Management Report

for

City of Wayzata, Minnesota

December 31, 2019

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MMKR
CERTIFIED PUBLIC ACCOUNTANTS

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To the City Council and Management
City of Wayzata, Minnesota

We have prepared this management report in conjunction with our audit of the City of Wayzata, 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
May 8, 2020

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AUDIT SUMMARY

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

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

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

PLANNED SCOPE AND TIMING OF THE AUDIT

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

AUDIT OPINION AND FINDINGS

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

- We have issued an unmodified opinion on the City's basic financial statements. Our report included a paragraph emphasizing the City's implementation of Governmental Accounting Standards Board (GASB) Statement No. 84, *Fiduciary Activities* during the year ended December 31, 2019. Our opinion was not modified with respect to this matter.

- We reported one matter involving the City's internal control over financial reporting that we consider to be a significant deficiency. Due to the limited size of the City's finance department 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 *Government Auditing Standards.*

- We reported one finding based on our testing of the City's compliance with Minnesota laws and regulations. Two of forty disbursements selected for testing were not paid within 35 days of the receipt of goods or services, or the invoice for goods or services, as required by Minnesota Statutes.

OTHER OBSERVATIONS AND RECOMMENDATIONS

Council Approval of Transactions

Two of forty transactions tested during our audit for the year ended December 31, 2019 were not included in the monthly check listing submitted to the Council for review and approval. Per further investigation, this was apparently due to a glitch in the City's Banyon finance software system, which from time to time assigned new check numbers to existing checks, causing them to be left out of the check sequence run for the City Council packets. We performed additional procedures to verify these two transactions were properly recorded in the finance system. We recommend that the City work with its software provider to rectify this issue and ensure all checks are properly included in the monthly listings being included in the City Council packets for review.

Wellness Program

As part of our legal compliance testing for the year ended December 31, 2019, we noted the City purchased gift cards as prizes for its Wellness Program. The Wellness Program awards participants with either monthly $20 Health Savings Account (HSA) contributions or $100 gift cards. There are a number of tax issues that could arise from this practice. First, the Internal Revenue Service considers gift cards to be equivalent to cash compensation, which would make these awards taxable income to the recipients. Second, all contributions to an HSA must be made through a qualified plan, and there is a possibility that making contributions for a select group of employees could create an issue for the plan. Lastly, there are individual and family limits to the amounts that may be contributed to an HSA plan, and the limits include employer contributions. The excess contributions could potentially put the individual over the limit for that fiscal year and be subject to a 10 percent penalty. We recommend that the City review its Wellness Program policy and consider switching the awards for the program to other physical items of de minimis value.

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:

- 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:

- The City has recorded liabilities and activity for pension benefits and other post-employment benefits (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.

- The City has recorded a liability for compensated absences payable. 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.

- The depreciation of capital assets involves estimates pertaining to useful lives.

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

We were not engaged to report on the introductory section, which accompanies the financial statements, but is 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

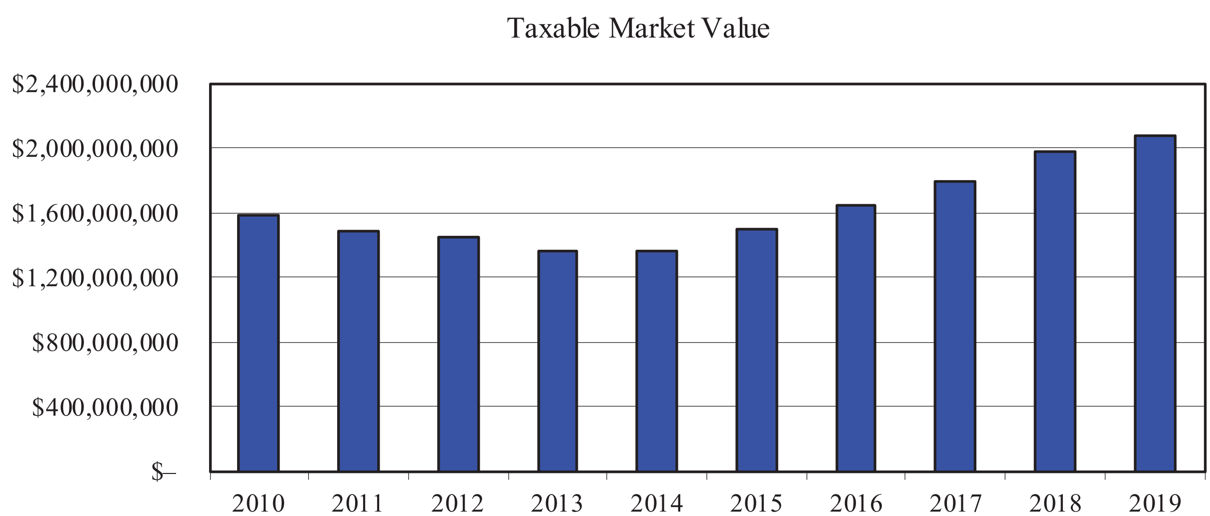
This section of the report provides you with an overview of the financial trends and activities of the City's governmental funds, which includes the General, special revenue, debt service, and capital project funds. These funds are used to account for the basic services the City provides to all of its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

