Management Report

for

City of Plymouth, Minnesota

December 31, 2019

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MMKR
CERTIFIED PUBLIC ACCOUNTANTS

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To the City Council and Management
City of Plymouth, Minnesota

We have prepared this management report in conjunction with our audit of the City of Plymouth, 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
June 12, 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, *GOVERNMENT AUDITING STANDARDS*, AND TITLE 2 U.S. CODE OF FEDERAL REGULATIONS (CFR) PART 200, *UNIFORM ADMINISTRATIVE REQUIREMENTS, COST PRINCIPLES, AND AUDIT REQUIREMENTS FOR FEDERAL AWARDS* (UNIFORM GUIDANCE)

We have audited the financial statements of the governmental activities, the business-type activities, the discretely presented component unit, 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, *Government Auditing Standards*, and the Uniform Guidance, as well as certain information related to the planned scope and timing of our audit. We have communicated such information to you verbally and in our audit engagement letter. Professional standards also require that we communicate the following information related to our audit.

PLANNED SCOPE AND TIMING OF THE AUDIT

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

AUDIT OPINION AND FINDINGS

Based on our audit of the City's financial statements for the year ended December 31, 2019:

- 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. It should be understood that internal controls are never perfected, and those controls which protect the City's funds from such things as fraud and accounting errors need to be continually reviewed and modified as necessary.

- The results of our testing disclosed no instances of noncompliance required to be reported under *Government Auditing Standards.*

- We reported that the Schedule of Expenditures of Federal Awards is fairly stated, in all material respects, in relation to the basic financial statements.

- The results of our tests indicate that the City has complied, in all material respects, with the types of compliance requirements that could have a direct and material effect on each of its major federal programs.

- We reported no deficiencies in the City's internal controls over compliance that we considered to be material weaknesses with the types of compliance requirements that could have a direct and material effect on each of its major federal programs.

- We reported no findings based on our testing of the City's compliance with Minnesota laws and regulations.

Other Observations and Recommendations

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. 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.

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.

- **Total Other Post-Employment Benefits (OPEB) and Net Pension Liabilities** – The City has recorded liabilities and activity for OPEB and pension benefits. These obligations are calculated using actuarial methodologies described in the GASB 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.

- **Compensated Absences –** Management's estimate is based on current rates of pay and sick leave balances.

- **Self-Insurance Reserves –** Management's estimates of self-insurance reserves are based on the estimated liability for incurred but not reported claims.

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 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.

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.

DIFFICULTIES ENCOUNTERED IN PERFORMING THE AUDIT

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

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 June 12, 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 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 supplementary information accompanying the financial statements and the separately issued Schedule of Expenditures of Federal Awards, which are not RSI. With respect to this 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 and Schedule of Expenditures of Federal Awards to the underlying accounting records used to prepare the financial statements or to the financial statements themselves.

We were not engaged to report on the introductory section and the statistical section, 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

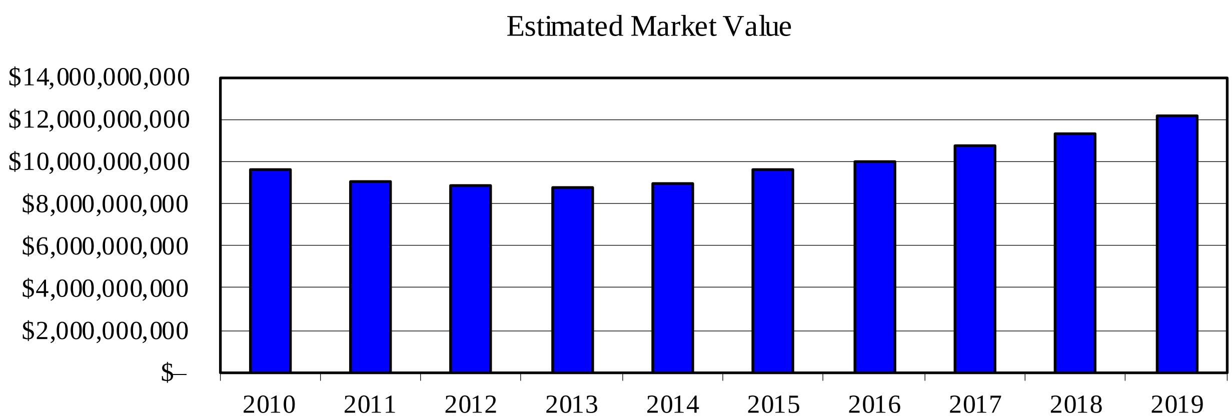
This section of the report provides you with an overview of the financial trends and activities of the City's governmental funds, which includes the General, special revenue, debt service, and capital project funds. These funds are used to account for the basic services the City provides to all of its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

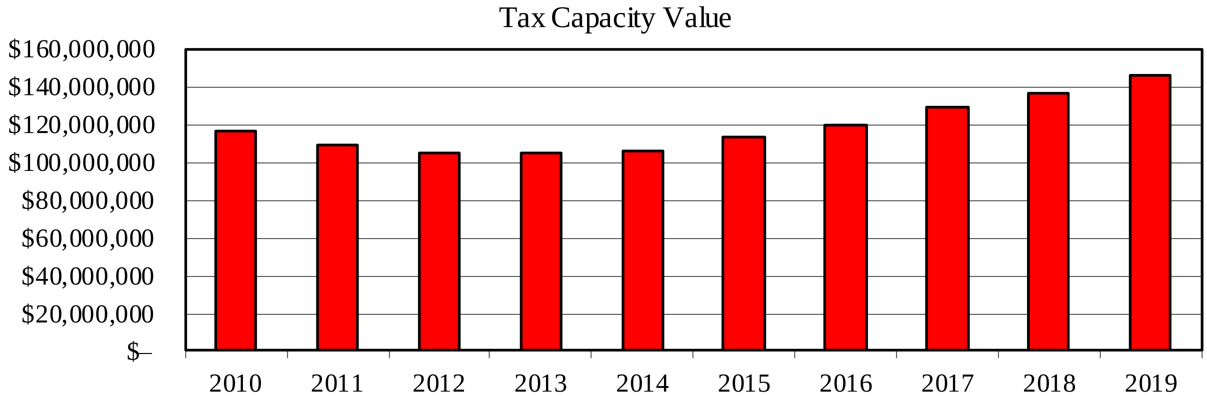
The total tax capacity value of property in Minnesota cities increased about 7.1 percent for the 2019 levy year. The tax capacity values used for levying property taxes are based on the assessed market values for the previous fiscal year (e.g., tax capacity values for taxes levied in 2019 were based 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 5.2 percent for taxes payable in 2018 and 7.7 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 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 5.9 percent for 2018 and 7.4 percent for 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 Plymouth		
	2017	2018	2019
Average tax rate			
City	26.5	26.3	25.9
County	44.1	42.8	41.9
School	26.3	25.5	24.8
Special taxing	10.7	10.3	9.9
Total	107.6	104.9	102.5

Increasing property values and additions to the tax base contributed to the decrease in the total average tax rate as presented in the above table.

