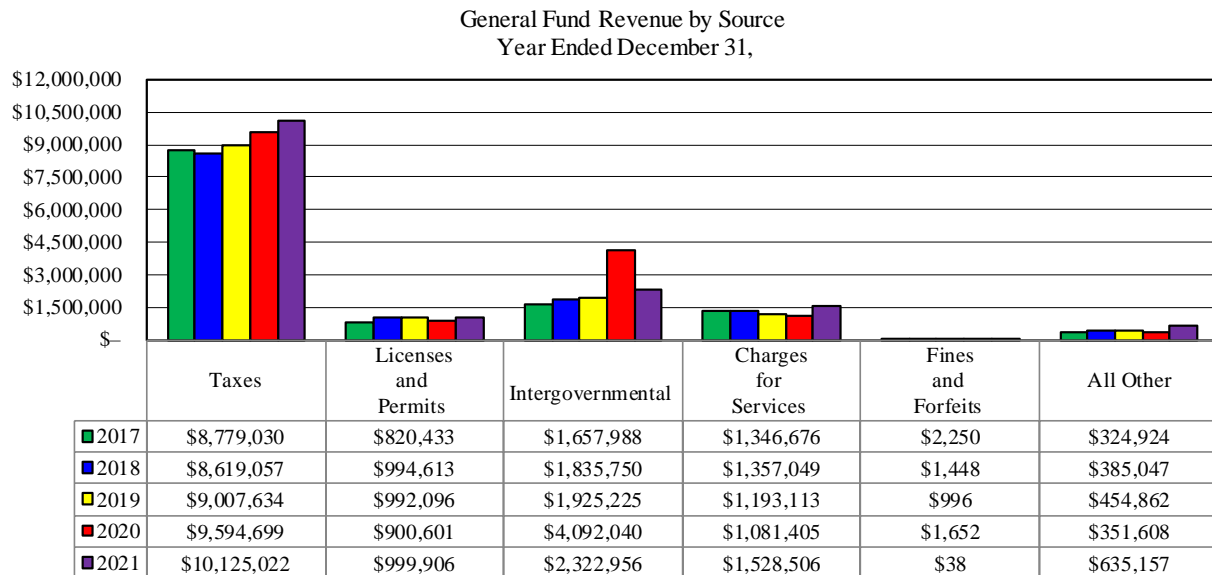
The City has formally adopted a fund balance policy regarding the minimum unrestricted fund balance for the General Fund. The policy establishes that the City will strive to maintain an unrestricted General Fund balance (which includes committed, assigned, and unassigned classifications) between 40.0 percent and 50.0 percent of the subsequent year's General Fund budgeted expenditures. At December 31, 2021, the unrestricted fund balance of the General Fund was 62.9 percent of the subsequent year's budgeted expenditures and transfers out.

The following graph reflects the City’s General Fund revenue sources for 2021 compared to budget:



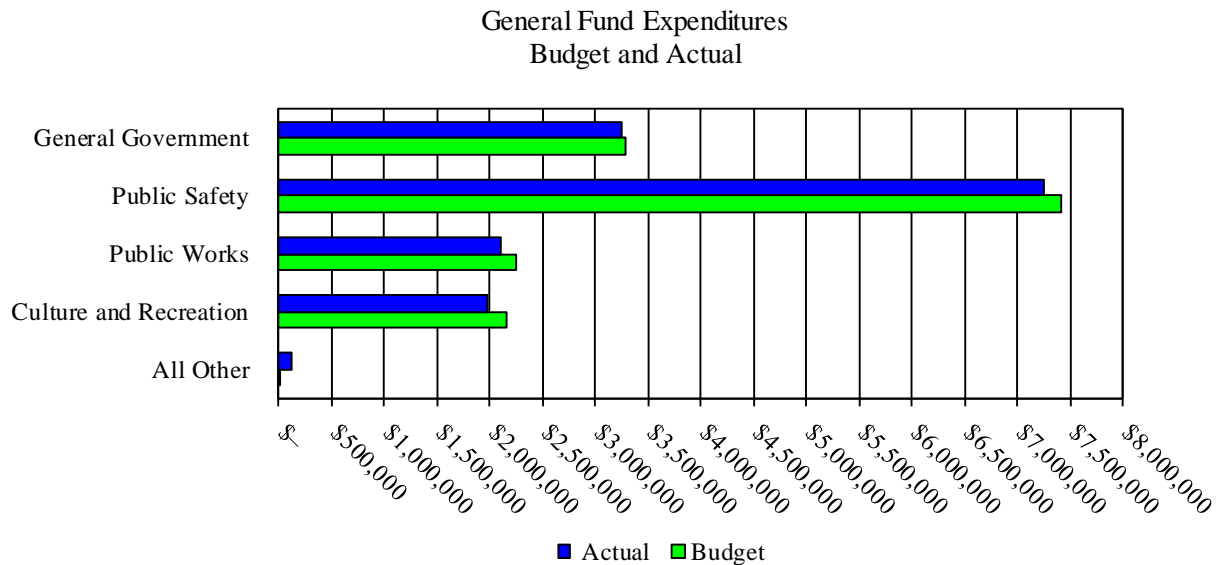
General Fund revenue for 2021 was \$15,611,585, which was \$1,180,868 (8.2 percent) more than budget. This was mainly due to increased development-related activity in 2021, which impacted multiple categories, including; licenses and permits, charges for services, and all other.

