

Management Report
for
City of Farmington, Minnesota
December 31, 2021

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PRINCIPALS

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To the City Council and Management
City of Farmington, Minnesota

We have prepared this management report in conjunction with our audit of the City of Farmington, Minnesota's (the City) financial statements for the year ended December 31, 2021. We have organized this report into the following sections:

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

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

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

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

Minneapolis, Minnesota
May 31, 2022

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AUDIT SUMMARY

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

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

We have audited the financial statements of the governmental activities, the business-type activities, each major fund, and the aggregate remaining fund information of the City as of and for the year ended December 31, 2021. Professional standards require that we provide you with information about our responsibilities under auditing standards generally accepted in the United States of America and *Government Auditing Standards*, as well as certain information related to the planned scope and timing of our audit. We have communicated such information to you verbally, in our audit engagement letter, and in a separate letter dated April 5, 2022. Professional standards also require that we communicate the following information related to our audit.

PLANNED SCOPE AND TIMING OF THE AUDIT

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

AUDIT OPINION AND FINDINGS

Based on our audit of the City's financial statements for the year ended December 31, 2021:

- We have issued an unmodified opinion on the City's basic financial statements.
- We reported one matter involving the City's internal control over financial reporting that we consider to be a material weakness. 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 that are required to be reported under *Governmental Auditing Standards*.
- We reported one finding based on our testing of the City's compliance with Minnesota laws and regulations. Minnesota Statutes require prompt payment of local government bills within a standard payment period of 35 days from the receipt of goods and services for governing boards that meet at least once a month. If such obligations are not paid within the appropriate time period, local governments must pay interest on the unpaid obligations at the rate of 1.5 percent per month or part of a month. One of twenty-five disbursements tested was not paid within the statutory time limit.

FOLLOW-UP ON PRIOR YEAR FINDINGS AND RECOMMENDATIONS

As a part of our audit of the City's financial statements for the year ended December 31, 2021, we performed procedures to follow-up on the findings and recommendations that resulted from our prior year audit. We reported the following finding that was corrected by the City in the current year:

The City did not have sufficient controls in place to ensure compliance with federal allowable cost standards for its Coronavirus Relief Fund (CRF) federal program. This resulted in the City charging unallowable costs of \$58,018 to the program for two employee salaries tested that did not meet federal allowable cost standards. There was no similar finding in the current year.

SIGNIFICANT ACCOUNTING POLICIES

Management is responsible for the selection and use of appropriate accounting policies. The significant accounting policies used by the City are described in Note 1 of the notes to basic financial statements. No new accounting policies were adopted and the application of existing policies was not changed during the year ended December 31, 2021.

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

SIGNIFICANT UNUSUAL ACCOUNTING TRANSACTIONS – CHANGE IN REPORTING ENTITY

In 2021, a change was made to reconfigure the Farmington Economic Development Authority's (EDA) governing board to be comprised entirely of the City's mayor and councilmembers. Due to this change in governance, under Governmental Accounting Standards Board (GASB) guidelines, the EDA became a blended component unit of the City, where it had been reported as a discretely presented component unit in prior years. The EDA's activity and balances for the current year are included within the City's financial statements as a blended component unit, reported within the (nonmajor) Economic Development Authority Special Revenue Fund and the (nonmajor) Trident Housing Tax Increment Special Revenue Fund. The City's governmental fund balances and governmental activities net position as of January 1, 2021, both increased by \$329,920 as a result of this change

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:

- **Pensions and Other Post-Employment Benefits (OPEB) Liabilities** – The City has recorded liabilities and activity for pension benefits and OPEB. These obligations are calculated using actuarial methodologies described in 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.
- **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, compensated absence balances, and the likelihood that sick leave will ultimately be paid at termination.

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

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

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

DIFFICULTIES ENCOUNTERED IN PERFORMING THE AUDIT

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

CORRECTED AND UNCORRECTED MISSTATEMENTS

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

DISAGREEMENTS WITH MANAGEMENT

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

MANAGEMENT REPRESENTATIONS

We have requested certain representations from management that are included in the management representation letter dated May 31, 2022.

MANAGEMENT CONSULTATIONS WITH OTHER INDEPENDENT ACCOUNTANTS

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

OTHER AUDIT FINDINGS OR ISSUES

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

OTHER MATTERS

We applied certain limited procedures to the management's discussion and analysis (MD&A) and the pension and OPEB-related required supplementary information (RSI) that supplements the basic financial statements. Our procedures consisted of inquiries of management regarding the methods of preparing the information and comparing the information for consistency with management's responses to our inquiries, the basic financial statements, and other knowledge we obtained during our audit of the basic financial statements. We did not audit the RSI and do not express an opinion or provide any assurance on the RSI.

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

We were not engaged to report on the introductory and 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

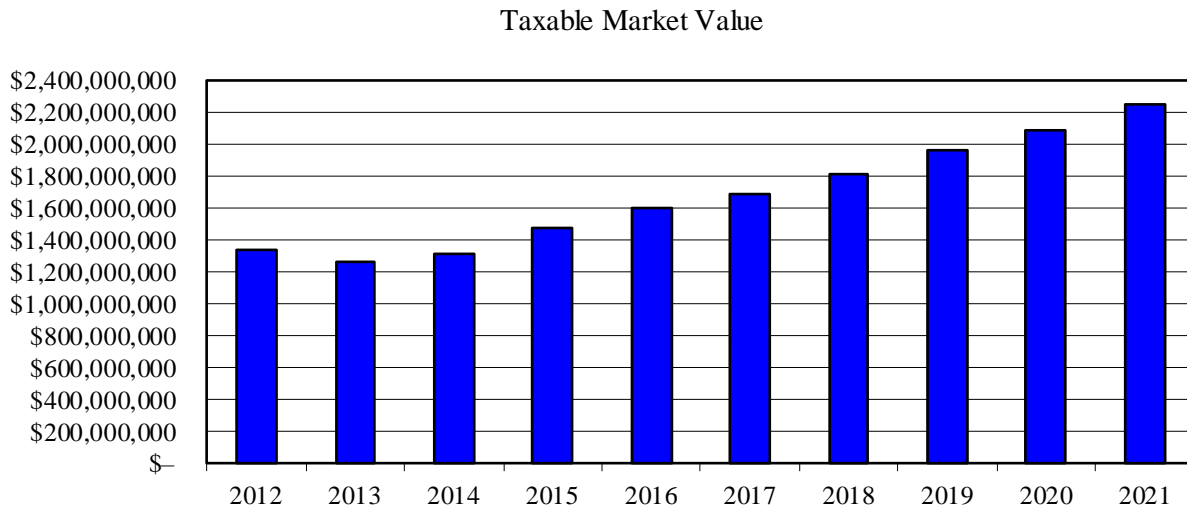
This section of the report provides you with an overview of the financial trends and activities of the City's governmental funds, which includes the General, special revenue, debt service, and capital project funds. These funds are used to account for the basic services the City provides to all of its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

The total tax capacity value of property in Minnesota cities increased about 6.3 percent for the 2021 levy year. The tax capacity values used for levying property taxes are based on the assessed market values for the previous fiscal year (e.g., tax capacity values for taxes levied in 2021 were based on assessed market values as of January 1, 2020), so the trend of change in these tax capacity values lags somewhat behind the housing market and economy in general.