Note: The school tax rate is based on Wayzata School's (District No. 284) tax rate and the special taxing rate uses the Bassett Creek Watershed (District No. 7), due to these two districts servicing the majority of the City.

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 Funds Change in Fund Balance

	Fund Balance as of December 31, 2019	Fund Balance as of December 31, 2018	Change
Fund balances of governmental funds			
Total by classification			
Nonspendable	$ 531,278	$ 144,942	$ 386,336
Restricted	24,035,958	20,047,533	3,988,425
Assigned	39,312,827	40,362,787	(1,049,960)
Unassigned	6,585,948	16,509,324	(9,923,376)
Total governmental funds	$ 70,466,011	$ 77,064,586	$ (6,598,575)
Total by fund			
General	$ 17,416,322	$ 16,686,422	$ 729,900
Transit System	10,554,889	9,163,544	1,391,345
General Capital Projects	6,210,470	6,018,707	191,763
Improvement Projects	(10,226,645)	2,719,810	(12,946,455)
Street Replacement	18,434,164	17,705,092	729,072
Nonmajor funds	28,076,811	24,771,011	3,305,800
Total governmental funds	$ 70,466,011	$ 77,064,586	$ (6,598,575)

In total, the fund balances of the City's governmental funds decreased $6,598,575 during the year ended December 31, 2019.

The decrease in the current year was primarily in the Improvement Projects Fund, with a decrease in assigned and unassigned amounts. The decrease was due to the City incurring the costs for the joint project for the I-494 Rockford Road bridge replacement joint project. The City will be reimbursed in 2020 by the state and county for costs associated with this project. Amounts are recognized in revenue for governmental fund reporting purposes when amounts are readily available.

GOVERNMENTAL FUND REVENUES

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

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

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

Governmental Funds Revenue per Capita
With State-Wide Averages by Population Class

	State-Wide		City of Plymouth		
Year	2017	2018	2017	2018	2019
Population	20,000–100,000	20,000–100,000	76,882	78,351	79,475
Property taxes	$ 475	$ 493	$ 421	$ 427	$ 441
Tax increments	38	43	21	25	24
Franchise fees and other taxes	48	50	29	29	30
Special assessments	59	57	–	–	–
Licenses and permits	49	47	65	58	64
Intergovernmental revenues	147	157	153	138	157
Charges for services	103	112	68	74	78
Other	48	49	66	67	71
Total revenue	$ 967	$ 1,008	$ 823	$ 818	$ 865

The City's governmental funds have typically generated 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. The City has less special assessment revenue than the state-wide average, which is due to the way the City finances certain capital projects and, therefore, is not included in the funds presented in the above table.

Total revenues for the City's governmental funds for 2019 were $68,750,544, an increase of $4,641,962 (7.2 percent) from the prior year. On a per capita basis, the City's governmental funds revenue for 2019 was $865, an increase of $47 from the prior year, including the effect of a change in estimated population. The most significant change was in intergovernmental revenues, which were $19 per capita more than the prior year. In 2019, the City recognized more intergovernmental revenues for MSA eligible construction projects as well as the DEED grant passed through the City. An increase in property taxes was due to an increase in the approved tax levy.

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 the state-wide averages, are presented in the following table:

Governmental Funds Expenditures per Capita
With State-Wide Averages by Population Class

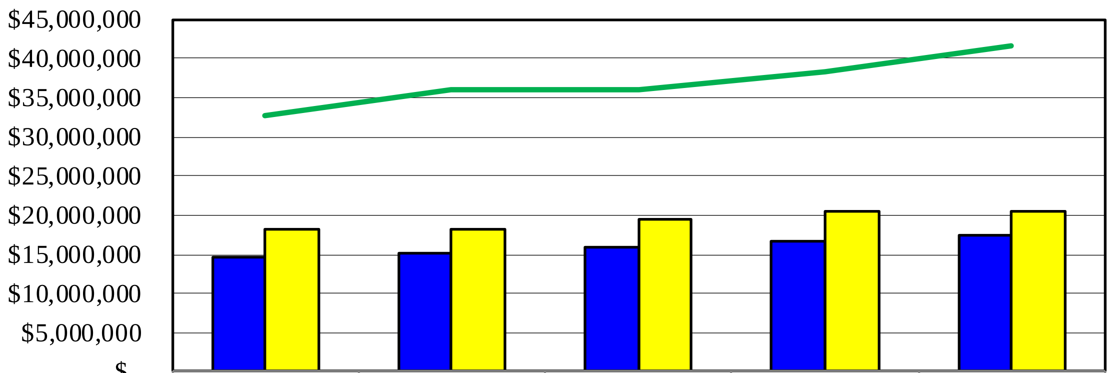
	State-Wide		City of Plymouth		
Year	2017	2018	2017	2018	2019
Population	20,000–100,000	20,000–100,000	76,882	78,351	79,475
Current					
General government	$ 101	$ 104	$ 83	$ 86	$ 86
Public safety	287	294	246	256	269
Streets and highways	101	106	108	77	261
Culture and recreation	99	104	101	105	107
All other	77	78	94	80	93
	665	686	632	604	816
Capital outlay and construction	263	307	156	212	166
Debt service					
Principal	121	109	34	13	13
Interest and fiscal	32	29	5	4	3
	153	138	39	17	16
Total expenditures	$ 1,081	$ 1,131	$ 827	$ 833	$ 998

Total expenditures for the City's governmental funds for 2019 were $79,278,542, an increase of $14,004,107 (21.5 percent) from the prior year. The City's per capita governmental fund expenditures for 2019 were $998, an increase of $165 per capita from the prior year. Streets and highways spending increased $184 per capita, due to the I-494 Rockford Road bridge replacement joint project. Since the assets will be reported by the other governments participating in this joint project, the expenditures are reported as current for financial reporting purposes of the City. The decrease in capital outlay and construction was due to less capital projects being undertaken by the City in the current 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, streets and highway maintenance, and parks and recreation. The graph below illustrates the change in the General Fund financial position over the last five years. We have also included a line representing annual expenditures to reflect the change in the size of the General Fund operation over the same period.