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 tax revenue in recent years.



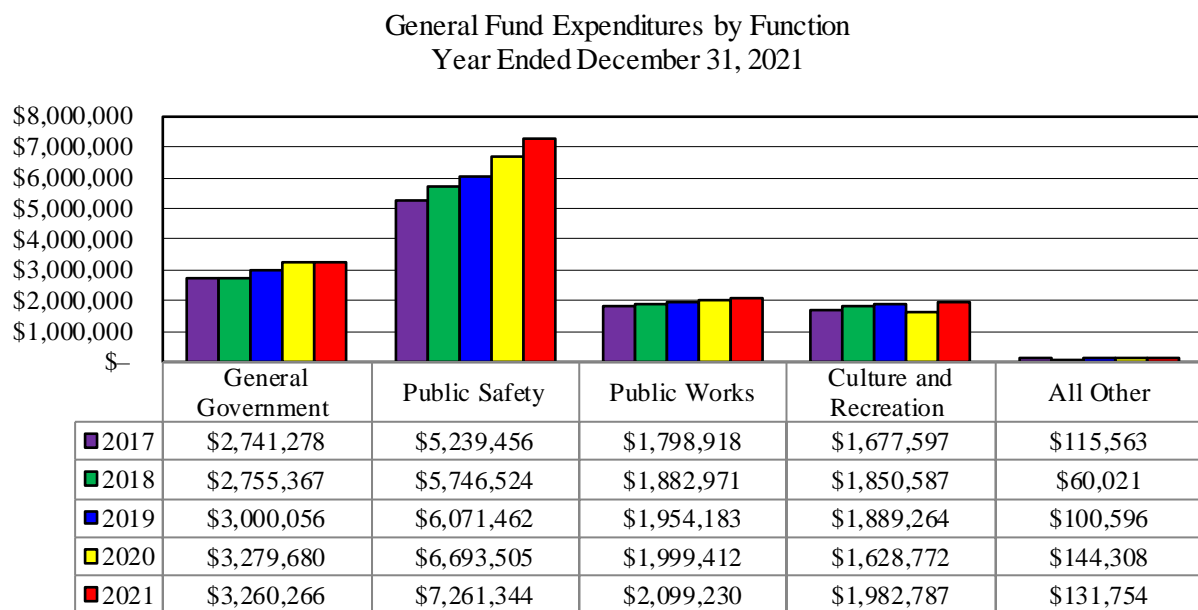
Total General Fund revenue for 2021 was \$410,420 (2.6 percent) lower than last year. Intergovernmental revenue decreased \$1,769,084, or 43.2 percent, related to federal Coronavirus Aid, Relief, and Economic Securities Act and stimulus-related grants and aids received in 2020. This decrease was offset by taxes increasing by \$530,323, related to a levy increase and a \$447,101 increase in charges for services, due to more development activity in 2021.

The following graph illustrates the components of General Fund spending for 2021 compared to budget:



Total General Fund expenditures for 2021 were \$14,735,381, which was \$374,635 (2.5 percent) under budget. Culture and recreation expenditures were under budget by \$171,382, mainly in salary costs, due to using fewer seasonal employees than expected. Public safety was also under budget by \$158,340, due to costs being lower than expected in a variety of areas.

