

Management Report
for
City of Arden Hills, Minnesota
December 31, 2019

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PRINCIPALS

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To the City Council and Management
City of Arden Hills, Minnesota

We have prepared this management report in conjunction with our audit of the City of Arden Hills, Minnesota's (the City) financial statements for the year ended December 31, 2019. 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
April 30, 2020

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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, 2019. 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, 2019:

- We have issued an unmodified opinion on the City's basic financial statements.
- We reported one matter involving the City's internal control over financial reporting that we consider to be a material weakness as detailed in the Special Purpose Audit Reports. Due to the limited size of the City's office staff, the City has limited segregation of duties in certain areas.
- 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.

FUND BALANCE/NET POSITION DEFICITS

As reported in the City's Comprehensive Annual Financial Report (CAFR), the EDA TIF District No. 5; Parks Fund; Public Safety Capital Equipment Fund; and TCAAP Fund; had year-end deficit equity balances of \$22,000, \$5,816, \$5,197, and \$194,879, respectively. Management has disclosed that these deficits will be eliminated with future contributions, grants, and internal fund transfers, if needed.

OTHER OBSERVATIONS AND RECOMMENDATIONS

Impact of Novel Coronavirus (COVID-19)

Shortly after the end of the 2019 fiscal year, the onset of the novel coronavirus (COVID-19) pandemic caused substantial volatility in economic conditions and tremendous disruption in the way governments, businesses, and individuals function. Minnesota cities may experience the impact of this pandemic in a myriad of financial areas, such as: declines in investment rates of return, cash flow issues, increased utility billing and property tax delinquencies, significant increases in the number and frequency of employees working remotely, challenges in processing general and payroll disbursements, disruption of prescribed internal control procedures, delays in internal and external financial reporting, and new compliance requirements attached to potential federal relief subsidies. As your city adapts to the new normal of municipal operations in a post-COVID-19 world, the assessment of and responses to new risks that may accompany operational changes will be critical to the safeguarding of city resources and sound financial stewardship. We encourage management and governance to include a robust financial risk assessment process when planning responses to these challenges, and to reassess and adapt internal controls over financial transactions and reporting to align with significant changes made to daily operations, even those intended to be temporary.

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, 2019; however, the City implemented the following governmental accounting standards during the fiscal year:

- Governmental Accounting Standards Board (GASB) Statement No. 83, *Certain Asset Retirement Obligations*, which addressed accounting and financial reporting for certain asset retirement obligations, which are legally enforceable liabilities associated with the retirement of a tangible capital asset.
- GASB Statement No. 84, *Fiduciary Activities*, which established new criteria for identifying and reporting fiduciary activities.
- GASB Statement No. 88, *Certain Disclosures Related to Debt, Including Direct Borrowings and Direct Placements*, which improved and clarified the information to be disclosed in notes to government financial statements related to debt, including direct borrowings and direct placements.
- GASB Statement No. 90, *Majority Equity Interest—an Amendment of GASB Statements No. 14 and No. 61*, which improved the consistency and comparability of reporting a government's majority equity interest in a legally separate organization and the relevance of financial statement information for certain component units.

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** – Management's estimate is based on current rates of pay and unused compensated absences balances.
- **Pension Benefits** – The City has recorded amounts and activities for pension benefits. Actuarial estimates of the net pension balances are calculated using actuarial methodologies described in GASB Statement No. 68. The actuarial calculations include significant assumptions, including projected changes, investment returns, retirement ages, proportionate share, and employee turnover.

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

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

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

DIFFICULTIES ENCOUNTERED IN PERFORMING THE AUDIT

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

CORRECTED AND UNCORRECTED MISSTATEMENTS

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

DISAGREEMENTS WITH MANAGEMENT

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

MANAGEMENT REPRESENTATIONS

We have requested certain representations from management that are included in the management representation letter dated April 30, 2020.

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 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 supplemental 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 supplemental 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 or statistical 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 2018 fiscal year, local ad valorem property tax levies provided 41.5 percent of the total governmental fund revenues for cities over 2,500 in population, and 36.7 percent for cities under 2,500 in population. Total property taxes levied by all Minnesota cities for taxes payable in 2019 increased 5.6 percent from the prior year.

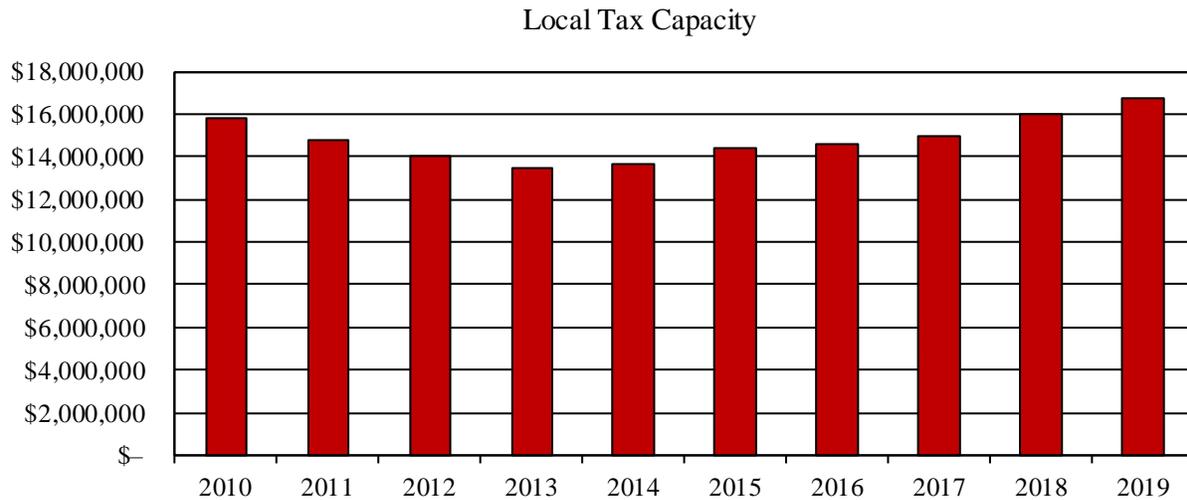
The total tax capacity value of property in Minnesota cities increased about 7.1 percent for the 2019 levy year. The tax capacity values used for levying property taxes are based on the assessed market values for the previous fiscal year (e.g., tax capacity values for taxes levied in 2019 were based on assessed market values as of January 1, 2018), so the trend of change in these tax capacity values lags somewhat behind the housing market and economy in general.