General Fund Financial Position
Year Ended December 31,



	2015	2016	2017	2018	2019
Fund Balance	$14,598,184	$15,076,781	$15,835,810	$16,686,422	$17,416,322
Cash Balance	$18,104,236	$18,176,730	$19,493,971	$20,406,006	$20,506,981
Expenditures	$32,850,824	$35,922,594	$35,927,938	$38,374,949	$41,750,445

The City's General Fund cash and investments balance at December 31, 2019 was $20,506,981, an increase of $100,975. Total fund balance at December 31, 2019 was $17,416,322, which is an increase of $729,900 from the prior year, after a year-end transfer of $884,091 to the General Capital Projects Fund, in accordance with the fund balance policy of the City for the General Fund.

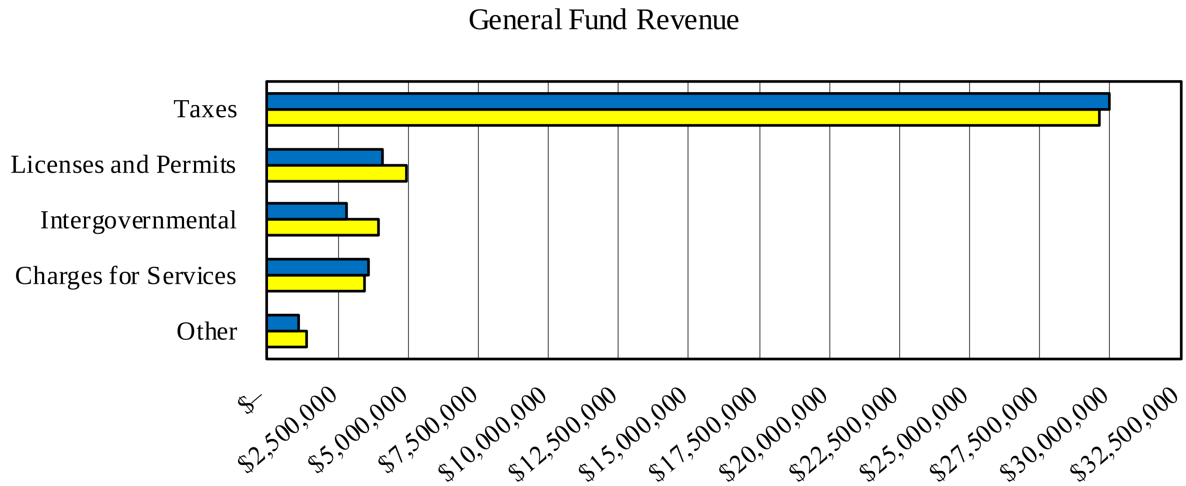
As the graph above illustrates, the City has generally been able to maintain healthy cash and fund balance levels as the volume of financial activity has grown. This is an important factor because a government, like any organization, requires a certain amount of equity to operate. A healthy financial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

A trend that is typical to Minnesota local governments, especially the General Fund of cities, is the unusual cash flow experienced throughout the year. The City's General Fund cash disbursements are made fairly evenly during the year other than the impact of seasonal services, such as snowplowing, street maintenance, and park activities. Cash receipts of the General Fund are quite a different story. Taxes comprise about 68 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.

In accordance with the City's fund balance policy, the General Fund balance at the end of the 2019 fiscal year represents 40 percent of the subsequent year's budgeted expenditures and transfers out.

GENERAL FUND REVENUES

The following graph illustrates the City's General Fund revenue sources for 2019 compared to budget:

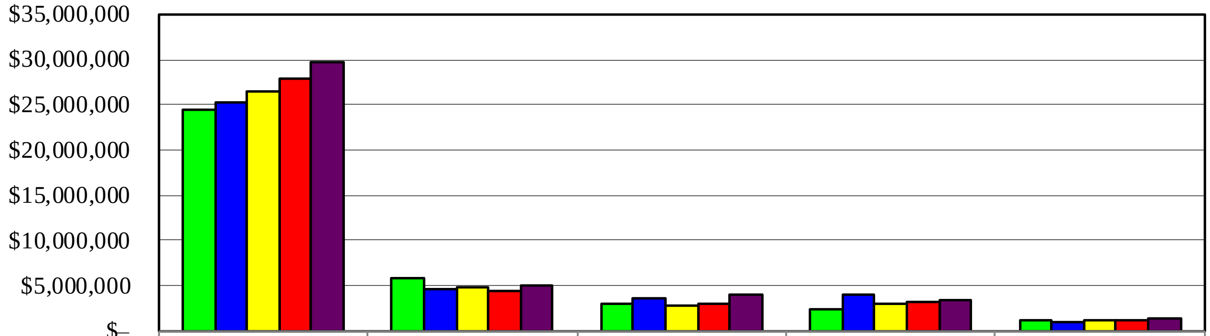


	Other	Charges for Services	Intergovernmental	Licenses and Permits	Taxes
Budget	$1,088,500	$3,577,035	$2,818,866	$4,071,330	$29,958,324
Actual	$1,406,345	$3,462,536	$3,950,320	$4,960,592	$29,623,326

Total General Fund revenues for 2019 were $43,403,119, which was $1,889,064 (4.6 percent) more than budget. Licenses and permits, intergovernmental revenues, and other sources were over budget $889,262, $1,131,454, and $317,845, respectively. Elevated development activity, improved investment earnings, and conservative budgeting contributed to the favorable variances. The City also reported extra intergovernmental revenue from a pass-through grant that was not anticipated in the budget. Taxes and charges for services ended the year less than anticipated by $334,998 and $114,499, respectively, partially offsetting the favorable variances previously mentioned.