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



Total General Fund expenditures for 2021 were \$989,704 (7.2 percent) greater than the previous year. Public safety expenditures increased \$567,839, due to wage increases and increased overtime costs. Expenditures were also higher in culture and recreation by \$354,015, mainly due to resuming normal seasonal hires and programs in parks and recreation in 2021.



## 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, 2021, presented by both classification and by fund:

<b>Enterprise Funds Change in Financial Position</b>			
	Net Position as of December 31,		Change
	<u>2021</u>	<u>2020</u>	
Net position of enterprise funds			
Total by classification			
Net investment in capital assets	\$ 68,923,937	\$ 69,058,053	\$ (134,116)
Unrestricted	<u>11,099,055</u>	<u>9,784,086</u>	<u>1,314,969</u>
Total enterprise funds	<u>\$ 80,022,992</u>	<u>\$ 78,842,139</u>	<u>\$ 1,180,853</u>
Total by fund			
Water	\$ 47,310,844	\$ 46,737,472	\$ 573,372
Sewer	28,265,386	27,724,006	541,380
Water Quality	<u>4,446,762</u>	<u>4,380,661</u>	<u>66,101</u>
Total enterprise funds	<u>\$ 80,022,992</u>	<u>\$ 78,842,139</u>	<u>\$ 1,180,853</u>

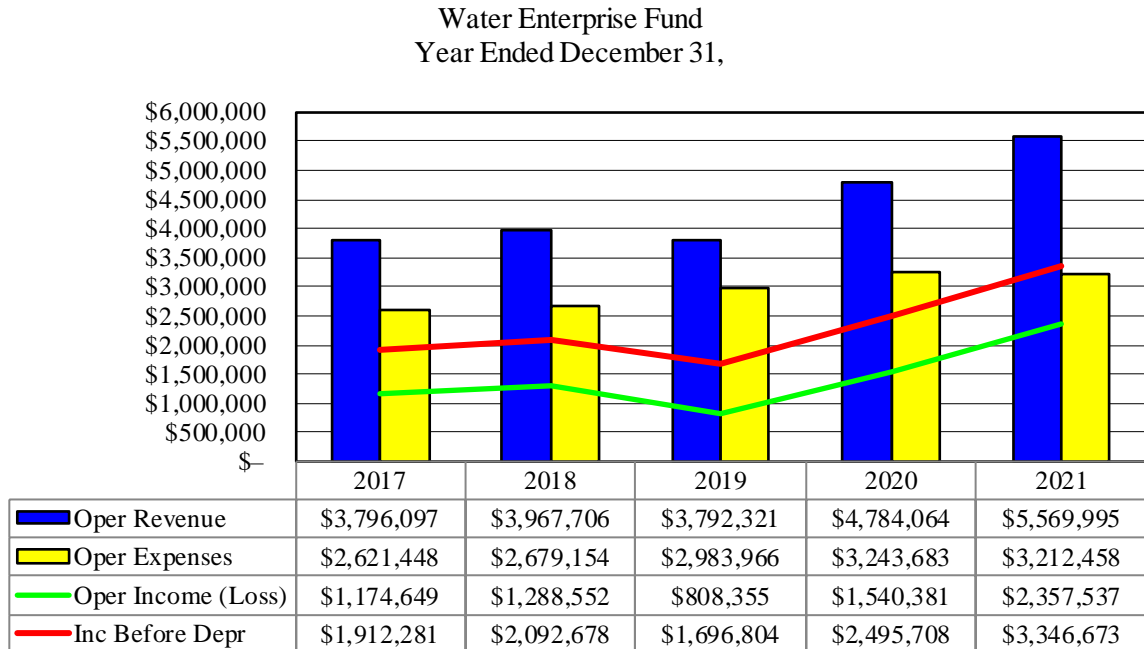
### INTERNAL SERVICE FUND

The City has established a severance compensation internal service fund to finance the compensated absence obligations of the governmental funds of the City. At December 31, 2021, this fund had assets totaling \$549,138, while liabilities totaled \$1,054,767, leaving a deficit net position balance of (\$505,629). 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, 2021, this fund had assets totaling \$92,358, and no liabilities, leading to a net position balance of \$92,358.