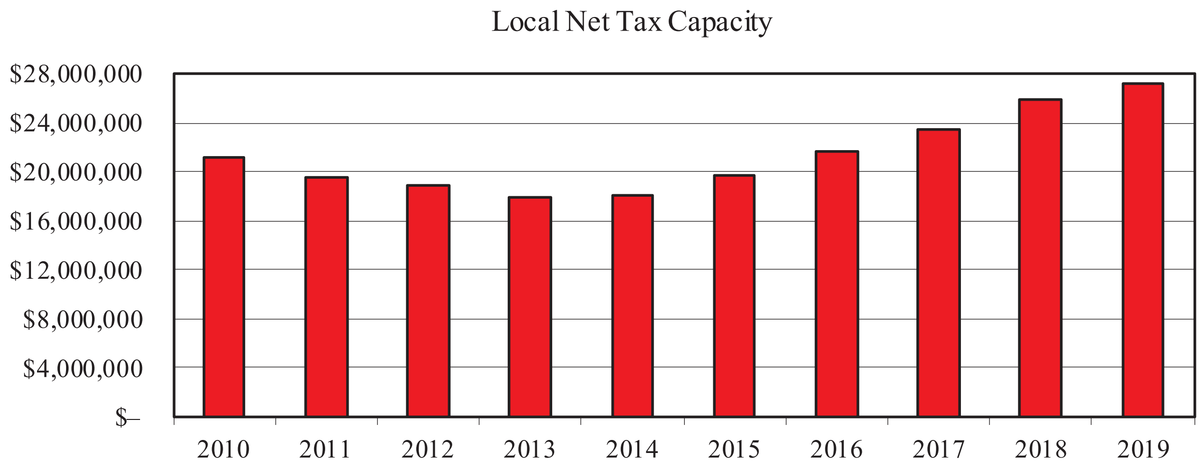
The total tax capacity value of property in Minnesota cities increased about 7.1 percent for the 2019 levy year. The tax capacity values used for levying property taxes are based on the assessed market values for the previous fiscal year (e.g., tax capacity values for taxes levied in 2019 were based 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 taxable market value increased 9.8 percent for taxes payable in 2018 and 5.1 percent for taxes payable in 2019. 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 9.8 percent and 5.3 percent for taxes payable in 2018 and 2019, respectively.

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



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

Rates Expressed as a Percentage of Net Tax Capacity

	City of Wayzata		
	2017	2018	2019
Average tax rate			
City	23.4	21.7	21.7
County	44.1	42.8	41.9
School	26.3	25.5	24.8
Special taxing	11.0	10.7	10.1
Total	104.8	100.7	98.5

The City's portion of the tax capacity rates for Wayzata residents, as well as the total tax capacity rate, have slowly been declining in recent years. This is due to the City's relatively low annual tax levies, coupled with its high property values and strong commercial tax base.

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	$ 540,681	$ 679,482	$ (138,801)
Restricted	1,300,874	1,228,089	72,785
Committed	112,726	119,380	(6,654)
Assigned	10,001,324	8,761,098	1,240,226
Unassigned	3,261,720	3,146,470	115,250
Total governmental funds	$ 15,217,325	$ 13,934,519	$ 1,282,806
Total by fund			
General	$ 4,074,455	$ 4,095,409	$ (20,954)
Debt Service	694,534	569,881	124,653
Lakefront Improvement Capital Projects	3,159,573	2,886,817	272,756
Street Improvement Capital Projects	914,951	742,834	172,117
Nonmajor funds	6,373,812	5,639,578	734,234
Total governmental funds	$ 15,217,325	$ 13,934,519	$ 1,282,806

In total, the fund balances of the City's governmental funds increased $1,282,806 during the year ended December 31, 2019. The majority of the increase was in fund balances assigned for various future capital purposes in the nonmajor capital projects funds, which were primarily accumulated through transfers of available resources from other city funds.

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 for cities with comparable populations.

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 on 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.

The per capita information presented in this report excludes the Wayzata Housing and Redevelopment Authority (HRA), the City's discretely presented component unit.

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

	State-Wide		City of Wayzata		
Year	2017	2018	2017	2018	2019
Population	2,500–10,000	2,500–10,000	4,804	4,719	4,719
Property taxes	$ 474	$ 495	$ 975	$ 982	$ 1,008
Tax increments	26	28	–	–	–
Franchise and other taxes	38	41	32	33	34
Special assessments	57	53	52	53	52
Licenses and permits	39	38	159	188	143
Intergovernmental revenues	322	303	440	122	116
Charges for services	108	130	221	338	299
Other	68	97	107	99	226
Total revenue	$ 1,132	$ 1,185	$ 1,986	$ 1,815	$ 1,878

The City's total governmental funds revenue for 2019 was $8,865,563, an increase of $300,772 (3.5 percent), or about $63 per capita, from the previous year. The majority of the increase was in other revenues, which were $127 per capita higher than the previous year. The increase in this category was primarily due to a $318,278 increase in investment earnings, along with $167,134 of developer reimbursements for third party services originally paid for by the City, which had been accounted for in a fiduciary (agency) fund in prior years.

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, which 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 for cities with comparable populations, are presented in the following table:

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

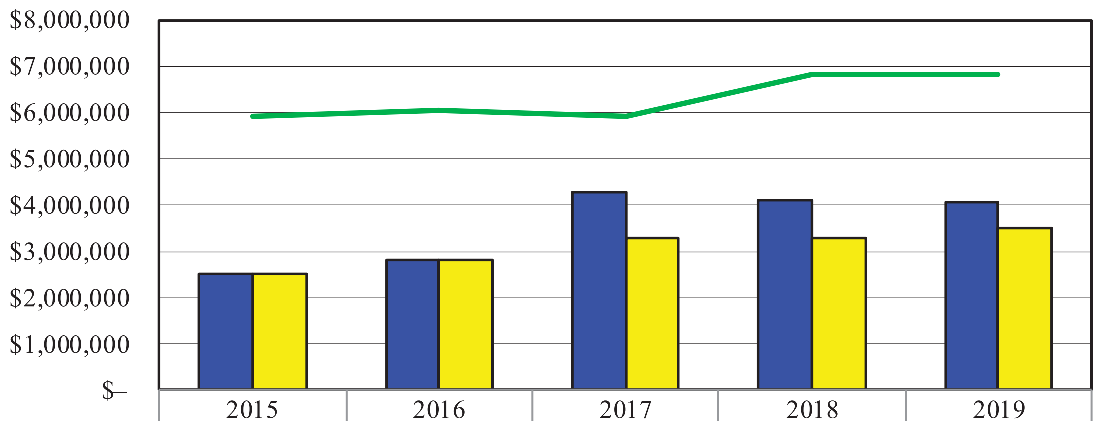
	State-Wide		City of Wayzata		
Year	2017	2018	2017	2018	2019
Population	2,500–10,000	2,500–10,000	4,804	4,719	4,719
Current					
General government	$ 147	$ 150	$ 375	$ 322	$ 353
Public safety	270	286	470	497	501
Public works	128	135	146	157	192
Culture and recreation	96	96	151	250	256
All other	76	75	59	57	59
Total current	717	742	1,201	1,283	1,361
Capital outlay and construction	403	417	2,037	247	683
Debt service					
Principal	228	178	68	71	73
Interest and fiscal	44	41	54	73	83
Total debt service	272	219	122	144	156
Total expenditures	$ 1,392	$ 1,378	$ 3,360	$ 1,674	$ 2,200