The City's estimated market value increased 7.4 percent for taxes payable in 2018 and increased 4.2 percent for taxes payable in 2019. The following graph shows the City's changes in estimated 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 the City’s 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 7.3 percent for taxes payable in 2018, and increased 4.3 percent for taxes payable in 2019.

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



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

Rates Expressed as a Percentage of Net Tax Capacity			
	City of Arden Hills		
	<u>2017</u>	<u>2018</u>	<u>2019</u>
Average tax rate			
City	27.2	25.5	25.5
County	55.9	54.0	52.9
School	25.3	28.5	26.3
Special taxing	<u>8.6</u>	<u>8.2</u>	<u>8.3</u>
Total	<u><u>117.0</u></u>	<u><u>116.2</u></u>	<u><u>113.0</u></u>

A slight decrease in the county and school portions contributed to the overall decrease in the average tax rate.

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, 2019, presented both by fund balance classification and by fund:

Governmental Fund Change in Fund Balance			
	Fund Balance as of December 31,		Increase (Decrease)
	<u>2019</u>	<u>2018</u>	
Fund balances of governmental funds			
Total by classification			
Nonspendable	\$ 22,652	\$ 25,696	\$ (3,044)
Restricted	1,096,484	1,010,521	85,963
Committed	580,243	508,241	72,002
Assigned	4,263,009	3,136,684	1,126,325
Unassigned	<u>2,759,291</u>	<u>2,862,678</u>	<u>(103,387)</u>
Total governmental funds	<u>\$ 8,721,679</u>	<u>\$ 7,543,820</u>	<u>\$ 1,177,859</u>
Total by fund			
General	\$ 3,215,583	\$ 3,340,369	\$ (124,786)
Permanent Improvement Revolving	3,762,602	2,656,977	1,105,625
Other governmental funds	<u>1,743,494</u>	<u>1,546,474</u>	<u>197,020</u>
Total governmental funds	<u>\$ 8,721,679</u>	<u>\$ 7,543,820</u>	<u>\$ 1,177,859</u>

In total, the fund balances of the City's governmental funds increased by \$1,177,859 during the year ended December 31, 2019. The majority of the increase was in assigned fund balance in the Permanent Improvement Revolving Fund, due to revenues and transfers from other funds exceeding current year spending for street and trail projects.

GOVERNMENTAL FUND REVENUES

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

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

We have designed this section of our management report using per capita data in order to better identify unique or unusual trends and activities of the City. We intend for this type of comparative and trend information to complement, rather than duplicate, information in 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.

Year	State-Wide			City of Arden Hills		
	December 31, 2018			2017	2018	2019
	2,500–10,000	10,000–20,000	20,000–100,000	9,969	9,889	9,988
Population						
Property taxes	\$ 495	\$ 472	\$ 493	\$ 355	\$ 362	\$ 380
Tax increments	28	27	43	30	36	39
Franchise and other taxes	41	48	50	11	10	10
Special assessments	53	40	57	31	74	83
Licenses and permits	38	35	47	73	53	72
Intergovernmental revenues	303	271	157	213	101	60
Charges for services	130	102	112	59	43	44
Other	97	78	49	46	50	64
Total revenue	<u>\$ 1,185</u>	<u>\$ 1,073</u>	<u>\$ 1,008</u>	<u>\$ 818</u>	<u>\$ 729</u>	<u>\$ 752</u>

The City’s governmental funds have generated significantly less revenue per capita in total than other Minnesota cities in its population class. A city’s stage of development, along with the way a city finances various capital projects, will impact the mix of revenue sources it receives.

The City generated \$7,509,130 of total revenue in its governmental funds in 2019, an increase of \$286,455 (4.0 percent) from the prior year. The City’s per capita governmental fund revenues for 2019 were \$752, an increase of \$23 (3.2 percent) per capita from the prior year. Intergovernmental revenues decreased \$41 per capita, due to one-time reimbursements on joint projects in the prior year. This decrease was more than offset by increases in all remaining categories. An increase in the approved levy contributed to the change in property taxes. The City continued to see an increase in development activity with the increase in licenses and permits. An increase in the “other” category in the table above was due, in part, to improved investment earnings.

GOVERNMENTAL FUND EXPENDITURES

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

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

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

Governmental Funds Expenditures per Capita							
With State-Wide Averages by Population Class							
Year	State-Wide			City of Arden Hills			
	December 31, 2018			2017	2018	2019	
Population	2,500–10,000	10,000–20,000	20,000–100,000	9,969	9,889	9,988	
Current							
General government	\$ 150	\$ 121	\$ 104	\$ 119	\$ 118	\$ 120	
Public safety	286	272	294	206	211	240	
Public works	135	125	106	45	59	63	
Parks and recreation	96	115	104	62	66	68	
All other	75	74	78	27	33	30	
	<u>742</u>	<u>707</u>	<u>686</u>	<u>459</u>	<u>487</u>	<u>521</u>	
Capital outlay and construction	417	351	307	118	601	145	
Debt service							
Principal	178	153	109	–	–	–	
Interest and fiscal	41	39	29	–	–	–	
	<u>219</u>	<u>192</u>	<u>138</u>	<u>–</u>	<u>–</u>	<u>–</u>	
Total expenditures	<u>\$ 1,378</u>	<u>\$ 1,250</u>	<u>\$ 1,131</u>	<u>\$ 577</u>	<u>\$ 1,088</u>	<u>\$ 666</u>	