The following graph presents the City's General Fund revenue by source for the last five years and reflects the City's reliance on property taxes in recent years:

General Fund Revenue by Source
Year Ended December 31,



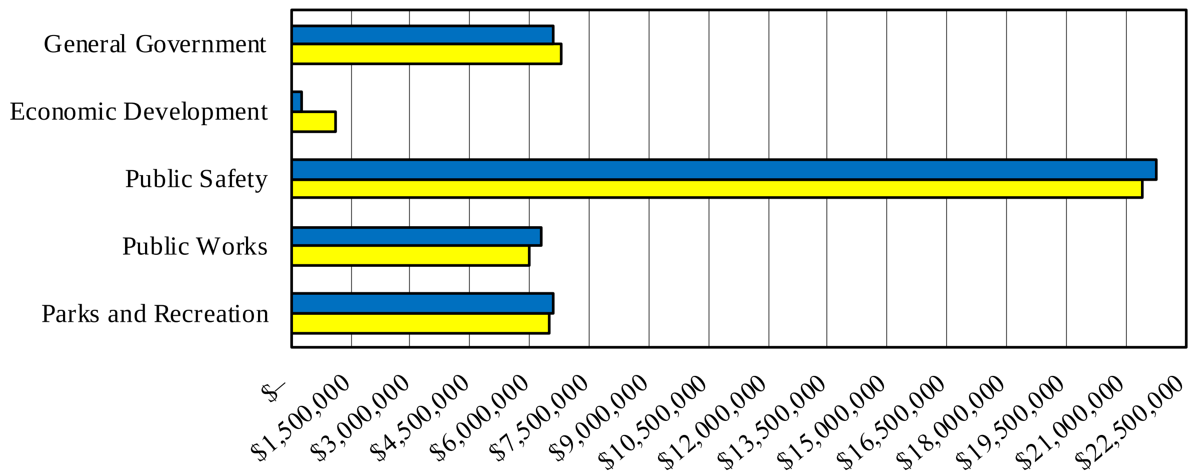
	Taxes	Licenses and Permits	Intergovernmental	Charges for Services	Other
2015	$24,414,150	$5,797,610	$2,880,999	$2,385,480	$1,126,309
2016	$25,247,809	$4,510,095	$3,488,202	$3,959,231	$929,909
2017	$26,543,658	$4,821,527	$2,725,138	$2,937,238	$1,253,460
2018	$27,836,128	$4,441,208	$2,926,320	$3,189,093	$1,148,802
2019	$29,623,326	$4,960,592	$3,950,320	$3,462,536	$1,406,345

Total General Fund revenue for 2019 was $3,861,568 (9.8 percent) higher than last year. Taxes increased by $1,787,198, due to an increase in the tax levy over the prior year. Licenses and permits revenue increased by $519,384. Intergovernmental revenue increased $1,024,000, due to an increase in pass-through grants and aid received from the state. Charges for services increased by $273,443, due to an increase in project-related activity. Remaining revenues increased by $257,543, primarily due to an increase in investment earnings in 2019 compared to the prior year.

GENERAL FUND EXPENDITURES

The following graph illustrates the components of General Fund spending for 2019 compared to budget:

General Fund Expenditures

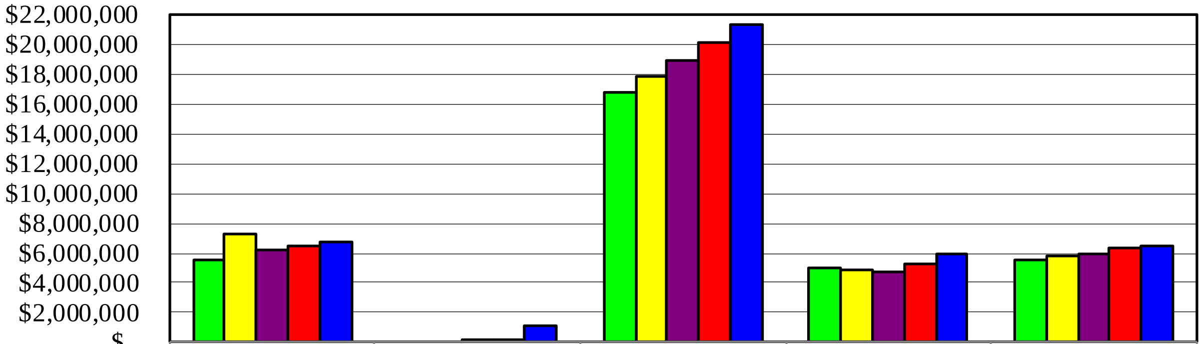


	Parks and Recreation	Public Works	Public Safety	Economic Development	General Government
Budget	$6,618,703	$6,269,704	$21,782,671	$266,893	$6,577,584
Actual	$6,479,420	$5,980,062	$21,399,681	$1,107,852	$6,783,430

Total General Fund expenditures for 2019 were $41,750,445, which was $234,890 (0.6 percent) over the final budget. The largest variance was in economic development, which included a DEED grant passed through to a local business from the state. Overall savings in personal costs, due to attrition and cost restraints shared by all departments, contributed to the favorable expenditure variances in other functions.

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

General Fund Expenditures by Function
Year Ended December 31,



	General Government	Economic Development	Public Safety	Public Works	Parks and Recreation
2015	$5,547,072	$–	$16,760,687	$4,968,666	$5,574,399
2016	$7,328,302	$–	$17,814,799	$4,922,496	$5,856,997
2017	$6,162,737	$187,110	$18,925,718	$4,783,693	$5,868,680
2018	$6,517,799	$181,094	$20,110,258	$5,204,919	$6,360,879
2019	$6,783,430	$1,107,852	$21,399,681	$5,980,062	$6,479,420

Total General Fund expenditures for 2019 increased $3,375,496 over the prior year. General government expenditures increased by $265,631 (4.1 percent) from the prior year, mainly in personal and contractual services. Economic development spending increased by $926,758 (511.8 percent), due to the pass-through grant previously discussed. Public safety expenditures increased by $1,289,423 (6.4 percent), public works increased by $775,143 (14.9 percent), and parks and recreation expenditures increased by $118,541 (1.9 percent) over the prior year, mainly in personal and contractual services as anticipated in the budget.