## WATER ENTERPRISE FUND

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



The Water Fund ended 2021 with a net position of \$47,310,844, an increase of \$573,372 from the prior year. Of this, \$41,606,349 represents the net investment in capital assets, leaving \$5,704,495 in unrestricted net position. The Water Fund had transfers out totaling \$1,801,456 in 2021 to support other funds, pay debt service, and provide for construction projects.

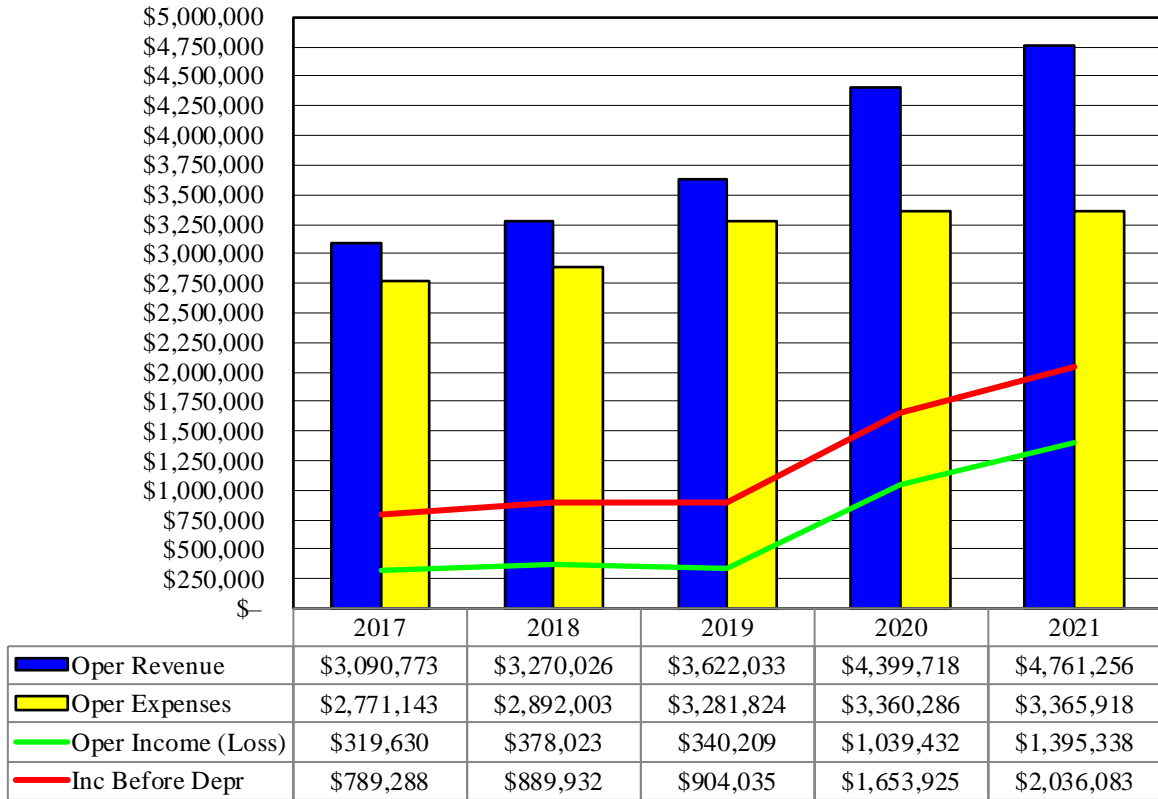
Operating revenue in the Water Fund increased \$785,931 (16.4 percent) from the prior year. This increase was due to increased rates, increased usage, and a change in rate structure in the current year.

Water Fund operating expenses for 2021 decreased \$31,225 (1.0 percent) from the previous year. This decrease was mainly related to significant repairs and maintenance that occurred in fiscal 2020.