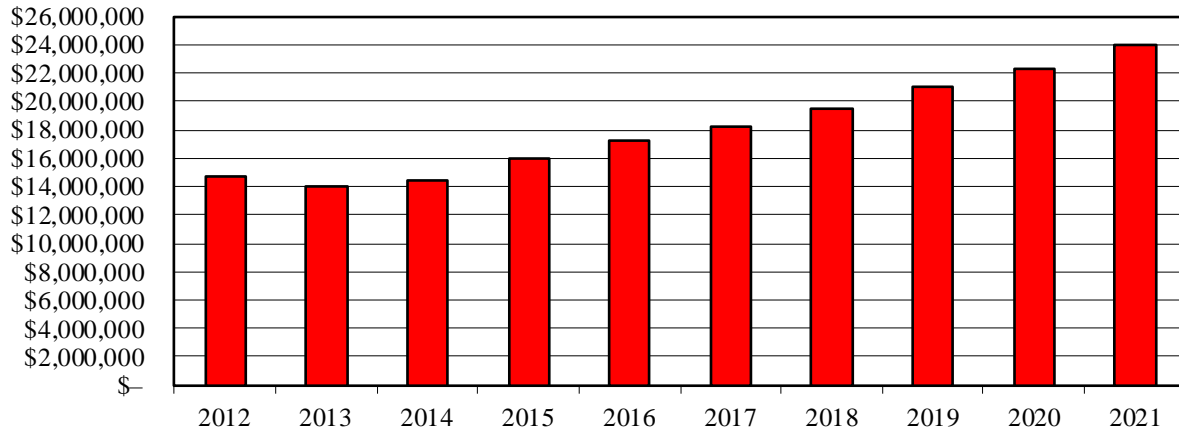
The City's taxable market value increased 6.3 percent for taxes payable in 2020 and 7.4 percent for taxes payable in 2021. The following graph shows the City's changes in taxable market value over the past 10 years:



Tax capacity is considered the actual base available for taxation. It is calculated by applying the state’s property classification system to each property’s market value. Each property classification, such as commercial or residential, has a different calculation and uses different rates. Consequently, a city’s total tax capacity will change at a different rate than its total market value, as tax capacity is affected by the proportion of its tax base that is in each property classification from year-to-year, as well as legislative changes to tax rates. The City’s tax capacity increased 5.7 percent and 7.6 percent for taxes payable in 2020 and 2021, respectively.

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

Local Net Tax Capacity



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 Farmington		
	2019	2020	2021
Average tax rate			
City	54.4	51.0	49.3
County	25.4	24.1	22.7
School	51.4	53.1	50.8
Special taxing	3.0	2.9	2.8
Total	134.2	131.1	125.6

Despite the City historically having a higher dependence on property taxes than the average Minnesota city, both the City portion of the tax rate and the overall tax rate on Farmington residents have been steadily declining in recent years, due to the increasing taxable market value of property within 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, 2021, presented both by fund balance classification and by major fund:

Governmental Funds Change in Fund Balance			
	Fund Balance as of December 31,		Change
	<u>2021</u>	<u>2020</u>	
Fund balances of governmental funds			
Total by classification			
Nonspendable	\$ 84,453	\$ 1,325,873	\$ (1,241,420)
Restricted	4,411,713	3,565,637	846,076
Committed	8,876,306	8,427,605	448,701
Unassigned	<u>6,813,564</u>	<u>6,060,870</u>	<u>752,694</u>
Total governmental funds	<u>\$ 20,186,036</u>	<u>\$ 19,379,985</u>	<u>\$ 806,051</u>
Total by fund			
General	\$ 6,926,484	\$ 6,202,066	\$ 724,418
Federal Aid Special Revenue	(13,763)	-	(13,763)
Debt Service	3,146,223	2,677,368	468,855
Maintenance Capital Projects	1,572,324	1,660,550	(88,226)
Private Capital Projects	104,087	112,218	(8,131)
Nonmajor	<u>8,450,681</u>	<u>8,727,783</u>	<u>(277,102)</u>
Total governmental funds	<u>\$ 20,186,036</u>	<u>\$ 19,379,985</u>	<u>\$ 806,051</u>

In total, the fund balances of the City's governmental funds increased by \$806,051 during the year ended December 31, 2021.

The decrease in nonspendable fund balances of \$1,241,420 relates primarily to a prepayment of \$1,156,674 in the (nonmajor) Fire Capital Projects Fund for an aerial fire truck in the prior year that was ordered for completion and delivery in 2021.

Increases in the fund balance restricted for debt service and in park development and dedication fees restricted for park improvements contributed to an overall increase of \$846,076 in restricted fund balances.

Committed fund balance increased \$448,701, with the majority of the increase in resources committed for storm water trunk in the Storm Water Trunk Capital Projects Fund.

Unassigned fund balance increased \$752,694, mainly due to positive operating results in the General Fund.

GOVERNMENTAL FUNDS REVENUE AND EXPENDITURES

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

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

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

Governmental Funds Revenue per Capita					
With State-Wide Averages by Population Class					
Year	State-Wide		City of Farmington		
	December 31, 2020		2019	2020	2021
Population	10,000–20,000	20,000–100,000	23,123	23,632	23,632
Property taxes	\$ 517	\$ 537	\$ 559	\$ 552	\$ 580
Tax increments	33	44	–	–	–
Franchise and other taxes	60	46	11	10	10
Special assessments	39	54	27	17	12
Licenses and permits	39	46	18	25	33
Intergovernmental revenues	367	273	78	125	53
Charges for services	89	91	45	38	72
Other	69	69	37	28	24
Total revenue	\$ 1,213	\$ 1,160	\$ 775	\$ 795	\$ 784

The City’s governmental fund revenues for 2021 were \$18,525,368, a decrease of \$267,201 (1.4 percent), or \$11 per capita, from the prior year. Intergovernmental revenue was \$72 per capita less than last year, due to the City receiving one-time federal CRF grant entitlement in 2020 to provide assistance to the community and fund unanticipated COVID-19-related expenses. This was partially offset by increases in revenues from property taxes (\$28 per capita) and charges for services (\$34 per capita)

The City has historically received more of its governmental fund revenue from property taxes than the average Minnesota city, due to the lower than average amount of aid it typically receives from the state and the debt levies for the City’s capital improvement bonds.

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.