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 includes the Water Sewer Utility, Ice Center, Water Resources, Solid Waste Management, and Field House 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 position 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 years ended December 31, 2019 and 2018, presented both by classification and by fund:

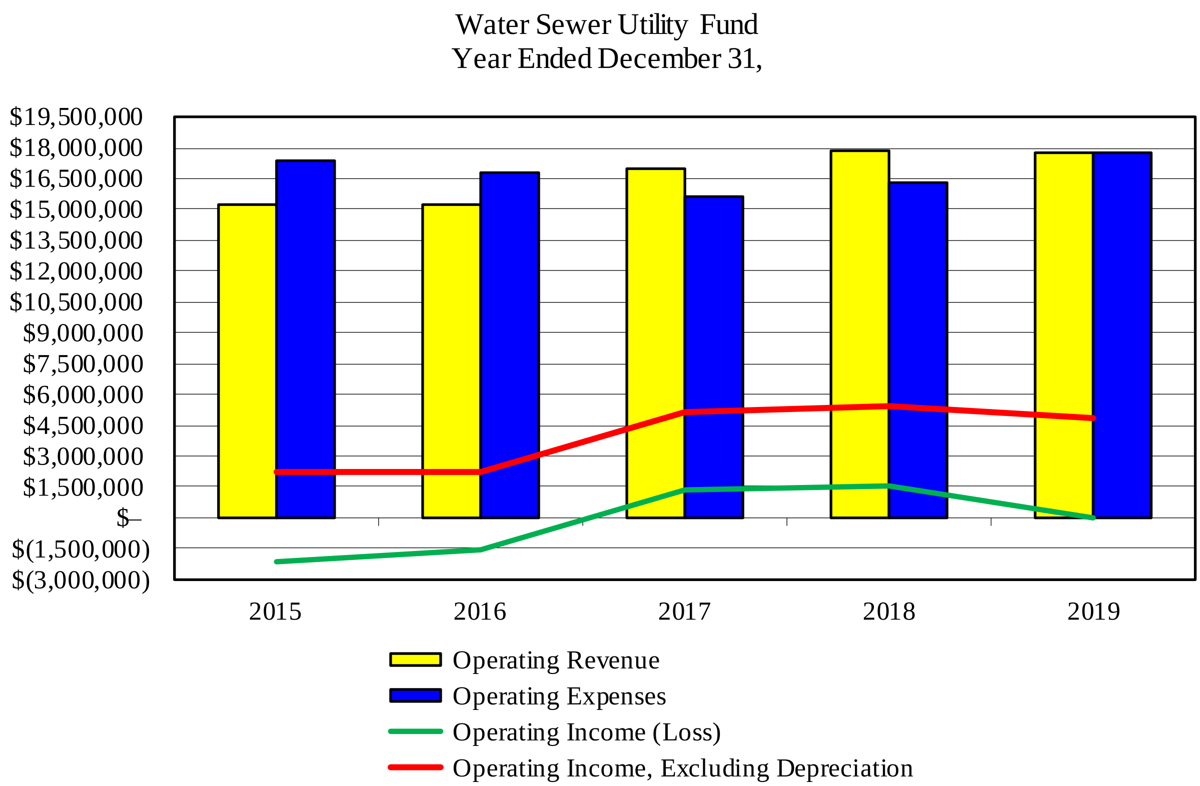
Enterprise Funds Change in Financial Position

	Net Position as of December 31, 2019	Net Position as of December 31, 2018	Change
Net position of enterprise funds			
Total by classification			
Net investment in capital assets	$ 144,608,169	$ 137,396,254	$ 7,211,915
Restricted	21,823,114	20,483,426	1,339,688
Unrestricted	12,105,612	12,623,433	(517,821)
Total enterprise funds	$ 178,536,895	$ 170,503,113	$ 8,033,782
Total by fund			
Water Sewer Utility	$ 135,176,194	$ 133,311,224	$ 1,864,970
Ice Center	11,608,278	9,824,209	1,784,069
Water Resources	27,775,662	24,084,139	3,691,523
Nonmajor funds			
Solid Waste Management	1,318,777	1,481,900	(163,123)
Field House	2,657,984	1,801,641	856,343
Total enterprise funds	$ 178,536,895	$ 170,503,113	$ 8,033,782

In total, enterprise fund net position increased by $8,033,782, for the year ended December 31, 2019. The City's net investment in capital assets increased by $7,211,915, including capital contributions from governmental funds and developers. The restricted portion of net position increased $1,339,688 for utility trunk and water resources, which reflects restricted equity to invest in capital infrastructure of the City. Unrestricted net position decreased ($517,821) from the prior year-end balance as presented in the table above. Capital contributions, mentioned earlier, contributed significantly to the increases in net position of the Water Sewer Utility, Ice Center, Water Resources, and Field House Funds.

WATER SEWER UTILITY FUND

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



The Water Sewer Utility Fund ended 2019 with a total net position of $135,176,194, an increase of $1,864,970 from the prior year. Of this, $107,583,699 represents the net investment in capital assets, and $17,901,382 is restricted, leaving $9,691,113 of unrestricted net position.

The Water Sewer Utility Fund operating revenue was $17,718,345 for 2019, a decrease of $185,527 (1.0 percent). An increase in rates was offset by reduced consumption in 2019 contributing to this decrease. Consumption will fluctuate from year-to-year based on many factors, including weather patterns and the number of utility customers.