**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,

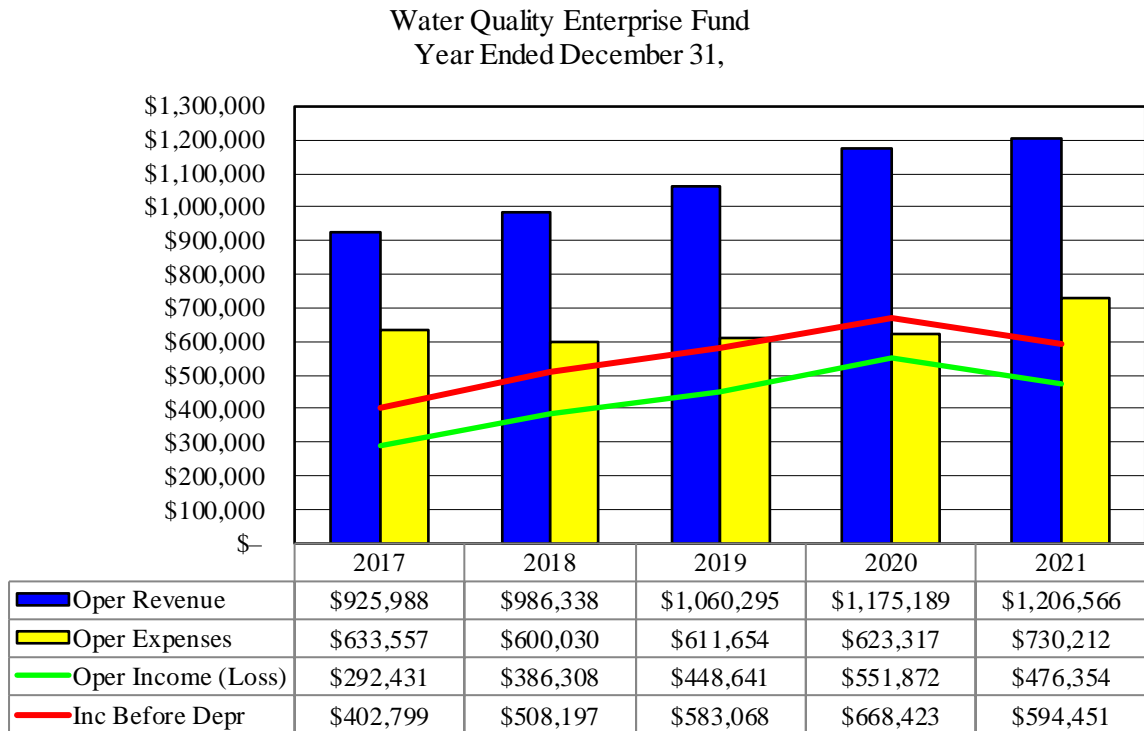


The Sewer Fund ended 2021 with a net position of \$28,265,386, an increase of \$541,380 from the prior year. Of this, \$24,839,355 represents the City’s net investment in capital assets, leaving \$3,426,031 in unrestricted net position. The Sewer Fund had transfers out totaling \$1,031,690 in 2021 to support other funds, pay debt service, and provide for construction projects.

Operating revenue in the Sewer Fund increased \$361,538 (8.2 percent) from the prior year, mainly related to increased usage, rates, and a change in rate structure implemented in 2021. Sewer Fund operating expenses for 2021 increased \$5,632 from the previous year.

## 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 2021 with a net position of \$4,446,762, an increase of \$66,101 from the prior year. Of this, \$2,478,233 represents the investment in capital assets, leaving \$1,968,529 in unrestricted net position.

Operating revenue in the Water Quality Fund increased \$31,377 from the prior year, due to an increase in the rates in 2021. Water Quality Fund operating expenses for 2021 increased \$106,895 (17.2 percent) from the previous year, mainly in repairs and maintenance and other service charges.

## 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, 2021 and 2020, for governmental activities and business-type activities:

	As of December 31,		Change
	2021	2020	
Net position			
Governmental activities			
Net investment in capital assets	\$ 129,907,250	\$ 118,120,401	\$ 11,786,849
Restricted	11,915,717	10,865,279	1,050,438
Unrestricted	14,525,709	11,944,650	2,581,059
Total governmental activities	<u>156,348,676</u>	<u>140,930,330</u>	<u>15,418,346</u>
Business-type activities			
Net investment in capital assets	68,923,937	69,058,053	(134,116)
Unrestricted	11,099,055	9,784,086	1,314,969
Total business-type activities	<u>80,022,992</u>	<u>78,842,139</u>	<u>1,180,853</u>
Total net position	<u>\$ 236,371,668</u>	<u>\$ 219,772,469</u>	<u>\$ 16,599,199</u>

The City's total net position at December 31, 2021, was \$16,599,199 higher than the total net position reported at the previous year-end. The increase in the government activities net investment in capital assets balance was mostly due to capital outlay and capital contribution activity during fiscal 2021.