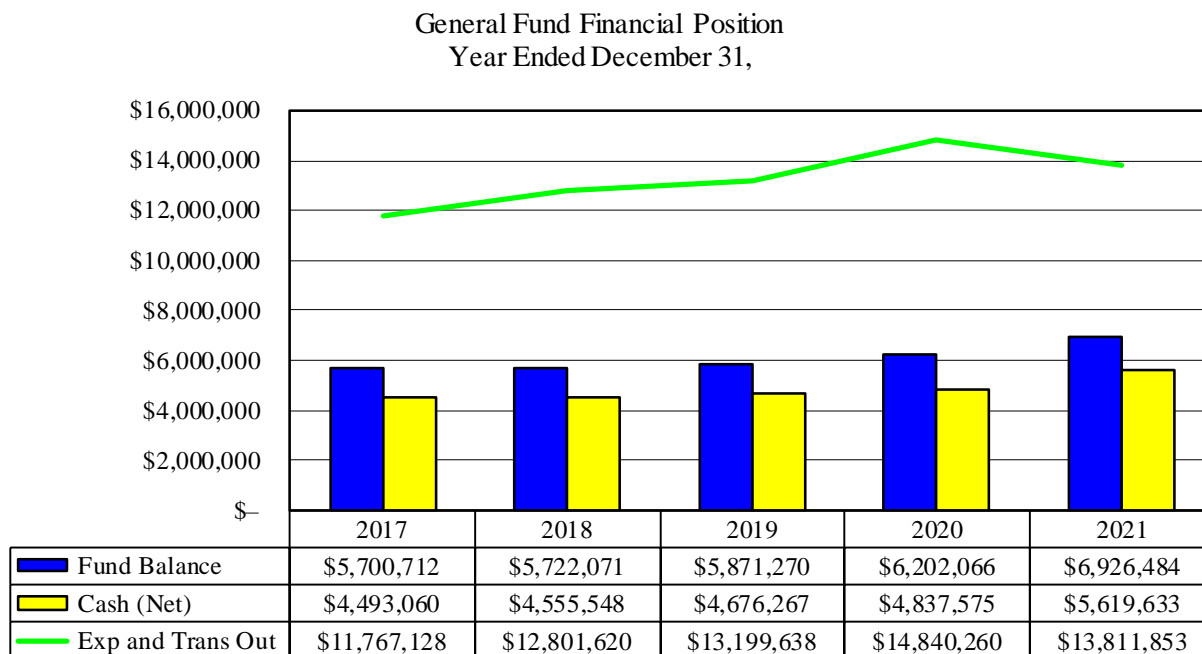
The City’s expenditures per capita of its governmental funds for the past three years, together with state-wide averages, are presented in the following table:

Governmental Funds Expenditures per Capita					
With State-Wide Averages by Population Class					
Year	State-Wide		City of Farmington		
	December 31, 2020		2019	2020	2021
Population	10,000–20,000	20,000–100,000	23,123	23,632	23,632
Current					
General government	\$ 140	\$ 118	\$ 104	\$ 112	\$ 114
Public safety	288	320	247	250	272
Streets and highways	122	112	142	118	112
Culture and recreation	112	95	80	66	80
All other	108	104	2	12	16
	<u>770</u>	<u>749</u>	<u>575</u>	<u>558</u>	<u>594</u>
Capital outlay and construction	429	331	204	113	129
Debt service					
Principal	149	91	105	123	91
Interest and fiscal charges	42	33	18	17	16
	<u>191</u>	<u>124</u>	<u>123</u>	<u>140</u>	<u>107</u>
Total expenditures	<u><u>\$ 1,390</u></u>	<u><u>\$ 1,204</u></u>	<u><u>\$ 902</u></u>	<u><u>\$ 811</u></u>	<u><u>\$ 830</u></u>

Total expenditures in the City’s governmental funds for 2021 were \$19,612,052, an increase of \$452,246 (2.4 percent), or \$19 per capita, from the previous year. Current governmental expenditures for 2021 were \$36 per capita more than last year, mainly due to increased personnel costs in public safety and culture and recreation. Capital outlay expenditures were \$16 per capita more than last year, primarily due to the purchase of an aerial fire truck in the current year. Debt service expenditures were \$33 lower than last year, due to a decrease in scheduled bond principal payments.

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



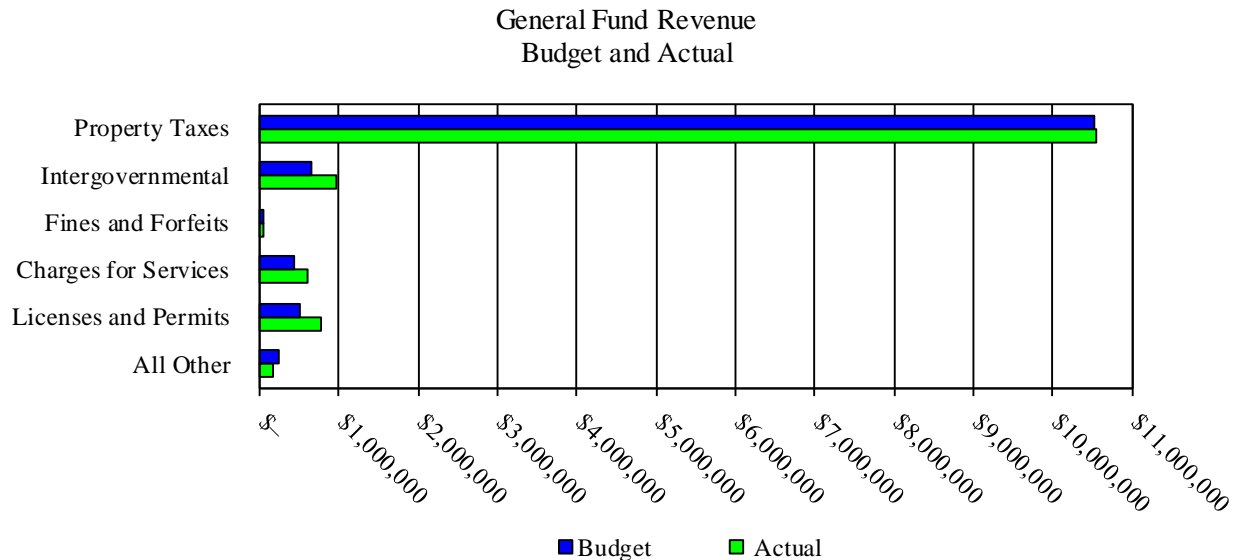
The City's General Fund cash and investments, net of interfund borrowing at December 31, 2021 was \$782,058 higher than at the previous year-end. Total fund balance at December 31, 2021 of \$6,926,484 represented an increase of \$724,418 from the prior year, as compared to a breakeven budget.

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

A trend that is typical to Minnesota local governments, especially the General Fund of cities, is the unusual cash flow experienced throughout the year. The City's General Fund cash disbursements are made fairly evenly during the year other than the impact of seasonal services, such as snowplowing, street maintenance, and park activities. Cash receipts of the General Fund are quite a different story. Property taxes comprise about 80.2 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.