The City's total governmental funds expenditures for 2019 were $10,380,020, an increase of $2,487,346 (31.5 percent) from the prior year, or $526 per capita. The majority of this increase was in capital outlay, which was $436 per capita higher than last year, primarily due to an increase in capital outlay related to the reconstruction of Wayzata Boulevard and Superior Street.

GENERAL FUND

The City's General Fund accounts for the financial activity of the basic services provided to the community. The primary services included within this fund are the administration of the municipal operation, police and fire protection, building inspection, streets and highway maintenance, and culture and recreation. The graph below illustrates the change in the General Fund financial position over the last five years. We have also included a line representing annual expenditures and transfers out to reflect the change in the size of the General Fund operation over the same period.

General Fund Financial Position
Year Ended December 31,



	2015	2016	2017	2018	2019
Fund Balance	$2,529,396	$2,835,183	$4,258,409	$4,095,409	$4,074,455
Cash Balance	$2,511,386	$2,792,940	$3,306,531	$3,308,723	$3,482,533
Exp & Trans Out	$5,897,406	$6,056,578	$5,902,131	$6,843,803	$6,816,402

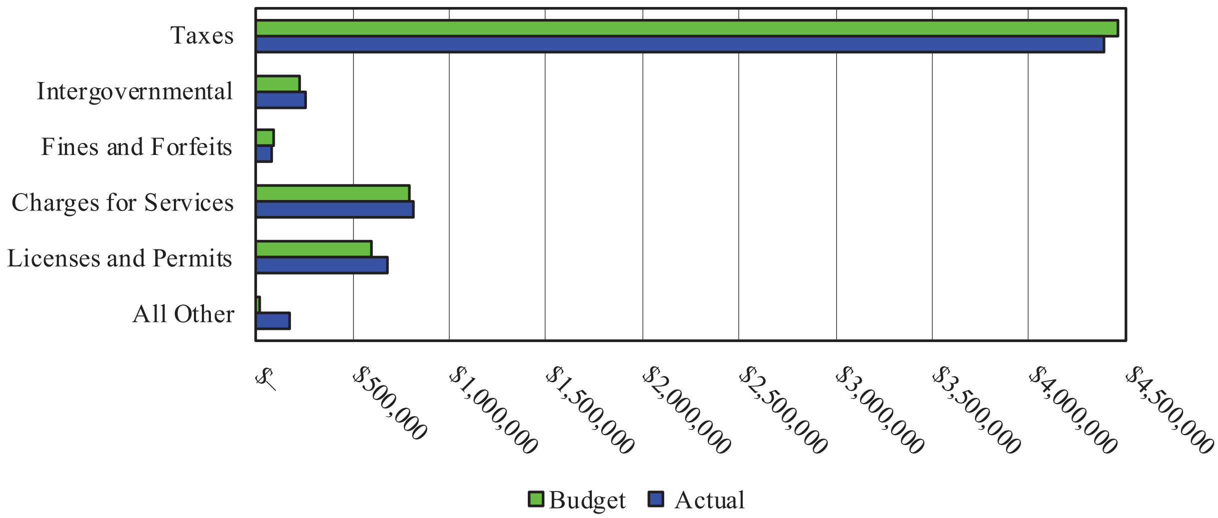
The City's General Fund cash and investments balance at December 31, 2019 was $3,482,533, an increase of $173,810 from the previous year. Total fund balance at year-end was $4,074,455, which was a decrease of $20,954 from the prior year, as compared to a break-even budget. The unassigned portion of fund balance was $3,261,720 at year-end, which represents 47.9 percent of the City's annual General Fund expenditures and transfers out based on 2019 levels.

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.

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 67.3 percent of the fund's total annual revenue. Approximately half of these revenues are received by the City at mid-year and the rest at year-end. Consequently, the City needs to have adequate cash reserves to finance its everyday operations between these payments.

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

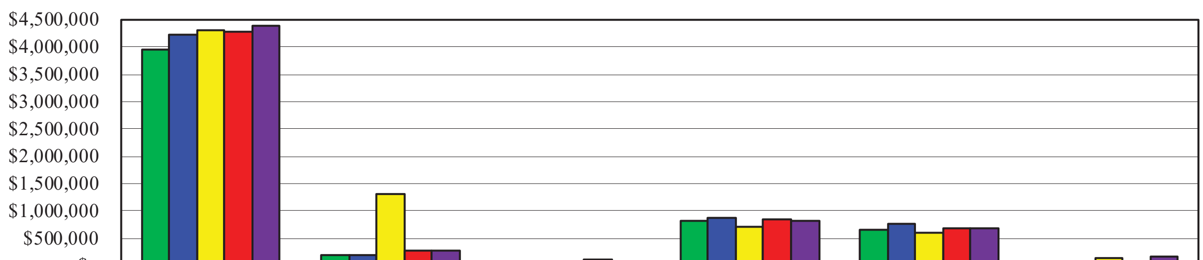
General Fund Revenue
Budget to Actual



General Fund revenue for 2019 totaled $6,390,661 which was $209,875 (3.4 percent) higher than budget. Licenses and permits were $80,401 higher than projected, as building permits exceeded budget. All other revenues, as presented above, were $148,990 over budget, mainly due to better investment earnings than projected.

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.