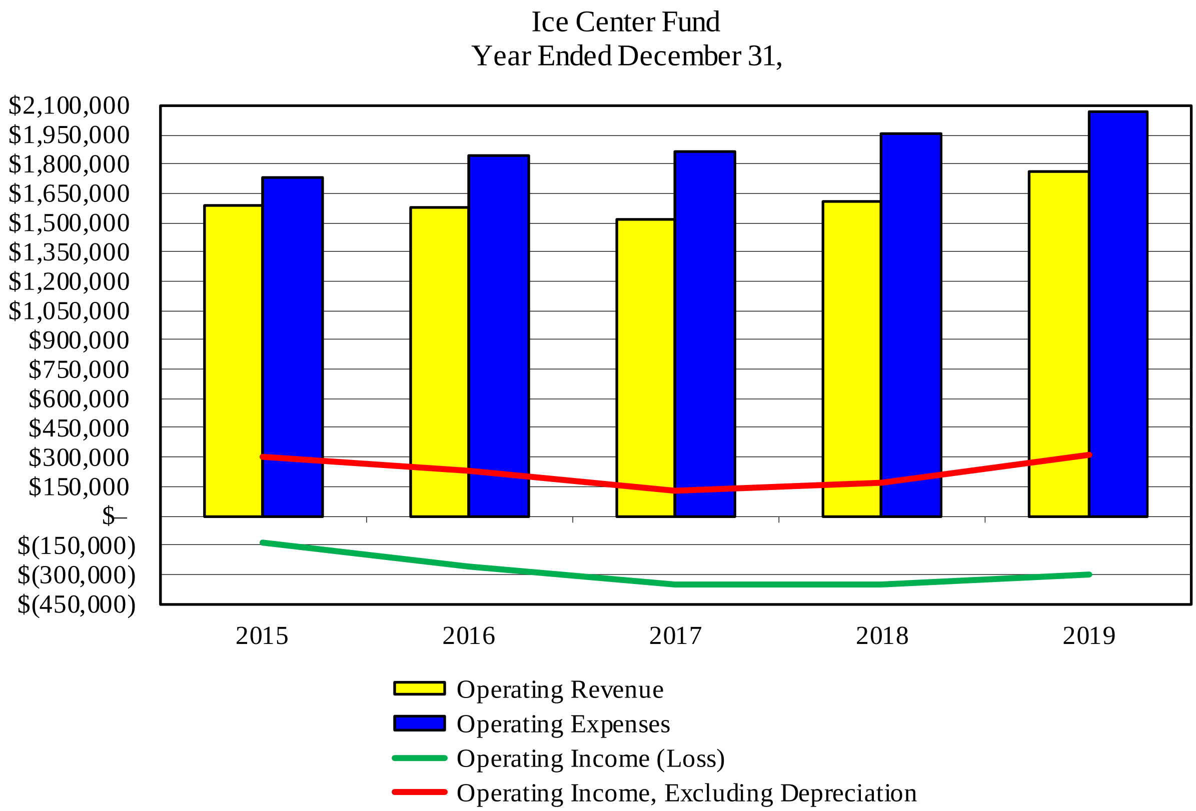
Operating expenses (including depreciation of $4,897,436) were $17,768,446, an increase of $1,446,219 (8.9 percent); the increase was mainly due to increases in contractual services and depreciation.

It is important to note that a portion of the operating expenses in this fund is depreciation on assets paid for and contributed to the City by developers. In general, the City's utility rates have not been designed to fully recover depreciation costs on such assets. Utility rates are normally designed to cover current operating expenses and to provide for future repairs and replacement of these assets.

These operating losses, however, have generally been more than offset by amounts in other revenues and contributions over the same time period. Other revenues and contributions include a number of revenue sources that are normally one-time or inconsistent from year-to-year. It includes such things as interest income, grants, contributions from developers and residents, special assessments, and income from sales of assets.

ICE CENTER FUND

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



The Ice Center Fund ended 2019 with a net position of $11,608,278, an increase of $1,784,069 from the prior year. Of this, $11,698,442 represents the net investment in capital assets, leaving an unrestricted deficit net position of $90,164.

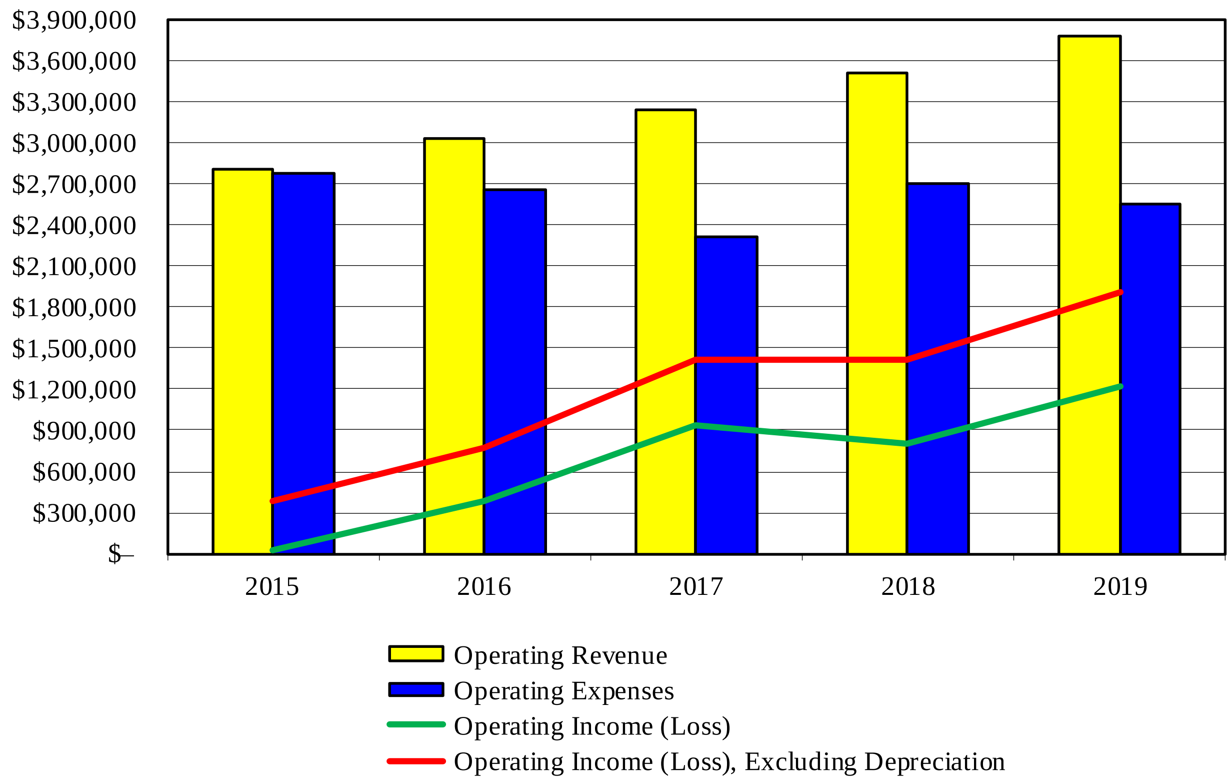
Operating revenue in the Ice Center Fund was $1,762,922, an increase of $150,630 from the prior year. Operating expenses for 2019 were $2,066,381, an increase of $103,941 from the prior year. The increase in expenses was primarily due to more depreciation, which was $92,934 over the prior year amount.