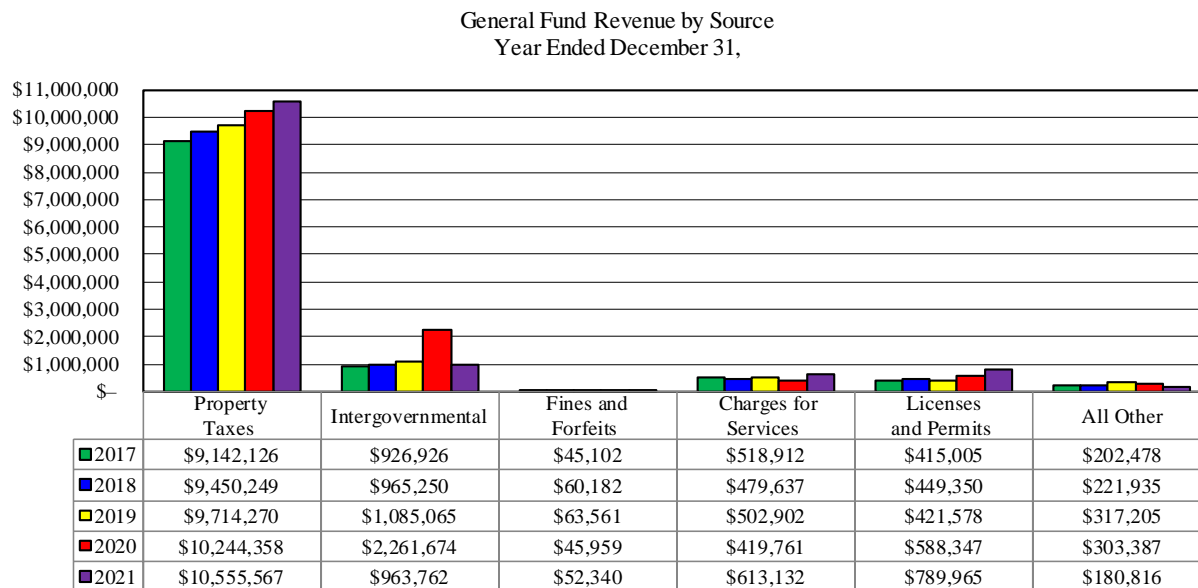
The City's unassigned General Fund balance of \$6,843,396 at the end of the 2021 fiscal year represents approximately 43.5 percent of budgeted expenditures and transfers out for 2022. This is within the City's policy that calls for maintaining an unassigned fund balance of between 40.0–50.0 percent of the subsequent year's budgeted expenditures and transfers out.

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



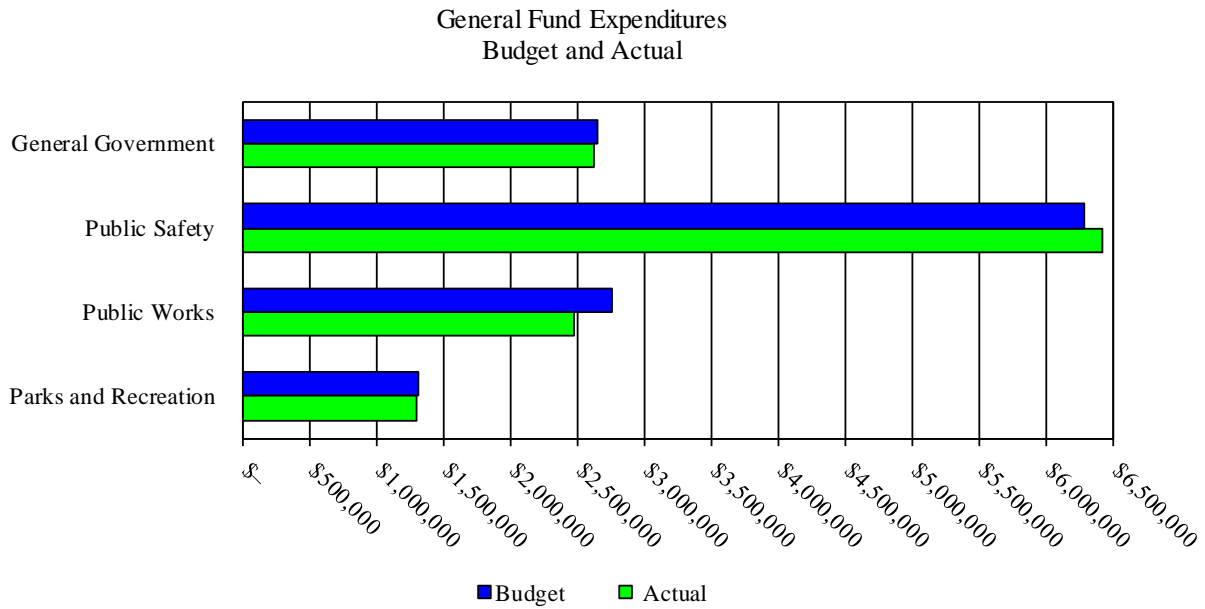
General Fund revenue for 2021 was \$13,155,582, which was \$702,807 (5.6 percent) more than budget. Intergovernmental revenue exceeded budget by \$295,850, mainly due to street maintenance, training reimbursements, and other miscellaneous grants in excess of budget. Licenses and permits were \$272,889 higher than budget, due to increased development within the City. Charges for services exceeded the City’s conservative budget by \$181,935.

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



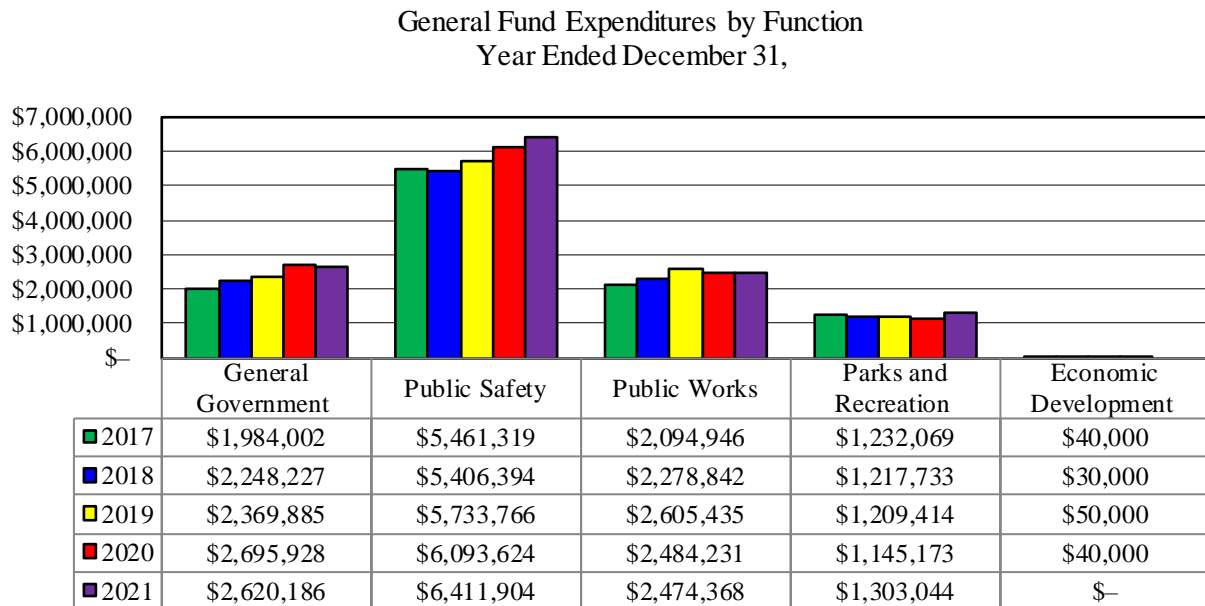
Total General Fund revenue for 2021 was \$707,904 (5.1 percent) lower than last year. Intergovernmental revenues decreased \$1,297,912 from last year, mainly due to the one-time federal CRF grant revenue received in 2020, as previously discussed. Property taxes were \$311,209 higher than last year, due an increased tax levy. Revenues from charges for services and licenses and permits were \$193,371 and \$201,618, respectively, higher than last year, mainly due to increases in development activity and recreation programs that had been reduced due to COVID-19 restrictions.