The increase in unrestricted net position in governmental activities is mostly related to improvements in the unfunded portions of state-wide pension plans. Increases in unrestricted net position in the business-type activities is related to positive operating results in these utility operations 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, and 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, 2021 and 2020:

	2021		2020	
	Expenses	Program Revenues	Net Change	Net Change
Net (expense) revenue				
Governmental activities				
General government	\$ 3,730,464	\$ 861,801	\$ (2,868,663)	\$ (3,337,191)
Public safety	6,923,614	3,108,162	(3,815,452)	(3,871,375)
Public works	6,754,247	12,660,798	5,906,551	60,378
Culture and recreation	2,495,667	1,047,068	(1,448,599)	(1,691,816)
Economic development	889,952	8,743	(881,209)	(949,277)
Interest on long-term debt	752,861	–	(752,861)	(896,377)
Business-type activities				
Water	3,245,146	5,604,983	2,359,837	2,411,521
Sewer	3,398,606	4,794,891	1,396,285	1,904,397
Water quality	730,212	1,240,227	510,015	588,913
Total net (expense) revenue	<u>\$ 28,920,769</u>	<u>\$ 29,326,673</u>	405,904	(5,780,827)
General revenues				
Taxes			15,781,921	15,066,374
Unrestricted grants and contributions			579	1,951,940
Investment income (losses)			(45,123)	1,089,194
Miscellaneous			311,417	184,583
Gain on sale of assets			144,501	38,913
Total general revenues			<u>16,193,295</u>	<u>18,331,004</u>
Change in net position			<u>\$ 16,599,199</u>	<u>\$ 12,550,177</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

As the first year of the fiscal biennium, the primary focus of the 2021 Minnesota legislative session would typically have been the development of the state's fiscal year (FY) 2022–2023 biennial budget. Positive news on the state's budget forecast entering the session, with projections for the end of the FY 2020–2021 biennium improving from a \$2.4 billion shortfall predicted in a May 2020 special pandemic budget projection to a \$940.0 million surplus predicted in the February 2021 budget and economic forecast, was expected to ease the budget process and relieve the pressure to make budget cuts during an already uncertain time. However, given the significant events of the preceding year, including the COVID-19 pandemic and death of George Floyd, the focus of the regular session shifted to legislation responding to the pressing issues that resulted from those events. The business of setting a biennial budget was ultimately not addressed until a June special session that ended in the early morning hours of July 1st.

The following is a brief summary of legislative changes from the 2021 session or previous legislative sessions potentially impacting Minnesota cities.

**American Rescue Plan (ARP) Act** – The federal ARP Act, signed into law in March 2021, provided federal economic recovery funding for federal, state, and local government responses to the COVID-19 pandemic. Minnesota local governments received approximately \$2.1 billion in funding under the ARP Act, including \$644.0 million awarded to 21 large cities (over 50,000 population) and \$377.0 million awarded to cities and towns with a population below 50,000, with half distributed in FY 2021 and half in FY 2022. Local governments can use ARP Act funding in four broad categories: responding to public health and economic impacts; providing premium pay to essential workers; providing general government services to the extent of revenue loss; or investments in water, sewer, and broadband infrastructure.

**Potential State Aid Enhancements** – The 2021 Legislature increased state general fund base spending by approximately \$1.3 billion. Included are funding increases for several programs potentially of benefit to Minnesota cities, including:

- A one-time appropriation of \$5.5 million for supplemental aid to cities for FY 2022, to offset losses of local government aid (LGA) for 96 cities under the current formula. It is expected the Legislature will review and consider updating the LGA formula during the 2022 session.
- Annual appropriations of \$1.8 million for the Greater Minnesota Business Development Public Infrastructure Grant Program, intended to bolster local economic growth by providing grant assistance to cities for public infrastructure needed to create and retain jobs.
- Annual appropriations of \$2.5 million for local community childcare grants, intended to assist local communities to increase the number of childcare providers to support economic development.
- Allocating a total of \$70.0 million from the state's ARP Act funds over the biennium (\$35.0 million per year) to fund the Border-to-Border Broadband Grant Program, which provides grants to local governments for enhancing broadband availability.
- Annual allocations of \$4.5 million for reimbursements to local governments for firefighter training and education costs.
- Annual allocations of \$2.9 million for reimbursement to local governments for peace officer training costs.
- A one-time appropriation of \$18.0 million for FY 2022 to the small cities assistance account to provide additional road repair funding for cities under 5,000 population.