General Fund Revenue by Source
Year Ended December 31,

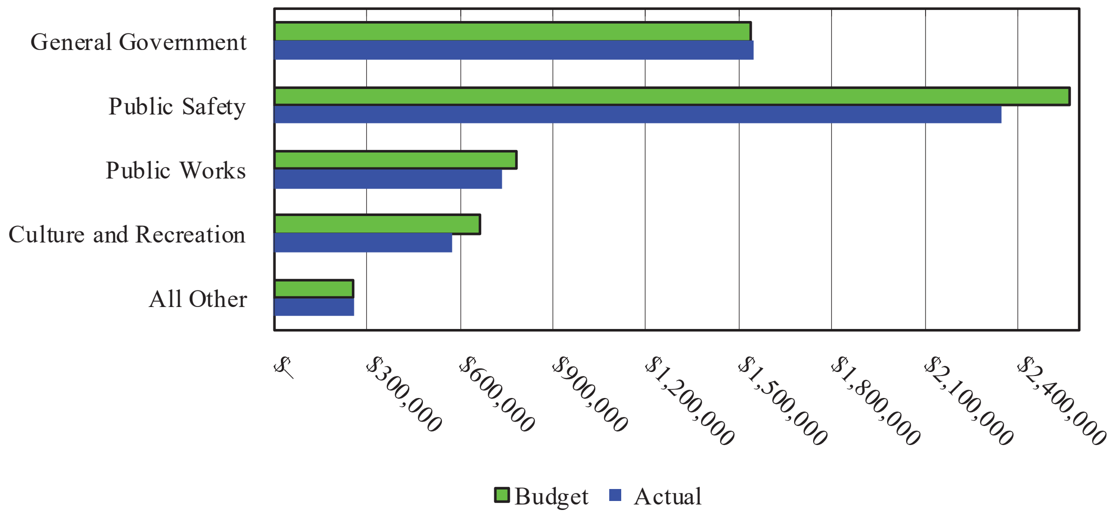


	Taxes	Intergovernmental	Fines and Forfeits	Charges for Services	Licenses and Permits	All Other
2015	$3,939,771	$193,931	$89,360	$827,582	$657,955	$37,141
2016	$4,211,953	$200,025	$77,268	$862,230	$769,641	$62,829
2017	$4,312,130	$1,306,099	$81,423	$716,702	$595,372	$141,912
2018	$4,263,785	$276,372	$100,118	$837,538	$683,900	$81,915
2019	$4,385,718	$260,846	$77,810	$817,871	$676,426	$171,990

Total General Fund revenues increased $147,033 (2.4 percent) from the previous year. Taxes revenue was $121,933 higher than the previous year, due to an increase in tax levy. Revenues from all other sources, as presented above, increased by $90,075 due primarily to increased investment earnings.

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

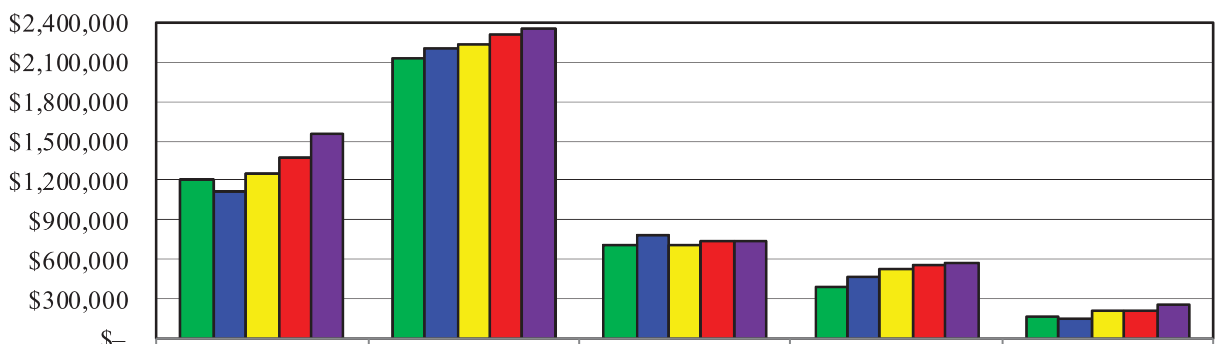
General Fund Expenditures
Budget to Actual



Total General Fund expenditures for 2019 of $5,468,040 were under budget by $338,271 (5.8 percent). This variance was spread across several areas, with the largest savings in public safety ($223,964), due to lower than budgeted salaries expenses, culture and recreation ($83,964), due to conservative budgeting for park maintenance, and public works ($41,266), due to lower than expected street maintenance and engineering costs.

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	Public Safety	Public Works	Culture and Recreation	All Other
2015	$1,211,694	$2,131,961	$707,177	$396,102	$172,467
2016	$1,110,852	$2,198,112	$782,691	$469,516	$150,633
2017	$1,251,354	$2,234,630	$703,182	$530,460	$214,831
2018	$1,374,287	$2,311,503	$740,013	$566,137	$214,552
2019	$1,548,038	$2,344,625	$738,012	$577,613	$259,752

Total General Fund expenditures were $261,548 (5.0 percent) higher than the previous year, with the increase spread across most functions, mainly due to increased personnel costs and development-related services. General government expenditures were $173,751 higher than the previous year, mainly related to higher costs for assessing, and planning and zoning.