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



General Fund expenditures for 2021 were \$12,809,502, which was \$200,611 (1.5 percent) under budget. Current expenditures were under budget in all functional areas shown above except for public safety, due to savings from open positions and decreases in materials used. Public safety was over budget, mainly in personnel costs due to an increase in level of services needed.

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



Total General Fund expenditures for 2021 were \$350,546 (2.8 percent) higher than the previous year. The increase was mainly in public safety (up \$318,280) and parks and recreation (up \$157,871) areas, due to increases in personnel, fuel, supplies, and training costs. General government expenditures were \$75,742 lower than last year, mainly due to a decrease in expenditures related to elections, which take place every other year.

ENTERPRISE FUNDS OVERVIEW

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

ENTERPRISE FUNDS FINANCIAL POSITION

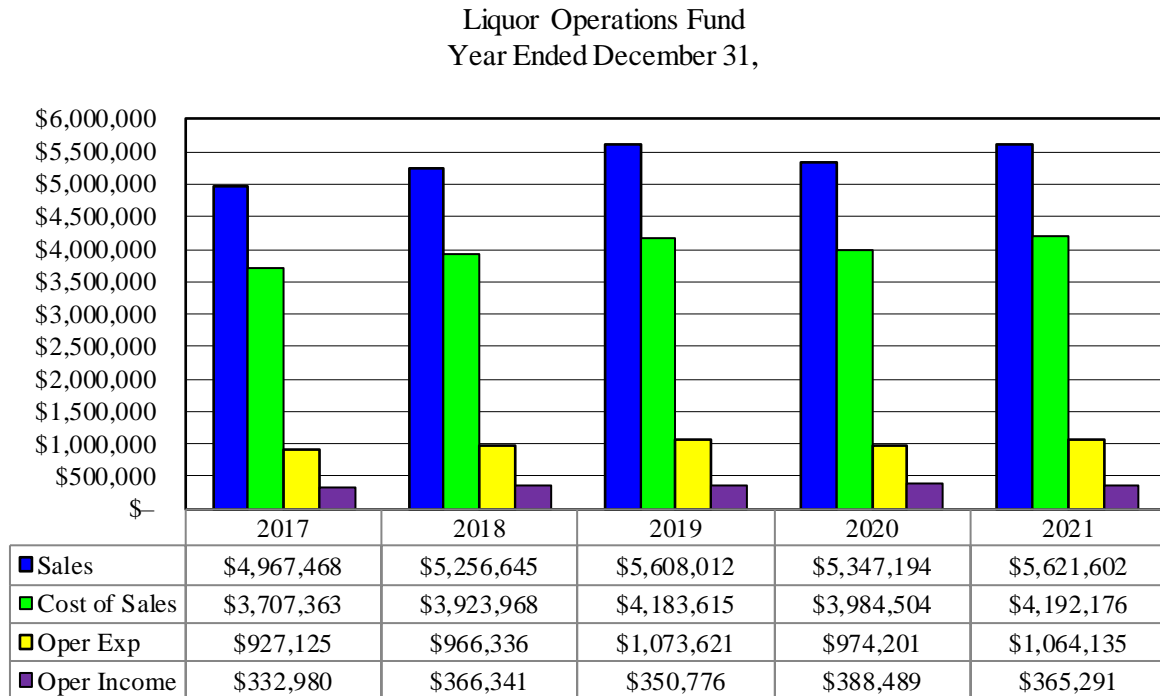
The following table summarizes the changes in the financial position of the City's enterprise funds during the year ended December 31, 2021, presented both by classification and by fund:

Enterprise Funds Change in Financial Position			
	Net Position as of December 31,		Change
	<u>2021</u>	<u>2020</u>	
Net position of enterprise funds			
Total by classification			
Net investment in capital assets	\$ 50,773,632	\$ 51,976,059	\$ (1,202,427)
Restricted – future drinking water treatment plant	2,461,488	2,461,488	–
Unrestricted	<u>18,123,198</u>	<u>15,418,911</u>	<u>2,704,287</u>
Total enterprise funds	<u><u>\$ 71,358,318</u></u>	<u><u>\$ 69,856,458</u></u>	<u><u>\$ 1,501,860</u></u>
Total by fund			
Liquor Operations	\$ 1,807,133	\$ 1,506,724	\$ 300,409
Sewer Operations	19,325,404	19,819,444	(494,040)
Solid Waste	2,230,188	1,832,590	397,598
Storm Water	15,332,726	15,129,294	203,432
Water	32,335,286	31,291,703	1,043,583
Street Light	<u>327,581</u>	<u>276,703</u>	<u>50,878</u>
Total enterprise funds	<u><u>\$ 71,358,318</u></u>	<u><u>\$ 69,856,458</u></u>	<u><u>\$ 1,501,860</u></u>

In total, the net position of the City's enterprise funds increased by \$1,501,860 during the year ended December 31, 2021. The City's net investment in capital assets decreased by \$1,202,427 during the year, mainly due to depreciation, as there were relatively few capital asset additions in the enterprise funds in 2021. Almost all of the City's enterprise operations had positive operating results for the year prior, generating income before transfers and capital contributions of \$2,856,501 across all funds. The enterprise funds transferred \$1,831,568 to the governmental and internal service funds during the year to support the General Fund and help finance capital improvements.