**Truth-in-Taxation Changes** – Effective for property taxes payable in 2023 and thereafter, county auditors will be required to prepare a new statement for inclusion in its parcel-specific truth-in-taxation notices that contains summary budget information for the county, cities, and school districts for which they spread and collect tax levies. Cities with a population greater than 500 will be required to compile and provide current and proposed summary budget information to the county auditor, based on the summary budget information cities are required to submit each year to the Minnesota state auditor.

**Tax Base Change for Low-Income Rental Property** – Effective for assessment years 2022 and 2023, the first-tier limit for class 4d low-income rental property is reduced from \$174,000 to \$100,000, with class rates remaining at 0.75 percent on the first \$100,000 and 0.25 percent on the remaining balance. The tier limit will once again be adjusted annually after assessment year 2023.

**Local Sales Tax Projects Defined** – Minnesota cities are authorized to include up to five capital projects in proposals for local sales taxes. The definition of a capital project for this purpose was updated to include: a single building or structure, including associated infrastructure; improvements within a single park or recreation area, or; a contiguous trail.

**Tax Increment Financing (TIF) Flexibility** – The Legislature enacted several measures that provide additional flexibility for TIF spending, including:

- Allowing unobligated TIF to be used to provide loans, interest rate subsidies, or other assistance to private developers for the construction or substantial rehabilitation of buildings and ancillary facilities, if doing so will create jobs. Transfer authority expires on December 31, 2022, and all transferred increment must be spent by December 31, 2025, or returned to the TIF district.
- Allowing TIF districts that have elected to increase pooling by 10 percent to use the increment for owner-occupied housing that meets the requirements of a housing TIF district, in addition to current low-income rental housing.
- Providing three-year extensions of the five-year and six-year rules for redevelopment districts created after December 31, 2017, but before June 30, 2020, thereby extending their duration.
- Creating a three-city pilot program, giving temporary authority to transfer unobligated housing TIF district increment to the cities affordable housing trust funds.

**Sales and Use Tax Refund Process** – Effective for purchases made after June 30, 2021, cities and other local governments are allowed to utilize a streamlined process to secure a sales tax refund on construction materials purchased by a contractor on behalf of the city for construction, remodeling, expansion, or improvement of public safety facilities owned by local governments, such as police and fire stations. The process also applies to materials used in related facilities, such as access roads, lighting, sidewalks, and utility components. Under the process, local governments would continue to initially pay sales tax on these materials, but would then be allowed to file for a refund of the sales tax paid. Contractors would be required to provide the local government with the information necessary to file for the refund.

**Fire Protection Special Taxing District Authority** – Effective for property tax levies payable in 2023 and thereafter, the current law giving emergency medical districts taxing authority is expanded to include fire protection districts. Two or more local units of government are now permitted to establish a special taxing district to provide fire protection, emergency medical services, or both. The special taxing district will have authority to levy property taxes to finance district operations, spread either across the entire district at a set rate, or allocated to each participating jurisdiction based on factors, such as population or service calls. Districts will also have authority to issue debt related to the function of the district. The property tax and debt issuance authority also apply to existing districts established prior to June 30, 2021.

**Open Meeting Law** – The Legislature made several pandemic-related changes to the Open Meeting Law, including removing the statutory cap of three times per year for elected officials to utilize a medical exception for attending meetings remotely between January 1, 2021, and July 1, 2021, and removing the requirement for elected officials participating in public meetings remotely, due to military service or medical exceptions, to disclose their remote locations. The law changes also updated the definition of “interactive technology” to replace “interactive television” throughout the text of the Open Meeting Laws, and added requirements for public bodies meeting remotely to enable remote participation by the public free of charge and enable public comment from remote locations, when practical.



## 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.

***GASB Statement No. 98, The Annual Comprehensive Financial Report***

This statement establishes the term *annual comprehensive financial report* and its acronym *ACFR*. That new term and acronym replace instances of *comprehensive annual financial report* and its acronym in generally accepted accounting principles for state and local governments. This statement was developed in response to concerns raised by stakeholders that the common pronunciation of the acronym for comprehensive annual financial report sounds like a profoundly objectionable racial slur. This statement's introduction of the new term is founded on a commitment to promoting inclusiveness. The requirements of this statement are effective for fiscal years ending after December 15, 2021. Earlier application is encouraged.