It is important to note that a significant portion of the operating expenses in this fund is depreciation on capital assets already funded. The fees charged in this fund are developed to cover operating expenses, repairs, and betterment of the ice center facilities.

WATER RESOURCES FUND

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

Water Resources Fund
Year Ended December 31,

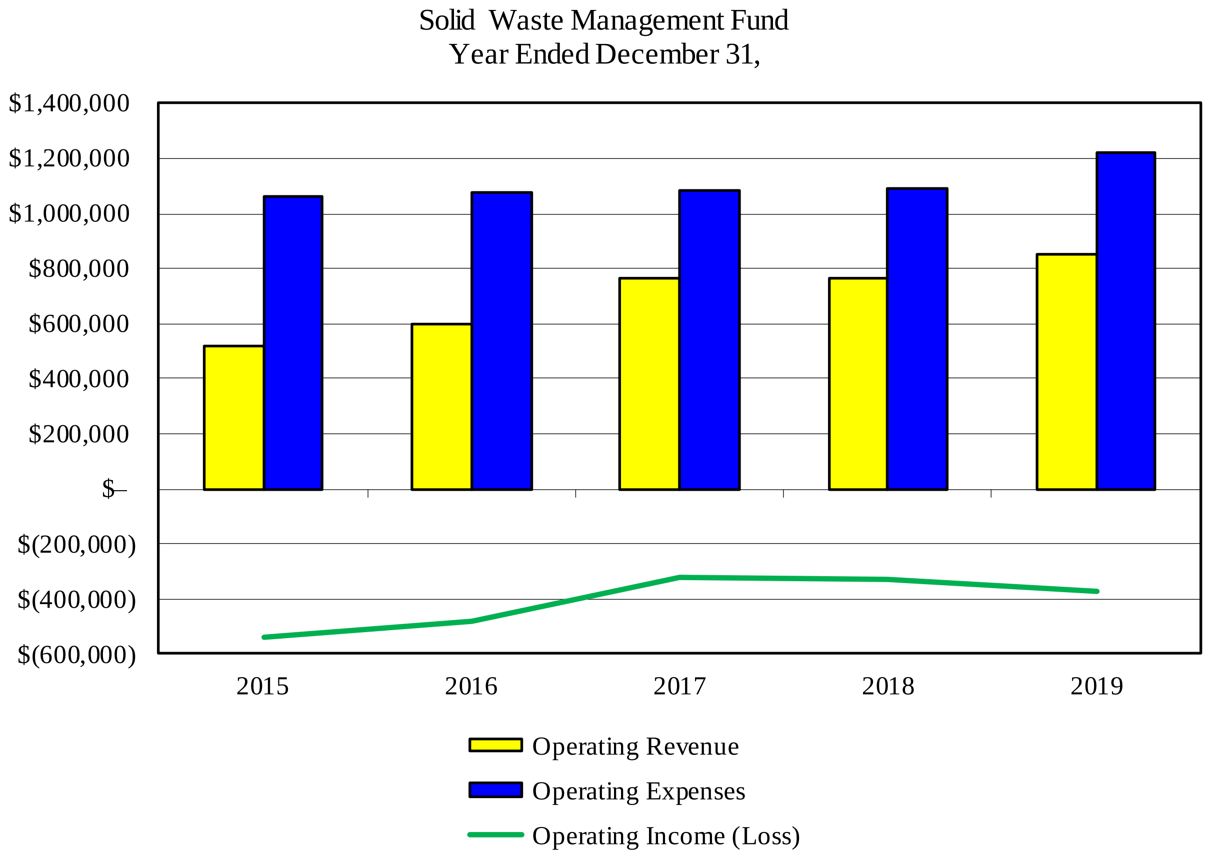


The Water Resources Fund ended 2019 with a net position of $27,775,662, an increase of $3,691,523 from the prior year. Of this, $23,853,930 represents the net investment in capital assets, while the remaining $3,921,732 is considered restricted.

Operating revenue in the Water Resources Fund totaled $3,778,873, an increase of $266,709 (7.6 percent) from the prior year. Operating expenses for 2019 were $2,553,333, a decrease of $150,574 from the prior year. The decrease in expenses was primarily due to decreased materials and supplies and contractual services.