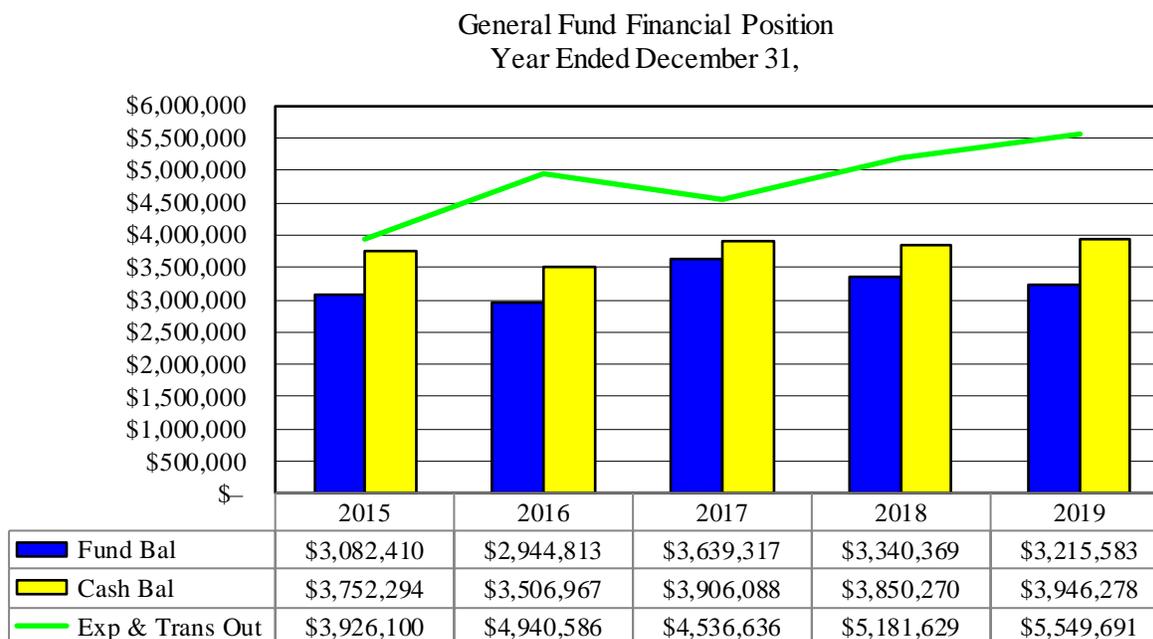
Total expenditures in the City's governmental funds for 2019 were \$6,658,661, a decrease of \$4,099,314 (38.1 percent). The City's per capita governmental funds current expenditures for 2019 were \$521, an increase from the per capita expenditures of \$487 in the prior year.

Capital outlay and construction decreased by \$456 per capita, with decreased activity in the City's Permanent Improvement Revolving Fund, due to significant street and trail projects ongoing in the prior year.

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, street maintenance, parks and recreation, and economic development.

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.



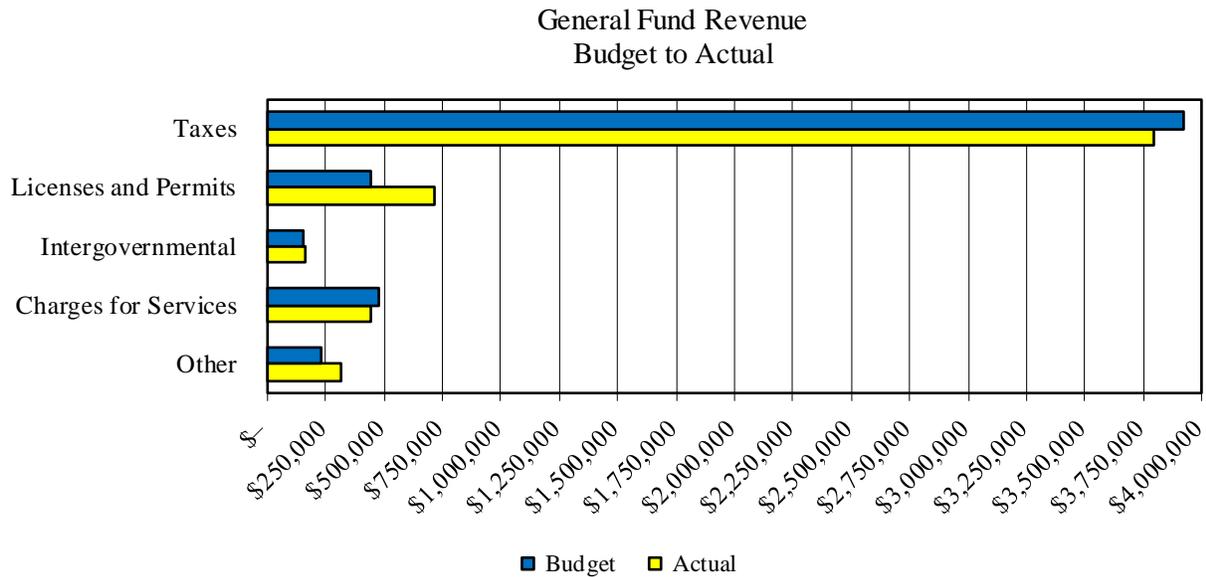
The City's General Fund cash and investments balance at December 31, 2019 was \$3,946,278, an increase of \$96,008 from the previous year. Total fund balance at December 31, 2019 was \$3,215,583, a decrease of \$124,786 from the prior year. This fund balance level represents approximately 67 percent of the City's annual General Fund expenditures, based on 2019 expenditure levels, which compares to a prior year fund balance level of 77 percent. The overall impact of operations on fund balance was \$568,094 better than anticipated in the final budget.

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

A trend that is typical to Minnesota local governments, especially the General Fund of cities, is the unusual cash flow experienced throughout the year. The City's General Fund cash disbursements are made fairly evenly during the year other than the impact of seasonal services, such as snowplowing, street maintenance, and park activities. Cash receipts of the General Fund are quite a different story. Property taxes comprise approximately 70 percent of the fund's total annual revenue. Approximately half of these revenues are received by the City in July and the rest in December. Consequently, the City needs to have adequate cash reserves to finance its everyday operations between these payments.

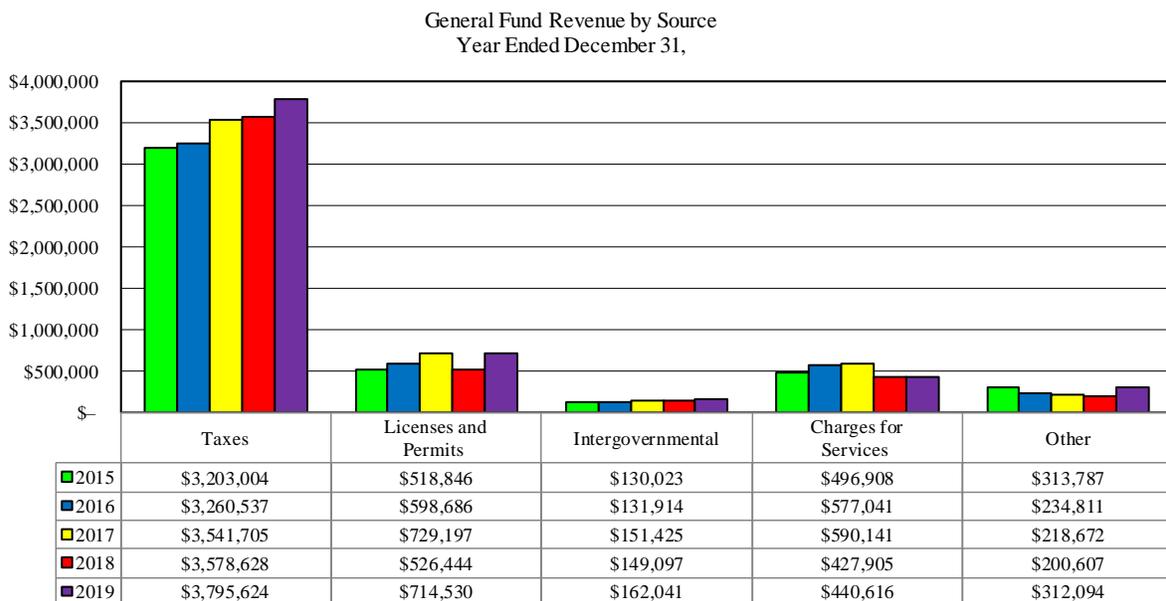
GENERAL FUND REVENUES

The following graph reflects the City's General Fund revenues, budget and actual, for 2019:



Total General Fund revenues for 2019 were \$5,424,905, which was \$200,485 (3.8 percent) over the final budget. Licenses and permits (\$271,510) and other (\$84,264) were over budget, due to conservative budgeting for these sources. Taxes were \$124,126 below anticipated levels, due to abatements and adjustments on delinquent balances.

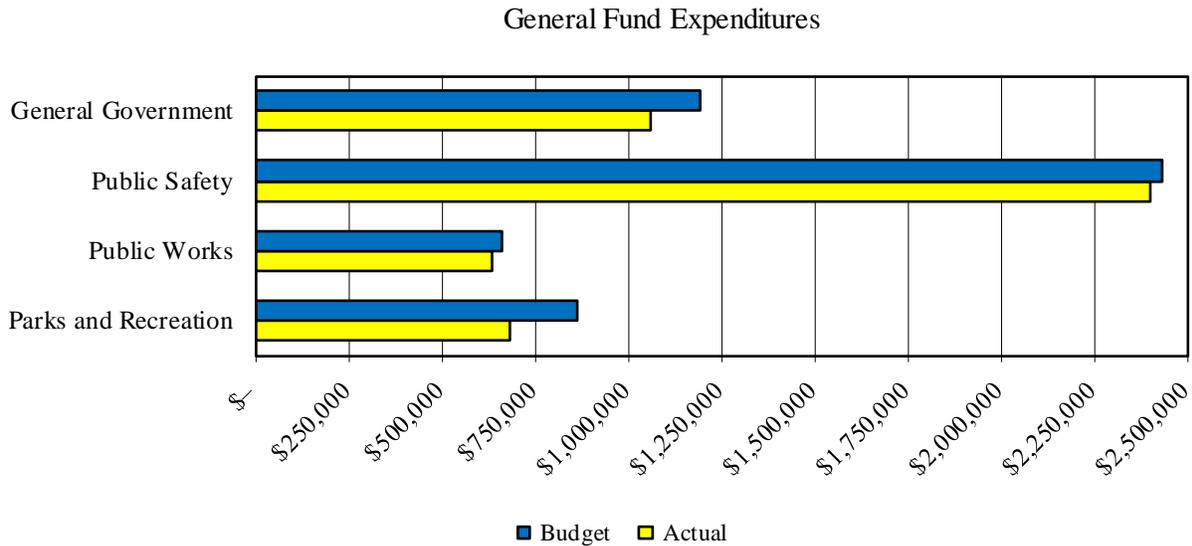
The following graph presents the City's General Fund revenues by source for the last five years. The graph reflects the City's reliance on property taxes:



Total General Fund revenues for 2019 were \$542,224 (11.1 percent) more than prior year. Taxes increased consistent with the change in the approved levy. Licenses and permits were more than the prior year, due to increased building activity in the current year. The increase in the other category was primarily in improved investment earnings.

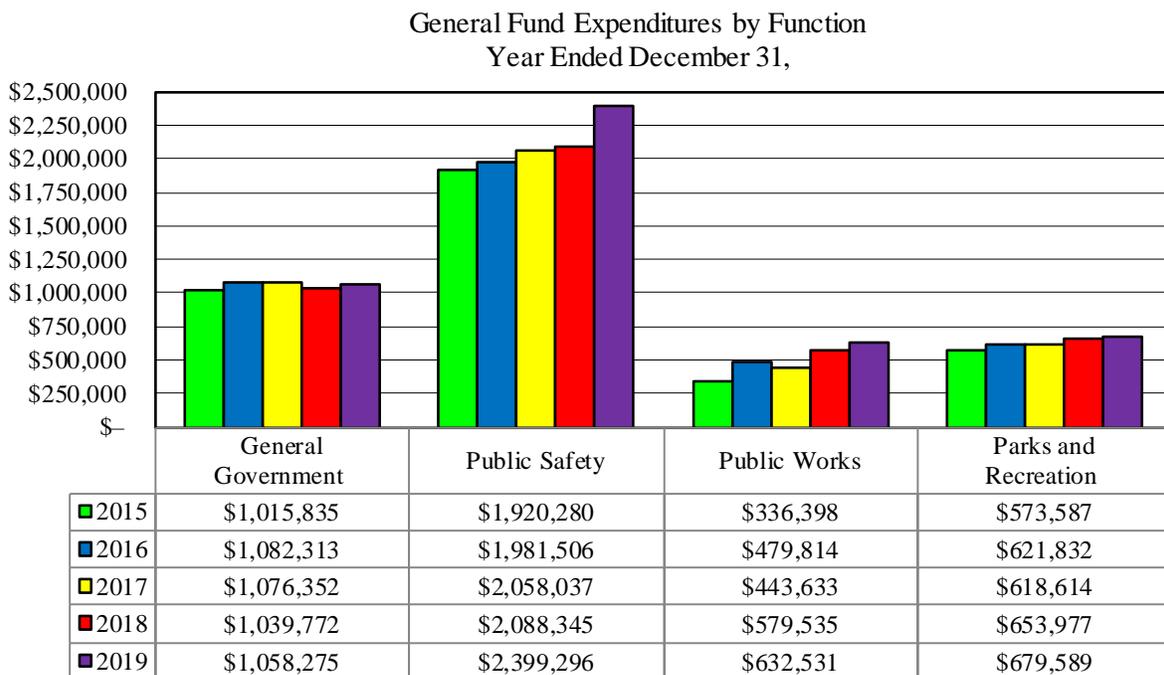
GENERAL FUND EXPENDITURES

The following graph reflects the City's General Fund expenditures, budget and actual, for 2019:



Total General Fund expenditures for 2019 were \$4,769,691, which was \$367,609 (7.2 percent) under the final budget. As presented in the budgetary comparison schedule (within the City's CAFR), expenditure variances were both favorable and unfavorable within the various functions and departments, while overall, they remained within total appropriations approved by the City Council. The general government function was \$133,355 under budget, mainly in TCAAP (\$75,037) and finance (\$26,102) within personal services other services and charges, respectively. The parks and recreation function was under budget by \$178,921, split between park maintenance and recreation.