LIQUOR OPERATIONS FUND

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



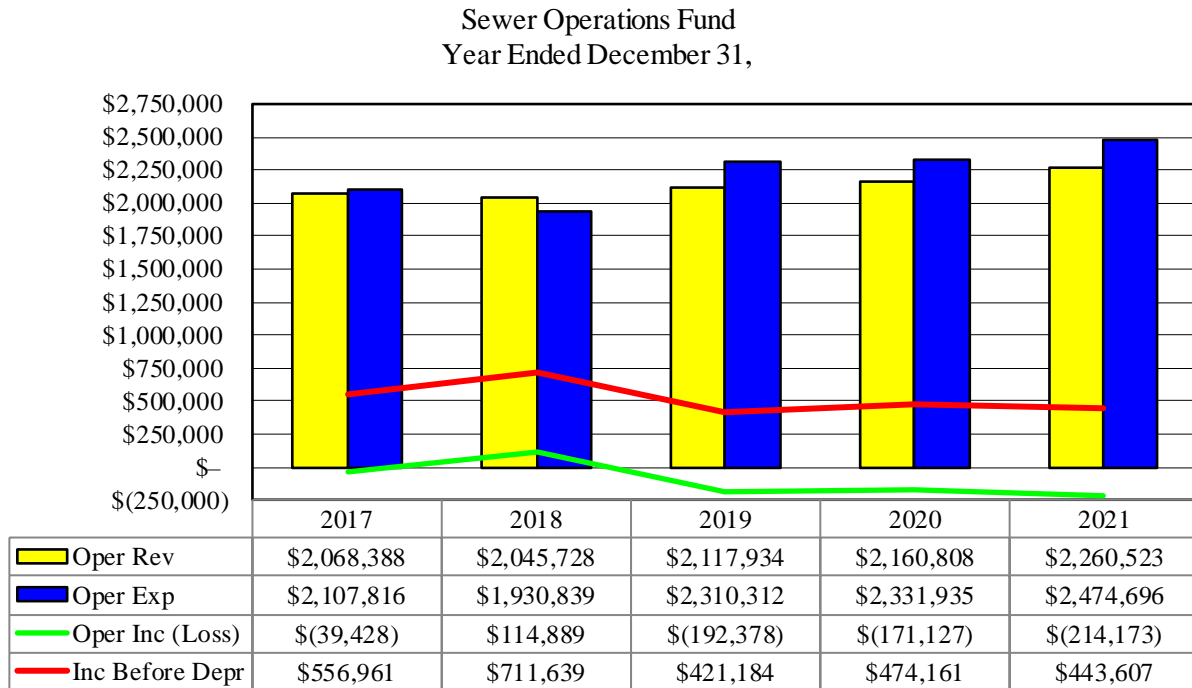
The City's Liquor Operations Fund ended 2021 with a total net position of \$1,807,133, an increase of \$300,409 from the prior year. Of this, \$319,936 represents the investment in liquor capital assets, leaving an unrestricted net position of \$1,487,197.

The Liquor Operations Fund had gross sales of \$5,621,602 in 2021, an increase of \$274,408 (5.1 percent) from the previous year. Sales were up in the current year, due to temporary closures and limited store hours related to COVID-19 in 2020. Gross profit was \$1,429,426, about 25.4 percent of sales, which is consistent with recent years.

Operating expenses for 2021 increased \$89,934 (9.2 percent) from the previous year, mainly in supplies and materials for costs incurred to move the Downtown store to its new location, as well as in salaries and benefits, due to the prior year COVID-19-related closures and operating hour limitations as discussed above.

SEWER OPERATIONS FUND

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



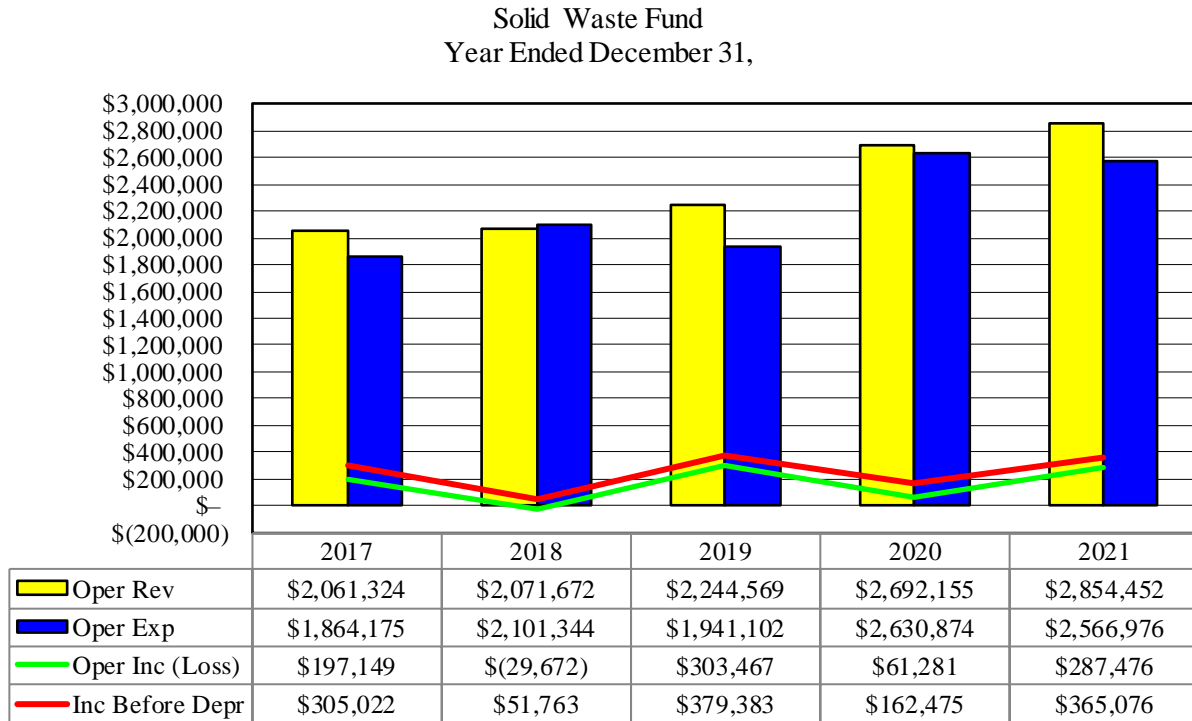
The Sewer Operations Fund ended 2021 with a total net position of \$19,325,404, a decrease of \$494,040 from the prior year. Of this, \$16,138,231 represents the investment in sewer collection system capital assets, leaving an unrestricted net position of \$3,187,173.

Operating revenue in the Sewer Operations Fund increased by \$99,715 (4.6 percent) from the prior year, due to an increase of 4.0 percent in sewer rates.

Operating expenses for 2021 were \$142,761 (6.1 percent) higher than the previous year, mainly in professional services due to increased municipal wastewater charges.

SOLID WASTE FUND

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



The Solid Waste Fund ended 2021 with a total net position of \$2,230,188, an increase of \$397,598 from the prior year. Of this, \$338,902 represents the investment in solid waste operation capital assets, leaving an unrestricted net position of \$1,891,286.