ENTERPRISE FUNDS OVERVIEW

The City maintains a number of enterprise funds to account for services the City provides that are financed primarily through fees charged to those utilizing the service. This section of the report provides you with an overview of the financial trends and activities of the City's enterprise funds, which include the Water, Sewer, Licensing, Liquor, Solid Waste, and Stormwater 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, 2019, presented both by classification and by fund:

Enterprise Funds Change in Financial Position

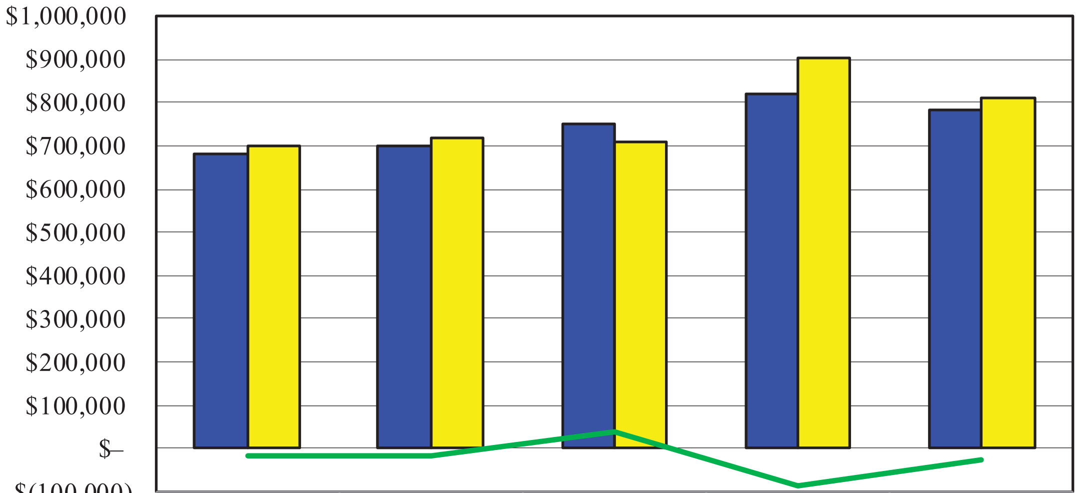
	Net Position as of December 31,		
	2019	2018	Change
Net position of enterprise funds			
Total by classification			
Net investment in capital assets	$ 13,435,091	$ 13,074,877	$ 360,214
Restricted	1,420,296	1,526,039	(105,743)
Unrestricted	2,908,736	3,100,098	(191,362)
Total enterprise funds	$ 17,764,123	$ 17,701,014	$ 63,109
Total by fund			
Water	$ 7,877,288	$ 7,852,589	$ 24,699
Sewer	3,824,521	3,914,123	(89,602)
Licensing	(95,941)	(216,190)	120,249
Liquor	1,574,995	1,638,743	(63,748)
Solid Waste	272,770	238,512	34,258
Stormwater	4,310,490	4,273,237	37,253
Total enterprise funds	$ 17,764,123	$ 17,701,014	$ 63,109

In total, the net position of the City's enterprise funds increased by $63,109 during the year ended December 31, 2019.

WATER FUND

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

Water Fund
Year Ended December 31,



	2015	2016	2017	2018	2019
Oper Rev	$680,803	$700,700	$750,334	$820,062	$785,225
Oper Exp	$697,742	$717,299	$710,647	$904,319	$810,291
Oper Inc (Loss)	$(16,939)	$(16,599)	$39,687	$(84,257)	$(25,066)

The Water Fund ended 2019 with a total net position of $7,877,288, which was an increase of $24,699 from the prior year. The Water Fund had a net investment in capital assets of $5,688,396, net position restricted for debt service of 1,033,248, and unrestricted net position of $1,155,644 at year-end.

Water Fund operating revenues for fiscal 2019 were $785,225, a decrease of $34,837 (4.2 percent) from the prior year, due to a decrease in water consumption for irrigation in 2019.

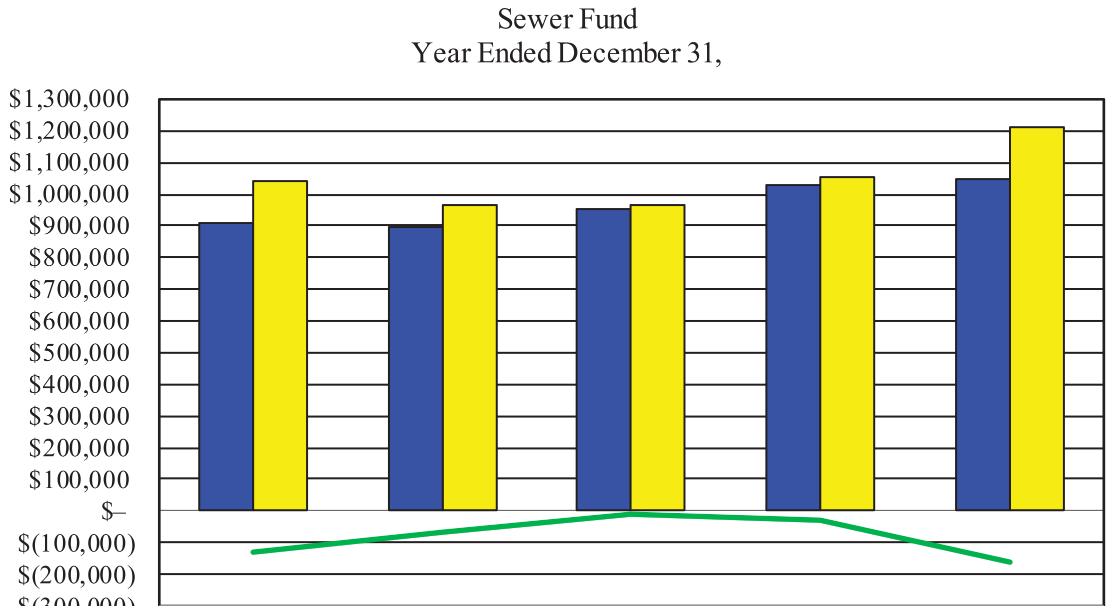
Operating expenses for 2019 were $810,291, a decrease of $94,028 (10.4 percent) from the previous year, mainly due to decreased contracted maintenance services.

After nonoperating revenues and expenses (such as interest revenue, tower rental revenue, and interest expense), the Water Fund had a loss before contributions and transfers of $60,813.

The Water Fund received capital contributions of $152,212 from special assessments and access charges to finance the water portion of street improvement projects. The Water Fund also transferred out $36,700 to support equipment purchases, and $30,000 to support the General Fund.