SOLID WASTE MANAGEMENT FUND

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



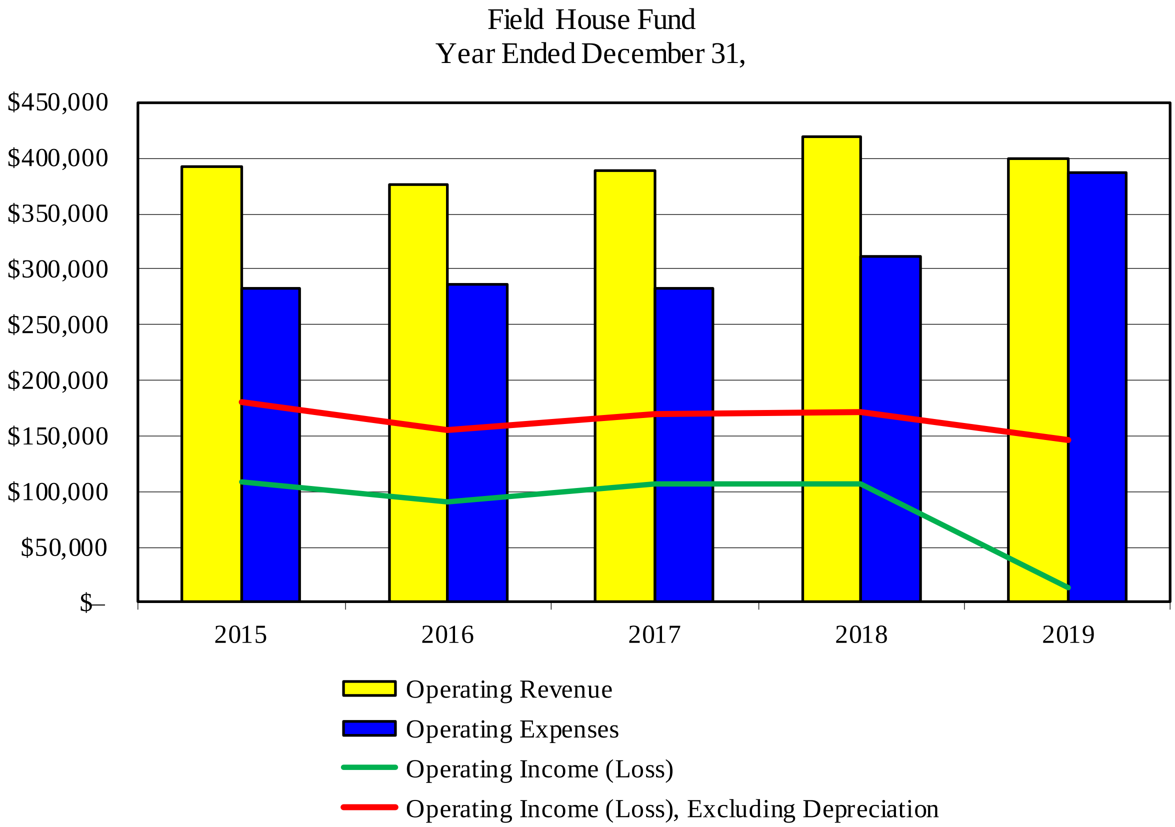
The Solid Waste Management Fund ended 2019 with a net position of $1,318,777, a decrease of $163,123 from the prior year. Of this, $120,894 represents the net investment in capital assets, leaving $1,197,883 of unrestricted net position.

Operating revenues in the Solid Waste Management Fund were $849,843, an increase of $88,393 from the prior year. Operating expenses for 2019 were $1,221,862, an increase of $130,823 from the prior year, mainly in contractual services.

The City also recognized $208,896 in net nonoperating revenues that offset a portion of the loss presented in the graph above.

FIELD HOUSE FUND

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



The Field House Fund ended 2019 with a net position of $2,657,984, an increase of $856,343 from the prior year. Of this, $1,351,204 represents the net investment in capital assets, leaving $1,306,780 of unrestricted net position.

As presented in the graph above, the Field House Fund experienced positive operating income for all years displayed. Total operating revenue in the Field House Fund was $399,870, a decrease of $19,088 from the previous year. The fees charged in this fund are developed to cover operating expenses, repairs, and betterment of field house facilities. Field House Fund operating expenses for 2019 were $387,213, an increase of $75,086, mainly in depreciation, from the previous year.

GOVERNMENT-WIDE FINANCIAL STATEMENTS

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

STATEMENT OF NET POSITION

The Statement of Net Position essentially tells you what 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: net 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, business-type activities, and the Housing and Redevelopment Authority (HRA) component unit:

	As of December 31,		
	2019	2018	Change
Net position			
Governmental activities			
Net investment in capital assets	$ 232,591,571	$ 234,394,816	$ (1,803,245)
Restricted	30,035,519	25,663,869	4,371,650
Unrestricted	72,591,837	67,359,816	5,232,021
Total governmental activities	335,218,927	327,418,501	7,800,426
Business-type activities			
Net investment in capital assets	144,608,169	137,396,254	7,211,915
Restricted	21,910,511	20,625,121	1,285,390
Unrestricted	9,834,062	10,261,298	(427,236)
Total business-type activities	176,352,742	168,282,673	8,070,069
Housing and Redevelopment Authority			
Net investment in capital assets	(84,066)	(434,730)	350,664
Restricted	4,216,964	4,124,483	92,481
Unrestricted	2,201,284	2,048,110	153,174
Total Housing and Redevelopment Authority	6,334,182	5,737,863	596,319
Total net position	$ 517,905,851	$ 501,439,037	$ 16,466,814

The City (including the HRA) ended 2019 with a combined total net position of $517,905,851, an increase of $16,466,814 from the prior year. Several factors contributed to this increase, as discussed earlier in the report. Significant capital contributions recognized from grantors and developers contributed to the increase over the prior year.

At the end of the fiscal year, the City is able to present positive balances in all three categories of net position for the governmental activities and business-type activities. The same situation held true for the prior fiscal 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 positions. 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 net position of the City and the HRA 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	$ 7,056,303	$ 1,718,717	$ (5,337,586)	$ (5,214,735)
Economic development	1,782,809	985,864	(796,945)	(799,171)
Parks and recreation	10,152,979	1,871,700	(8,281,279)	(4,092,151)
Public safety	21,211,191	7,624,715	(13,586,476)	(12,440,653)
Public service	5,643,686	6,516,180	872,494	896,279
Public works	30,504,192	24,320,273	(6,183,919)	(4,233,052)
Interest on long-term debt	197,995	–	(197,995)	(233,652)
Business-type activities				
Water Sewer Utility	17,889,041	20,296,516	2,407,475	5,325,794
Ice Center	2,055,524	1,887,192	(168,332)	(203,000)
Water Resources	2,536,578	4,555,143	2,018,565	2,636,219
Solid Waste Management	1,221,850	1,011,098	(210,752)	(153,481)
Field House	390,265	400,493	10,228	107,028
Housing and Redevelopment Authority	5,221,955	5,063,134	(158,821)	(347,558)
Total net (expense) revenue	$105,864,368	$ 76,251,025	(29,613,343)	(18,752,133)
General revenues				
Property taxes and franchise fees			39,904,315	38,241,559
Investment earnings			5,742,338	2,617,198
Gain on sale of capital assets			95,358	121,826
Other			338,146	950,146
Total general revenues			46,080,157	41,930,729
Change in net position			$ 16,466,814	$ 23,178,596

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 other general sources. 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.

The shift in the net changes presented above between the current and prior year reflects the change in level of developer contributions as previously mentioned. The change in public works is also due in part to expenses for joint street projects that were not capital assets of the City.

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. Due to the COVID-19 outbreak, 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 were originally effective for reporting periods beginning after December 15, 2019 and are now effective for fiscal years 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 were originally effective for reporting periods beginning after December 15, 2020 and are now effective after December 15, 2021. Earlier application is encouraged.