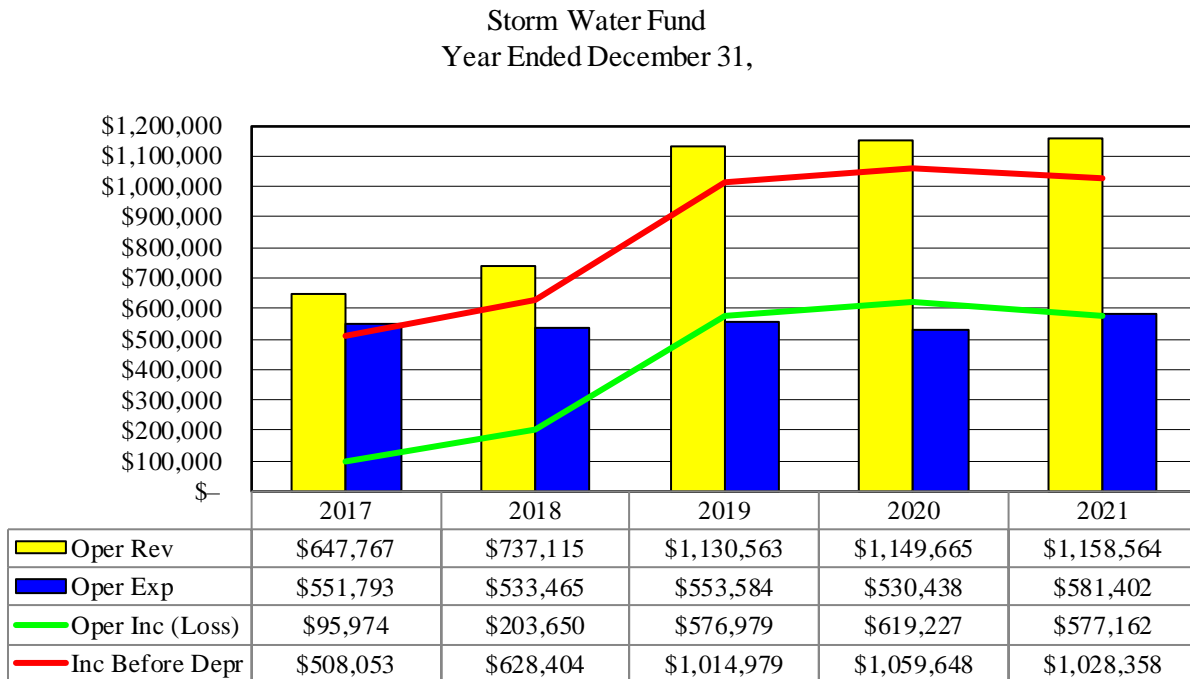
Operating revenue in the Solid Waste Fund increased \$162,297 (6.0 percent) from the prior year, due to an increase of 5.0 percent in solid waste rates.

Operating expenses for 2021 were \$63,898 (2.4 percent) less than the previous year, due to decreases in professional services and depreciation.

Beginning in 2022, the City will cease providing solid waste and recycling collection services directly to its residents and businesses, opting to contract with a commercial provider for these services in the future.

STORM WATER FUND

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



The Storm Water Fund ended 2021 with a total net position of \$15,332,726, an increase of \$203,432 from the prior year. Of this, \$12,794,284 represents the investment in storm water operation capital assets, leaving an unrestricted net position of \$2,538,442.

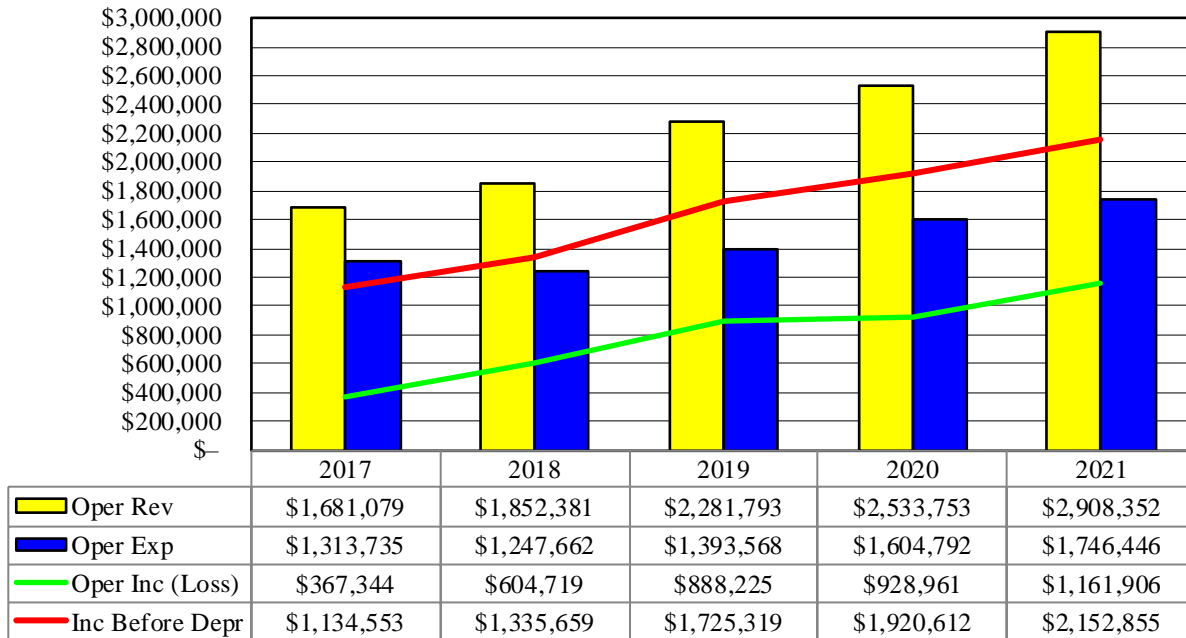
Operating revenue in the Storm Water Fund was similar to the prior year with no increase to rates in 2021, increasing \$8,899 (0.8 percent).

Operating expenses for 2021 were \$50,964 (9.6 percent) higher than the previous year, mainly due to an increase in contracted services expense.

WATER FUND

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

Water Fund
Year Ended December 31,



The Water Fund ended 2021 with a total net position of \$32,335,286, an increase of \$1,043,583 from the prior year. Of this, \$21,182,279 represents the investment in water distribution system capital assets, \$2,461,488 is restricted for a future drinking water treatment plant, and unrestricted net position is \$8,691,519.