SEWER FUND

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



	2015	2016	2017	2018	2019
Oper Rev	$909,799	$897,443	$950,007	$1,026,386	$1,050,037
Oper Exp	$1,041,186	$964,112	$963,435	$1,055,052	$1,214,010
Oper Inc (Loss)	$(131,387)	$(66,669)	$(13,428)	$(28,666)	$(163,973)

The Sewer Fund ended 2019 with a total net position of $3,824,521, a decrease of $89,602 from the prior year. The Sewer Fund had a net investment in capital assets of $2,804,400, net position restricted for debt service of $387,048, and unrestricted net position of $633,073 at year-end.

Sewer Fund operating revenue for fiscal 2019 was $1,050,037, an increase of $23,651 (2.3 percent) from the prior year, due to an increase in rates implemented this year.

Operating expenses for 2019 were $1,214,010, an increase of $158,958 (15.1 percent), mainly due to an increase in Metropolitan Council Environmental Services disposal charges ($59,716) and contracted maintenance services.

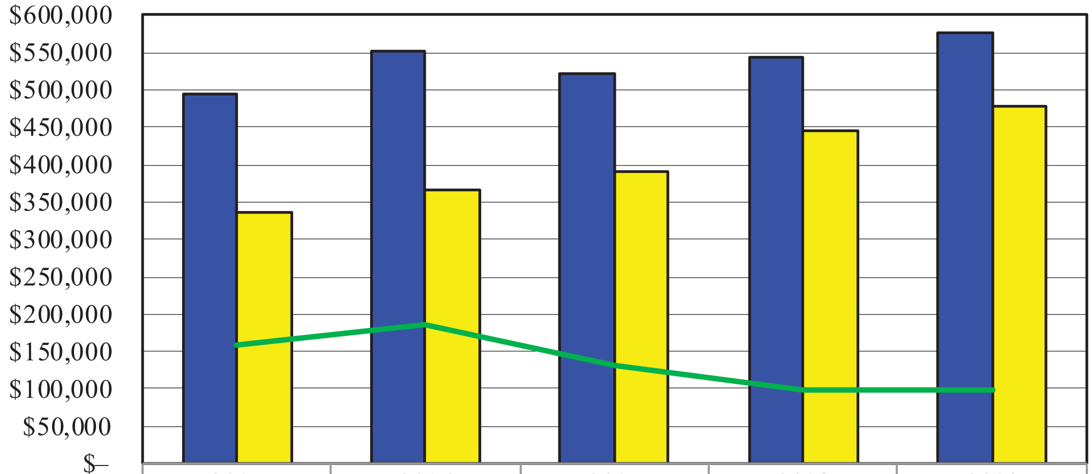
After nonoperating revenues and expenses, the Sewer Fund had a loss before contributions and transfers of $142,596.

The Sewer Fund received $132,094 of contributed capital from special assessments and access charges to finance the sewer portion of street improvement projects. The Sewer Fund also transferred out $49,100 to finance equipment purchases and $30,000 to support the General Fund.

LICENSING FUND

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

Licensing Fund
Year Ended December 31,



	2015	2016	2017	2018	2019
Oper Rev	$494,537	$552,514	$521,062	$544,247	$576,066
Oper Exp	$335,021	$366,121	$390,442	$445,935	$477,605
Oper Inc (Loss)	$159,516	$186,393	$130,620	$98,312	$98,461

The Licensing Fund ended 2019 with an unrestricted deficit net position of ($95,941), an improvement of $120,249 from the prior year.

Licensing Fund operating revenues for 2019 were $576,066, an increase of $31,819 (5.8 percent) from the prior year.

Operating expenses for 2019 were $477,605, an increase of $31,670 (7.1 percent) from last year, mainly due to a continued increase in personnel costs and overtime caused by flaws with the rollout of Minnesota Licensing and Registration System (MNLARS).

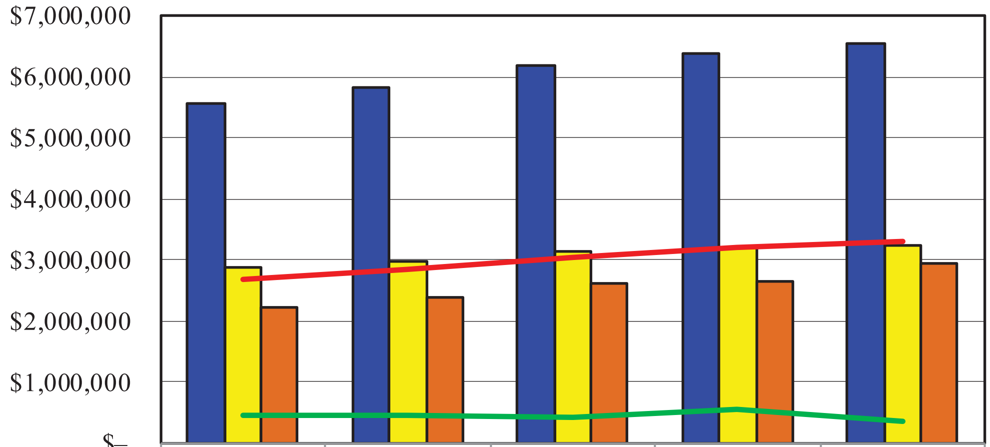
The Licensing Fund received $115,421 in 2019 through a one-time state grant to reimburse deputy registrars for excess costs incurred related to the failed MNLARS system.

The Licensing Fund transferred out $23,421 to fund the Lake Effect projects, $25,000 to finance general construction projects, and $55,000 to support the General Fund.

LIQUOR FUND

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

Liquor Fund
Year Ended December 31,



	2015	2016	2017	2018	2019
Sales	$5,579,188	$5,841,519	$6,184,891	$6,395,736	$6,551,840
Cost of Sales	$2,889,826	$2,987,361	$3,127,367	$3,198,367	$3,241,073
Oper Exp	$2,223,107	$2,383,344	$2,625,555	$2,636,737	$2,954,045
Gross Profit	$2,689,362	$2,854,158	$3,057,524	$3,197,369	$3,310,767
Oper Inc (Loss)	$466,255	$470,814	$431,969	$560,632	$356,722

The Liquor Fund ended 2019 with a total net position of $1,574,995, a decrease of $63,748 from the prior year. The Liquor Fund's net investment in capital assets was $1,264,263 at year-end, leaving unrestricted net position of $310,732 at year-end.