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



Overall, General Fund expenditures increased \$408,062 (9.4 percent) from the prior year, with the largest increase in public safety (\$310,951). The increase was split between contracted police and fire services and protective inspections.

ENTERPRISE FUNDS OVERVIEW

The City maintains 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, Surface Water Management, and Recycling Funds.

The utility funds comprise a considerable portion of the City’s activities. These funds help to defray overhead and administrative costs and provide additional support to general government operations by way of annual transfers. We understand that the City is proactive in reviewing these activities on an ongoing basis and we want to reiterate the importance of continually monitoring these operations. Over the years, we have emphasized to our city clients the importance of these utility operations being self-sustaining, preventing additional burdens on general government funds. This would include the accumulation of net assets for future capital improvements and to provide a cushion in the event of a negative trend in operations.

ENTERPRISE FUNDS FINANCIAL POSITION

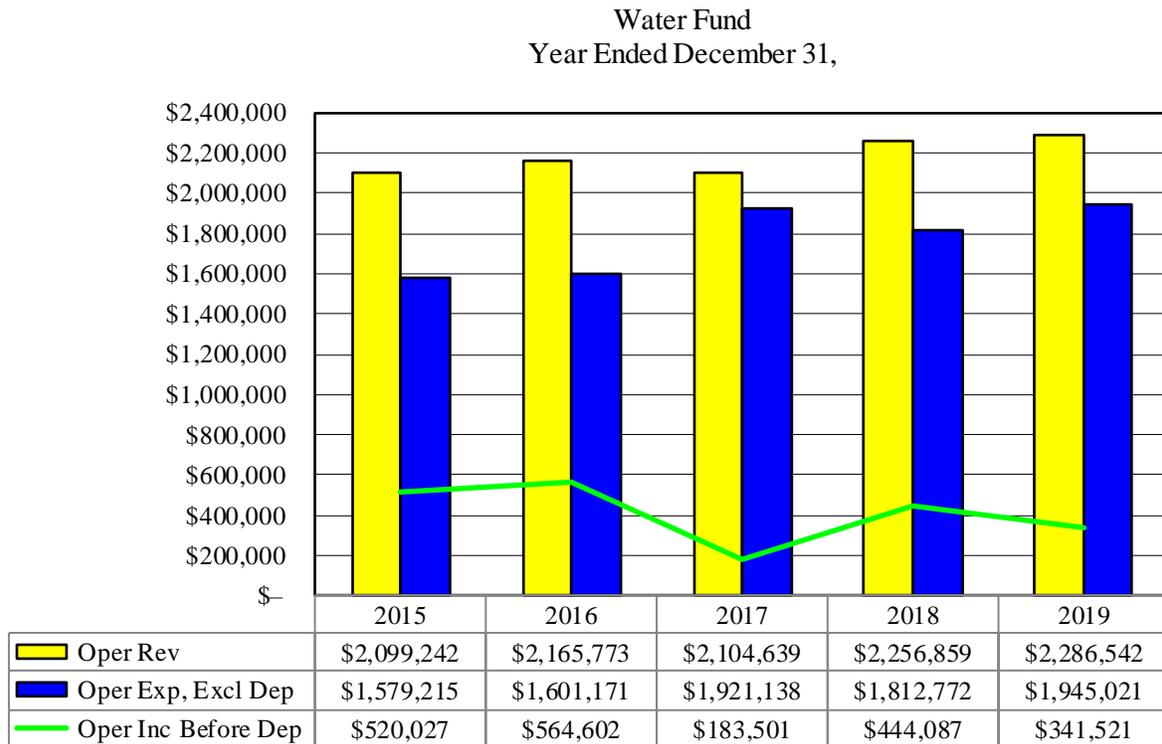
The following table summarizes the changes in the financial position of the City’s enterprise funds during the year ended December 31, 2019, presented both by classification and by fund:

Enterprise Funds Change in Financial Position			
	Net Position as of December 31,		Increase (Decrease)
	2019	2018	
Net position of enterprise funds			
Total by classification			
Net investment in capital assets	\$ 17,452,137	\$ 17,295,916	\$ 156,221
Unrestricted	<u>2,025,812</u>	<u>1,329,268</u>	<u>696,544</u>
Total enterprise funds	<u>\$ 19,477,949</u>	<u>\$ 18,625,184</u>	<u>\$ 852,765</u>
Total by fund			
Water	\$ 8,228,211	\$ 8,179,034	\$ 49,177
Sewer	6,412,749	5,875,144	537,605
Surface Water Management	4,718,789	4,447,569	271,220
Nonmajor Recycling	<u>118,200</u>	<u>123,437</u>	<u>(5,237)</u>
Total enterprise funds	<u>\$ 19,477,949</u>	<u>\$ 18,625,184</u>	<u>\$ 852,765</u>

In total, the net position of the City’s enterprise funds increased by \$852,765 during the year ended December 31, 2019. The increase in net position is primarily related to positive operating results and improved investment earnings in the current year.

WATER FUND

The following graph presents five years of operating results for the Water Fund:



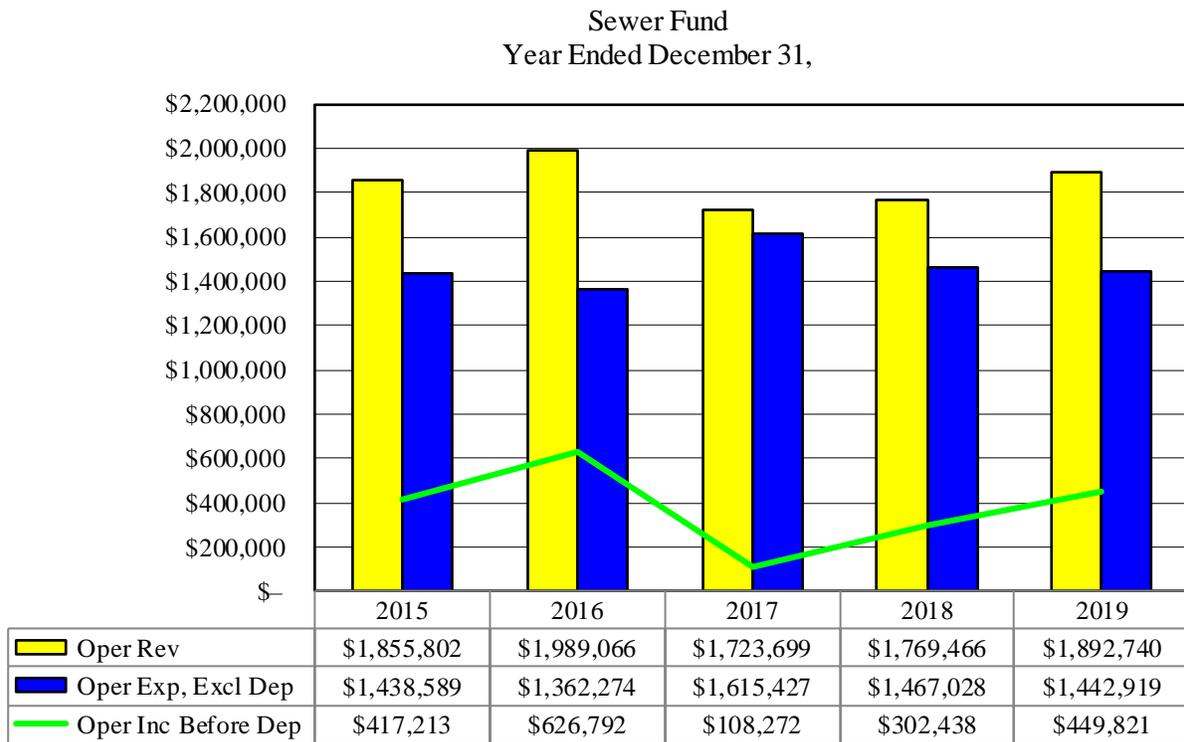
The Water Fund ended 2019 with a net position of \$8,228,211, an increase of \$49,177 from the prior year. Of total net position, \$7,046,791 represents the net investment in capital assets, leaving \$1,181,420 of unrestricted net position.

Water Fund operating revenues were \$2,286,542 for 2019, an increase of \$29,683, due to increased rates. Operating expenses (excluding depreciation of \$285,246) were \$1,945,021, which represents an increase of \$132,249. Expenses increased largely due to an increase in other services and charges, and personal services.

Consumption will fluctuate from year-to-year based on many factors, including weather patterns and number of utility customers.

SEWER FUND

The following graph presents five years of operating results for the Sewer Fund:



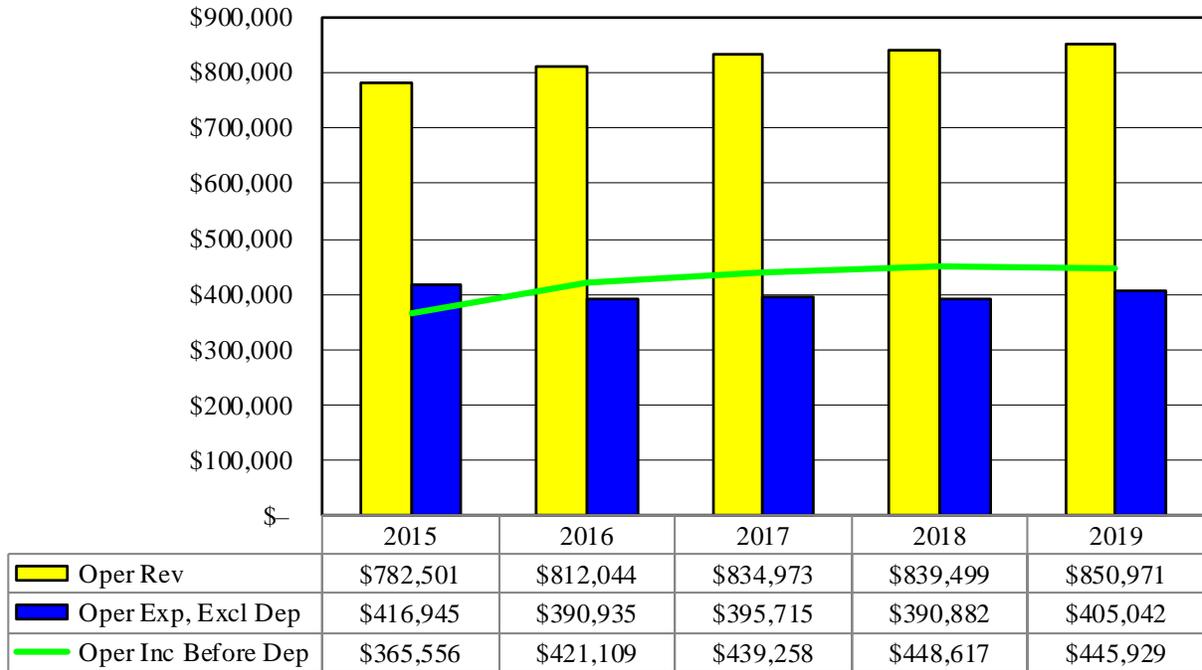
The Sewer Fund ended 2019 with a net position of \$6,412,749, an increase of \$537,605 from the prior year. Of total net position, \$5,792,106 represents the net investment in capital assets, leaving \$620,643 of unrestricted net position.

Sewer Fund operating revenues for 2019 were \$1,892,740, an increase of \$123,274 compared to last year, due to increased rates. Operating expenses for 2019 (excluding depreciation of \$180,169) were \$1,442,919, a decrease of \$24,109 from the prior year, due to a decrease in other services and charges.

SURFACE WATER MANAGEMENT FUND

The following graph presents five years of operating results for the Surface Water Management Fund:

Surface Water Management Fund
Year Ended December 31,

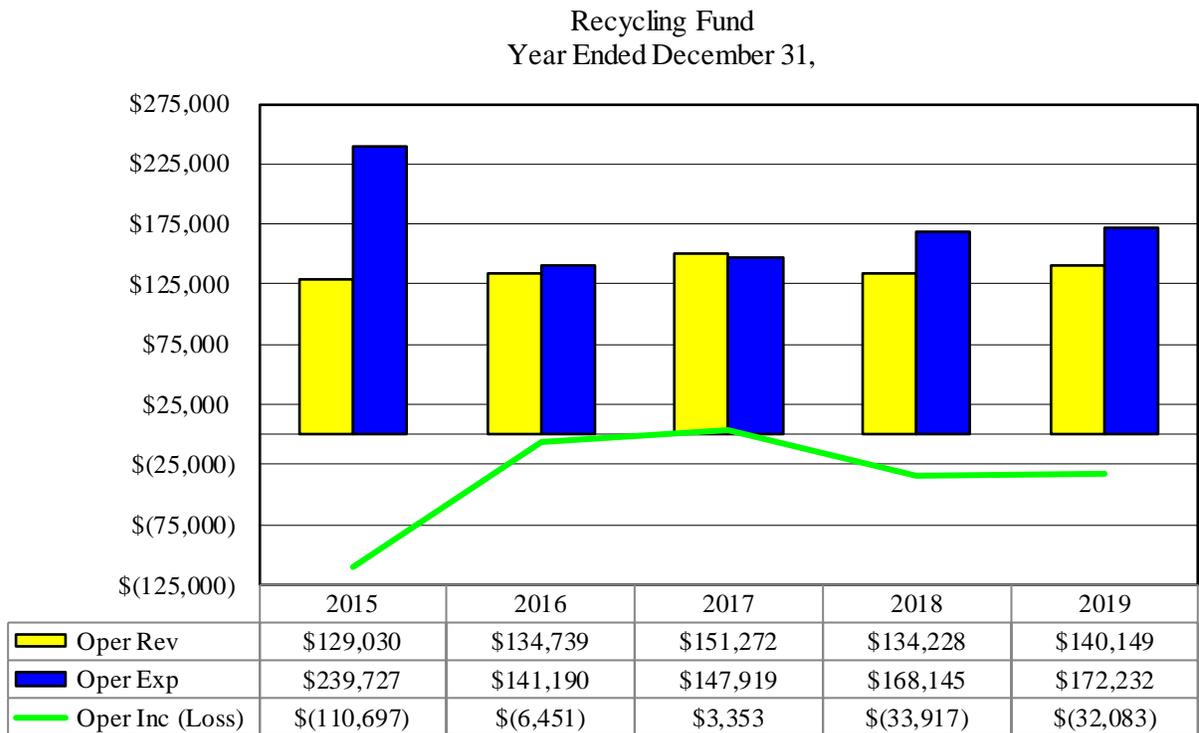


The Surface Water Management Fund ended 2019 with a net position of \$4,718,789, an increase of \$271,220 from the prior year. Of this, \$4,613,240 represents the investment in capital assets, leaving \$105,549 of unrestricted net position.

Surface Water Management Fund operating revenues for 2019 were \$850,971, an increase of \$11,472 from last year, due to an increase in rates. Operating expenses for 2019 (excluding depreciation of \$108,167) were \$405,042, or \$14,160 more than the prior year.

RECYCLING FUND

The following graph presents five years of operating results for the Recycling Fund:



The Recycling Fund ended 2019 with an unrestricted net position of \$118,200, a decrease of \$5,237 from the prior year.

Recycling Fund operating revenues for 2019 were \$140,149, an increase of \$5,921 from the prior year, due to an increase in rates. Operating expenses for 2019 were \$172,232, an increase of \$4,087 from the prior year.

The Recycling Fund also received \$23,597 of nonoperating intergovernmental revenues that are available for the operation of the City's Recycling Program.

In 2015, intergovernmental revenues included \$100,000 received from Ramsey County as a grant to upgrade city residents' recycling receptacles. This intergovernmental revenue is not reflected in the graph above; however, the expenses related to this grant are included in the operating results presented by the graph above. This one-time grant accounts for the increase in operating expenses in the 2015 fiscal year.

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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 your 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: investment in capital assets, restricted, and unrestricted.

The following table presents the components of the City's net position as of December 31, 2019 and 2018 for governmental activities and business-type activities (utility fund operations):

	As of December 31,		Increase (Decrease)
	2019	2018	
Net position			
Governmental activities			
Net investment in capital assets	\$ 26,988,912	\$ 26,972,898	\$ 16,014
Restricted	1,096,698	1,010,521	86,177
Unrestricted	<u>9,070,332</u>	<u>8,736,913</u>	<u>333,419</u>
Total governmental activities	37,155,942	36,720,332	435,610
Business-type activities			
Net investment in capital assets	17,452,137	17,295,916	156,221
Unrestricted	<u>2,025,812</u>	<u>1,329,268</u>	<u>696,544</u>
Total business-type activities	<u>19,477,949</u>	<u>18,625,184</u>	<u>852,765</u>
Total net position	<u>\$ 56,633,891</u>	<u>\$ 55,345,516</u>	<u>\$ 1,288,375</u>

Net position for governmental activities increased by \$435,610 in 2019, as presented above. The largest change in governmental activities occurred in unrestricted net position. Positive operations improved unrestricted net position.

The change in net position for business-type activities is consistent with our earlier discussion for the utility operations, which are presented under the same, full accrual, basis of accounting.

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, 2019 and 2018:

	2019		2018	
	Expenses	Program Revenues	Net Change	Net Change
Net (expense) revenue				
Governmental activities				
General government	\$ 1,337,262	\$ 392,923	\$ (944,339)	\$ (1,001,790)
Public safety	2,471,567	960,220	(1,511,347)	(1,477,024)
Public works	1,416,785	677,860	(738,925)	145,714
Parks and recreation	798,717	109,531	(689,186)	626,237
Economic development	369,256	—	(369,256)	(391,156)
Business-type activities				
Water	2,295,820	2,412,370	116,550	730,977
Sewer	1,663,498	2,099,857	436,359	231,795
Surface water management	513,209	851,273	338,064	341,395
Recycling	172,232	163,746	(8,486)	(10,098)
Total net (expense) revenue	<u>\$ 11,038,346</u>	<u>\$ 7,667,780</u>	(3,370,566)	(803,950)
General revenues				
Property taxes			3,793,754	3,578,894
Tax increment collections			388,697	351,569
Franchise taxes			100,464	101,237
Unrestricted investment earnings			376,026	199,687
Total general revenues			<u>4,658,941</u>	<u>4,231,387</u>
Change in net position			<u>\$ 1,288,375</u>	<u>\$ 3,427,437</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 taxes and unrestricted investment earnings. It also shows that, for the most part, 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 2019 legislative session began with a projected state general fund surplus of \$1.052 billion. The legislative agenda was primarily focused on setting an operating budget for the state's fiscal 2020-2021 biennium. At the end of the regular session, only a higher education budget bill had been completed. However, after a special session, the Legislature was able to address the 11 remaining budget bills, as well as pass an omnibus tax bill and small pension bill. The following is a brief summary of specific legislative changes from the 2019 session or previous legislative sessions potentially impacting Minnesota cities.

Local Government Aid (LGA) – An additional \$26 million was added to the appropriation for the city LGA formula beginning in fiscal 2020, bringing the total state-wide appropriation to \$560.4 million. An additional \$4 million was added to the appropriation beginning in fiscal 2021. The LGA distribution formula for 2020 was altered to provide that a city's 2020 LGA may not be less than its 2019 aid, and the cap on maximum aid losses in any year thereafter was modified.