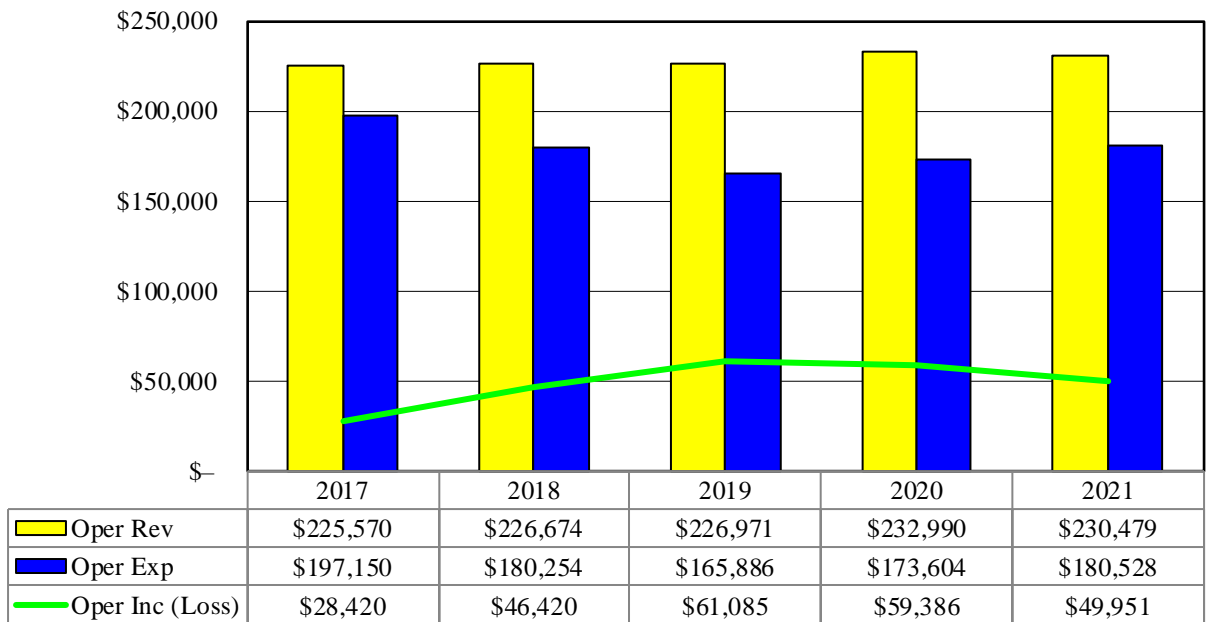
Operating revenue in the Water Fund for 2021 increased \$374,599 (14.8 percent) from the prior year, resulting from the combination of increased consumption and water availability charges due to a significant increase in permits issued.

Water Fund operating expenses for 2021 were \$141,654 (8.8 percent) higher than the previous year, mainly due to an increase in repairs and maintenance costs.

STREET LIGHT FUND

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

Street Light Fund
Year Ended December 31,



Street Light Fund operating revenue for 2021 decreased \$2,511 (1.1 percent) from the prior year.

Operating expenses were \$6,924 (4.0 percent) higher than the previous year, mainly in utilities expense.

Unrestricted net position increased \$50,878 in 2021, ending the year at \$327,581.

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

The following table presents the components of the City's net position as of December 31, 2021 and 2020, for governmental activities and business-type activities:

	As of December 31,		Change
	2021	2020	
Net position			
Governmental activities			
Net investment in capital assets	\$ 36,819,084	\$ 35,883,311	\$ 935,773
Restricted	9,841,913	5,553,935	4,287,978
Unrestricted	11,591,481	9,236,760	2,354,721
Total governmental activities	<u>58,252,478</u>	<u>50,674,006</u>	<u>7,578,472</u>
Business-type activities			
Net investment in capital assets	50,773,632	51,976,059	(1,202,427)
Restricted	2,461,488	2,461,488	-
Unrestricted	18,123,198	15,418,911	2,704,287
Total business-type activities	<u>71,358,318</u>	<u>69,856,458</u>	<u>1,501,860</u>
Total net position	<u>\$ 129,610,796</u>	<u>\$ 120,530,464</u>	<u>\$ 9,080,332</u>

The City's total net position at December 31, 2021 was \$9,080,332 higher than the previous year-end. The City's net position increased \$7,578,472 from current year governmental activities and \$1,501,860 from current year business-type activities.

The governmental activities net investment in capital assets increased \$935,773, due to the relationship between capital asset additions, the rate at which capital assets are depreciated, and the repayment of the debt issued to construct or acquire the assets. Restricted net position increased \$4,287,978, mainly in the amount restricted for debt service due to new special assessments, the amount restricted for park improvements due to increased park development and dedication fees received from new developments, and the amount restricted for state-funded street projects from unspent aid. The increase in governmental activities unrestricted net position of \$2,354,721 in 2021, reflects positive operating results in the City's governmental funds, along with resources transferred from the City's business-type activities for future capital needs.

Changes to the net position of the business-type activities are as detailed in the previous discussion of the City's enterprise fund operations.

STATEMENT OF ACTIVITIES

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

The following table presents the change in the net position of the City for the years ended December 31, 2021 and 2020:

	2021		2020	
	Expenses	Program Revenues	Net Change	Net Change
Net (expense) revenue				
Governmental activities				
General government	\$ 2,560,243	\$ 872,192	\$ (1,688,051)	\$ (2,275,269)
Public safety	6,549,508	1,136,717	(5,412,791)	(5,910,170)
Public works	3,977,134	5,112,324	1,135,190	(4,835,109)
Parks and recreation	2,789,326	988,091	(1,801,235)	(1,040,654)
Economic development	406,795	171,241	(235,554)	(404,937)
Interest and fiscal charges	189,858	–	(189,858)	(193,167)
Business-type activities				
Liquor operations	5,256,311	5,725,466	469,155	388,489
Sewer operations	2,459,637	2,264,006	(195,631)	(173,192)
Solid waste	2,566,976	3,245,525	678,549	83,743
Storm water	581,402	1,315,428	734,026	619,227
Water	1,764,908	3,424,912	1,660,004	911,722
Street light	180,528	232,378	51,850	59,386
Total net (expense) revenue	<u>\$ 29,282,626</u>	<u>\$ 24,488,280</u>	(4,794,346)	(12,769,931)
General revenues				
Property taxes			13,692,990	13,179,138
Franchise taxes			229,355	244,839
Unrestricted grants			107,962	2,060,517
Investment earnings (charges)			(155,629)	946,137
Gain on disposal of capital assets			–	16,174
Total general revenues			<u>13,874,678</u>	<u>16,446,805</u>
Change in net position			<u>\$ 9,080,332</u>	<u>\$ 3,676,874</u>

One of the goals of this statement is to provide a side-by-side comparison to illustrate the difference in the way the City's governmental and business-type operations are financed. The table clearly illustrates the dependence of the City's governmental operations on general revenues, such as property taxes and unrestricted grants. It also shows that, for the most part, the City's business-type activities are generating sufficient program revenues (service charges and program-specific grants) to cover expenses.

The significant net change from public works activity is primarily due to increases in capital grants and contributions from new special assessments and street maintenance aid recognized. The decrease in unrestricted grants reflects the one-time federal CRF grant received in 2020. The change in investment earnings (charges) is due to changes in the fair value of the City's investment portfolio caused by less favorable market conditions and available interest rates in 2021.

LEGISLATIVE UPDATES

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

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

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

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

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

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

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

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

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

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

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

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

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

ACCOUNTING AND AUDITING UPDATES

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

GASB Statement No. 87, *Leases*

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

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

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

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

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

GASB Statement No. 91, *Conduit Debt Obligations*

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

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

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

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

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

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

GASB Statement No. 92, *Omnibus 2020*

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

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

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

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

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

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

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

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

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

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

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

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

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

GASB Statement No. 98, The Annual Comprehensive Financial Report

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