Liquor Fund gross sales for 2019 were $6,551,840, an increase of $156,104 from the prior year. Gross sales for the liquor store increased $31,616 (1.1 percent) and $124,488 (3.6 percent) for the bar and restaurant side of the operation. Gross profits for 2019 increased $113,398 (3.5 percent) overall.

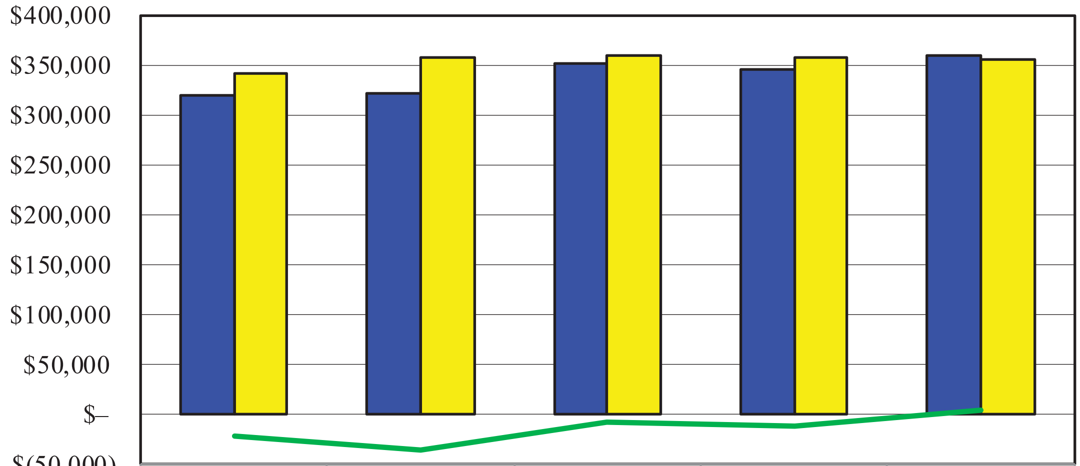
Operating expenses of $2,954,045 represented an increase of $317,308 (12.0 percent) from the prior year.

The Liquor Fund transferred out $9,607 to fund the Lake Effect projects, $139,184 to finance general construction projects, and $215,000 to support the General Fund.

SOLID WASTE FUND

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

Solid Waste Fund
Year Ended December 31,



	2015	2016	2017	2018	2019
Oper Rev	$319,208	$321,208	$351,457	$347,048	$360,373
Oper Exp	$341,994	$357,902	$359,495	$358,758	$356,087
Oper Inc (Loss)	$(22,786)	$(36,694)	$(8,038)	$(11,710)	$4,286

The Solid Waste Fund ended 2019 with an unrestricted net position of $272,770, an increase of $34,258 from the prior year.

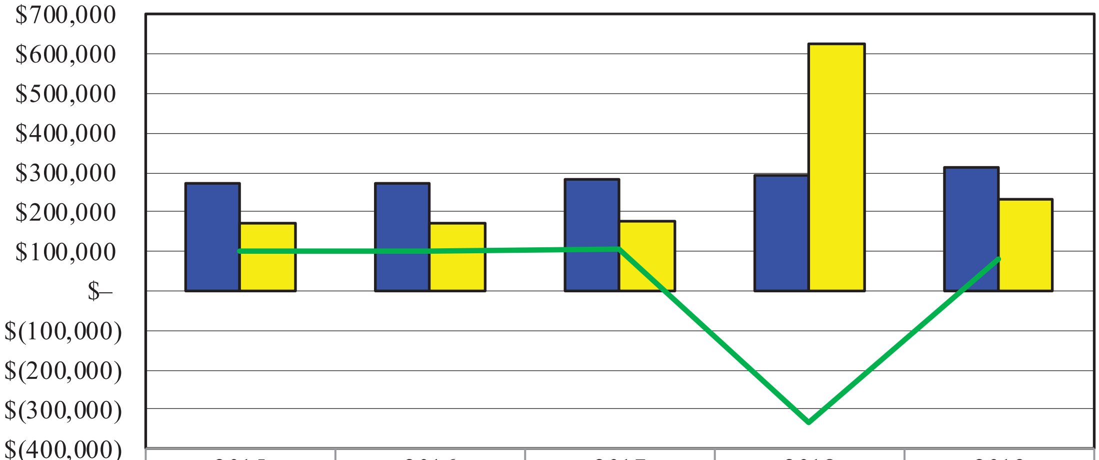
Operating revenues for 2019 were $360,373, an increase of $13,325 (3.8 percent) from last year, mainly due to an increase in rates.

Operating expenses for 2019 were $356,087, a decrease of $2,671 (0.7 percent) from the previous year.

STORMWATER FUND

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

Stormwater Fund
Year Ended December 31,



	2015	2016	2017	2018	2019
Oper Rev	$272,355	$273,816	$283,696	$294,936	$314,307
Oper Exp	$171,579	$171,774	$178,786	$628,207	$231,015
Oper Inc (Loss)	$100,776	$102,042	$104,910	$(333,271)	$83,292

The Stormwater Fund ended 2019 with a total net position of $4,310,490, an increase of $37,253 from the prior year. The Stormwater Fund's net investment in capital assets was $3,678,032 at year-end, leaving an unrestricted net position of $632,458.

Stormwater Fund operating revenue for 2019 was $314,307, an increase of $19,371 (6.6 percent) from last year, due to a 5.0 percent increase in rates.

Operating expenses for 2019 were $231,015 a decrease of $397,192 (63.2 percent) from last year, mainly in contracted services.

The Stormwater Fund transferred out $55,000 to finance street improvement construction projects, and $10,000 to support the General Fund.