Bonding Bill – The 2019 bonding bill provided financing for approximately \$102 million of projects and funding authorized by the 2018 omnibus bonding bill, which had been legally challenged due to their reliance on the use of the Environment and Natural Resources Trust Fund to generate appropriation bonds. The 2019 Legislature changed the funding source for these projects to general obligation bonds, clearing the way for the projects to go forward. Included in this was \$59 million earmarked for city water and wastewater projects through the state Public Facilities Authority.

Local Option Sales Tax Process – Effective May 1, 2019, the process for cities to enact a local option sales tax have been modified, requiring special legislation prior to a local referendum vote. Cities must now adopt a resolution specifying the proposed sales tax rate and time frame for the sales tax. The resolution must also include a detailed description of the project or projects (up to five) to be funded by the sales tax, the amount to be raised for each project, and documentation of the regional significance of each project. The resolution must be submitted to the House and Senate tax committee chairs by January 31st to be considered for special legislation by the State Legislature. If special legislation is approved, voter approval must be obtained by referendum at a general election within two years of legislative approval.

Wage Theft – The Legislature enacted a number of changes in employment law aimed at reducing wage theft by employers. The changes require employers to provide written notice to new employees of specific wage information including rate of pay, allowances, paid leave, deductions, days in a pay period, and the employer's legal name, address, and phone number. Employers must also provide an earnings statement that includes similar information. The changes also create new requirements for employer recordkeeping for hours worked each day and each workweek, and imposes penalties for failure to do so and for refusal to make the records available for inspection by the Department of Labor.

Written Estimates of Consulting Fees – Effective August 1, 2019, upon request by applicants for a permit, license, or other approval relating to real estate development or construction, cities are required to provide a written, nonbinding estimate of consulting fees to be charged to the applicant based on information available at that time. The related application will not be considered complete until the city has provided the estimate, received the required application fees, and received the applicant's signed acceptance of the fee estimate along with a signed statement that the applicant has not relied on the fee estimate in its decision to proceed with the application.

Contract Retainage – Effective for contracts entered into August 1, 2019 or later, contract retainage must be released no later than 60 days after the related construction project reaches substantial completion as defined by statute. After substantial completion, cities can still withhold amounts equal to, 1) 250 percent of the cost to correct or complete work known at the time of substantial completion, and 2) the greater of \$500 or 1 percent of the value of the contract pending the completion of "final paperwork," including documents required to fulfill contractual obligations such as operating manuals, payroll documents for projects subject to prevailing wage requirements, and contractor payroll tax withholding affidavits. Any resulting reduction in retainage must be passed from the contractor to all subcontractors at the same rate.

Driver and Vehicle Registration System (VTRS) – The Legislature selected VTRS, a third party vendor system, to replace the failed Minnesota Licensing and Registration System (MNLARS). Fees from driver’s licenses, license plates, and filing fees were increased and a technology surcharge imposed on vehicle registration renewals to pay for the implementation of VTRS, the decommissioning of MNLARS, and to temporarily increase the capacity of Driver and Vehicle Services to meet public service needs. Included in this is \$13 million appropriated in 2019 for reimbursement grants to deputy registrars for costs related to MNLARS. The grants, which would be determined by formula, would require the deputy registrar accepting the grant to release the state from any further liability or claims related to MNLARS.

Vaping Ordinance Authority – Effective July 1, 2019, cities are allowed to enact and enforce ordinances with more stringent measures than the Minnesota Clean Indoor Air Act to protect individuals from involuntary exposure to aerosol or vapor from electronic delivery devices.

Water Connection Fees – Effective January 1, 2020, the annual water connection fees cities are required to collect on behalf of the Minnesota Department of Health for water testing and support has been increased from \$6.36 to \$9.72.

Military Exception to Open Meeting Law – Effective August 1, 2019, members of a public body that are in the military will be allowed to participate in public meetings via interactive television when they are at a required drill, deployed, or on active duty. The member may participate under this exception up to three times a year.

Pension Plan Changes – The 2019 pension bill included several changes to the various pension plans throughout the state:

- Changes to plans administered by the Public Employees Retirement Association (PERA) included:
 - The rights of PERA General Employees Retirement Fund (GERF) plan and Public Employees Police and Fire Fund (PEPFF) plan members to purchase service credit for periods of military leave were expanded. This gives plan members the right to purchase up to five years of service credit for military service leave that is not federally protected because the service occurred prior to public employment or the member did not meet the payment deadlines applicable to federally protected leave service credit purchases.
 - The Phased Retirement Option (PRO) program, which gives cities an opportunity to retain potentially retiring employees that are GERF plan members aged 62 or over, was altered and made permanent. Under a PRO arrangement, an employee would begin collecting a retirement annuity, but could continue working for their current employer for up to five years if they agree to a work schedule that represents a reduction of at least 25 percent each pay period from their current schedule, up to a maximum of 1,044 hours per year. Employees would not be allowed to contribute to a pension benefit plan or accrue additional service time while working under a PRO.
 - A process was established for municipalities and joint powers entities to terminate participation in the PERA Statewide Volunteer Firefighter (SVF) plan if, 1) the entity has either eliminated its fire department or ceased using the services of all departing firefighters and any other noncareer or volunteer firefighters, and 2) the entity’s account has assets sufficient to cover all liabilities including the fully vested liabilities for all departing firefighters and administrative expenses.

- Changes impacting volunteer firefighter relief associations (VRFAs) included:
 - Effective January 1, 2020, vesting schedules for defined contribution plans cannot require that a member have more than 20 years of active service to become 100 percent vested in the member's account, or provide for a larger vesting percentage with respect to the completed years of service than as provided in the statutory schedule.
 - Effective January 1, 2020, the permitted graded vesting schedule for defined benefit pension plans is reduced from 20 years to 10 years for full vesting. Also, plans cannot require that a member have more than 20 years of active service to become 100 percent vested in the member's accrued service pension, or provide for a larger vesting percentage with respect to the completed years of service than as provided in the statutory schedule.
 - Effective January 1, 2020, supplemental benefits are allowed to be paid to designated beneficiaries or estates when plan members have no surviving spouse or children.

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ACCOUNTING AND AUDITING UPDATES

The following is a summary of GASB standards expected to be implemented in the next few years. However, due to the COVID-19 outbreak, the GASB is currently considering a proposal to delay the original implementation dates of these and other standards by a year. At this point, the implementation dates for the standards listed below are tentative and may be subject to change.

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 December 15, 2019.

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, 2020. Earlier application is encouraged.