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 City's components of net position as of December 31, 2019 and 2018:

	As of December 31,		
	2019	2018	Change
Net position – primary government			
Governmental activities			
Net investment in capital assets	$ 32,116,987	$ 32,946,238	$ (829,251)
Restricted	5,028,305	3,054,502	1,973,803
Unrestricted	10,563,817	9,419,661	1,144,156
Total governmental activities	47,709,109	45,420,401	2,288,708
Business-type activities			
Net investment in capital assets	13,435,091	13,074,877	360,214
Restricted	1,420,296	1,526,039	(105,743)
Unrestricted	2,908,736	3,100,098	(191,362)
Total business-type activities	17,764,123	17,701,014	63,109
Total net position – primary government	$ 65,473,232	$ 63,121,415	$ 2,351,817
Net position – HRA component unit			
Net investment in capital assets	$ 2,092,900	$ 2,092,900	$ –
Restricted	743,727	178,759	564,968
Unrestricted	(659,505)	(914,834)	255,329
Total net position – HRA component unit	$ 2,177,122	$ 1,356,825	$ 820,297

The City (excluding the HRA) ended 2019 with a combined total net position of $65,473,232, an increase of $2,351,817 from the prior year. The City's net investment in capital assets decreased $469,037 between the governmental and business-type activities, which is primarily due to the relationship between the depreciation of capital assets and the repayment of the debt issued to build or acquire them. The increase in the restricted net position of the governmental activities was mainly due to special assessments levied for debt service on the City's 2019A General Obligation Improvement Bonds. The increase in unrestricted net position in the governmental activities is mainly from increased resources accumulated for future capital projects.

The City's HRA discretely presented component unit ended the year with a total net position of $2,177,122. The $820,297 increase in net position was primarily the result of tax increments collected by the HRA from its Bay Center Tax Increment District during the year.

STATEMENT OF ACTIVITIES

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

The following table presents the change in net position of the City (primary government) and the HRA (discretely presented component unit) for the year ended December 31, 2019:

	Expenses	Program Revenues	Net Change Primary Government	Net Change Component Unit – HRA
Primary government				
Governmental activities				
General government	$ 2,279,745	$ 705,080	$ (1,574,665)	$ –
Public safety	2,724,722	1,165,501	(1,559,221)	–
Public works	2,344,835	2,903,964	559,129	–
Culture and recreation	1,405,782	451,505	(954,277)	–
Interest on long-term debt	366,146	–	(366,146)	–
Business-type activities				
Water	917,761	937,804	20,043	–
Sewer	1,223,890	1,182,498	(41,392)	–
Licensing	477,605	692,056	214,451	–
Liquor	6,308,017	6,570,158	262,141	–
Solid Waste	356,087	378,288	22,201	–
Stormwater	231,015	314,382	83,367	–
Total – primary government	$ 18,635,605	$ 15,301,236	(3,334,369)	–
Component unit – HRA	$ 2,502,576	$ –	–	(2,502,576)
General revenues				
Property taxes and tax increments			4,757,020	3,289,052
Franchise taxes			160,932	–
Unrestricted grants and contributions			77,508	–
Investment earnings			675,939	33,821
Other revenues			14,787	–
Total general revenues			5,686,186	3,322,873
Change in net position			$ 2,351,817	$ 820,297

One of the goals of this statement is to provide a side-by-side comparison to illustrate the difference in the way governmental and business-type operations are financed. The table clearly illustrates the dependence of the City's governmental operations and those of the HRA on general revenues, such as property taxes, tax increments, 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. This is critical given the current downward pressures on the general revenue sources.

LEGISLATIVE UPDATES

The 2019 legislative session began with a projected state general fund surplus of $1.052 billion. The legislative agenda was primarily focused on setting an operating budget for the state's fiscal 2020-2021 biennium. At the end of the regular session, only a higher education budget bill had been completed. However, after a special session, the Legislature was able to address the 11 remaining budget bills, as well as pass an omnibus tax bill and small pension bill. The following is a brief summary of specific legislative changes from the 2019 session or previous legislative sessions potentially impacting Minnesota cities.

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

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

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

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

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

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

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

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

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

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

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

- Changes to plans administered by the Public Employees Retirement Association (PERA) included:

    - The rights of PERA General Employees Retirement Fund (GERF) plan and Public Employees Police and Fire Fund (PEPFF) plan members to purchase service credit for periods of military leave were expanded. This gives plan members the right to purchase up to five years of service credit for military service leave that is not federally protected because the service occurred prior to public employment or the member did not meet the payment deadlines applicable to federally protected leave service credit purchases.

    - The Phased Retirement Option (PRO) program, which gives cities an opportunity to retain potentially retiring employees that are GERF plan members aged 62 or over, was altered and made permanent. Under a PRO arrangement, an employee would begin collecting a retirement annuity, but could continue working for their current employer for up to five years if they agree to a work schedule that represents a reduction of at least 25 percent each pay period from their current schedule, up to a maximum of 1,044 hours per year. Employees would not be allowed to contribute to a pension benefit plan or accrue additional service time while working under a PRO.

    - A process was established for municipalities and joint powers entities to terminate participation in the PERA Statewide Volunteer Firefighter (SVF) plan if, 1) the entity has either eliminated its fire department or ceased using the services of all departing firefighters and any other noncareer or volunteer firefighters, and 2) the entity's account has assets sufficient to cover all liabilities including the fully vested liabilities for all departing firefighters and administrative expenses.

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

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ACCOUNTING AND AUDITING UPDATES

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

GASB STATEMENT NO. 87, *LEASES*

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

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

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

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

To reduce the cost of implementation, this statement includes an exception for short-term leases, defined as a lease that, at the commencement of the lease term, has a maximum possible term under the lease contract of 12 months (or less), including any options to extend, regardless of their probability of being exercised. Lessees and lessors should recognize short-term lease payments as outflows of resources or inflows of resources, respectively, based on the payment provisions of the lease contract. The requirements of this statement are effective for reporting periods beginning after December 15, 2019.

GASB STATEMENT NO. 91, *CONDUIT DEBT OBLIGATIONS*

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

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

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

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

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

The requirements of this statement are effective for reporting periods beginning after December 15, 2020. Earlier application is encouraged.