

**City of Marshall
Lyon County, Minnesota**

Communications Letter

December 31, 2020

**City of Marshall
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Report on Matters Identified as a Result of the Audit of the Financial Statements

Honorable Mayor and Members of the
City Council and Management
City of Marshall
Marshall, Minnesota

In planning and performing our audit of the financial statements of the governmental activities, business-type activities, the discretely presented component units, each major fund, and the aggregate remaining fund information of the City of Marshall, Minnesota, as of and for the year ended December 31, 2020, in accordance with auditing standards generally accepted in the United States of America and the standards applicable to financial audits contained in the *Government Auditing Standards*, issued by the Comptroller General of the United States, we considered the City's internal control over financial reporting (internal control) as a basis for designing audit procedures that are appropriate in the circumstances for the purpose of expressing our opinions on the financial statements, but not for the purpose of expressing an opinion on the effectiveness of the City's internal control. Accordingly, we do not express an opinion on the effectiveness of the City's internal control over financial reporting.

Our consideration of internal control was for the limited purpose described in the preceding paragraph and was not designed to identify all deficiencies in internal control that might be material weaknesses or significant deficiencies and, therefore, material weaknesses or significant deficiencies may exist that have not been identified. In addition, because of inherent limitations in internal control, including the possibility of management override of controls, misstatements due to error, or fraud may occur and not be detected by such controls.

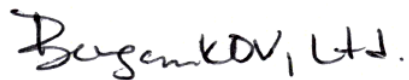
A deficiency in internal control exists when the design or operation of a control does not allow management or employees, in the normal course of performing their assigned functions, to prevent, or detect and correct, misstatements on a timely basis. A material weakness is a deficiency, or a combination of deficiencies, in internal control over financial reporting, such that there is a reasonable possibility that a material misstatement of the City's financial statements will not be prevented, or detected and corrected, on a timely basis. A reasonable possibility exists when the likelihood of an event occurring is either reasonably possible or probable as defined as follows:

- *Reasonably possible.* The chance of the future event or events occurring is more than remote but less than likely.
- *Probable.* The future event or events are likely to occur.

A significant deficiency is a deficiency, or a combination of deficiencies, in internal control that is less severe than a material weakness, yet important enough to merit attention by those charged with governance.

The accompanying memorandum also includes financial analysis provided as a basis for discussion. The matters discussed herein were considered by us during our audit and they do not modify the opinion expressed in our Independent Auditor's Report dated May 20, 2021, on such statements.

This communication is intended solely for the information and use of the City Council and management and others within the City and state oversight agencies and is not intended to be, and should not be, used by anyone other than these specified parties,

A handwritten signature in black ink that reads "BergankDV, LTD." in a cursive, slightly slanted font.

St. Cloud, Minnesota
May 20, 2021

City of Marshall Required Communication

We have audited the financial statements of the governmental activities, business-type activities, the discretely presented component units, each major fund, and the aggregate remaining fund information of the City as of and for the year ended December 31, 2020. Professional standards require that we advise you of the following matters related to our audit.

Our Responsibility in Relation to the Financial Statement Audit

As communicated in our engagement letter, our responsibility, as described by professional standards, is to form and express opinions about whether the financial statements prepared by management with your oversight are presented fairly, in all material respects, in accordance with accounting principles generally accepted in the United States of America. Our audit of the financial statements does not relieve you or management of its respective responsibilities.

Our responsibility, as prescribed by professional standards, is to plan and perform our audit to obtain reasonable, rather than absolute, assurance about whether the financial statements are free of material misstatement. An audit of financial statements includes consideration of internal control over financial reporting as a basis for designing audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of the City's internal control over financial reporting. Accordingly, as part of our audit, we considered the internal control of the City solely for the purpose of determining our audit procedures and not to provide any assurance concerning such internal control.

We are also responsible for communicating significant matters related to the audit that are, in our professional judgement, relevant to your responsibilities in overseeing the financial reporting process. However, we are not required to design procedures for the purpose of identifying other matters to communicate to you.

Generally accepted accounting principles provide for certain Required Supplementary Information (RSI) to supplement the basic financial statements. Our responsibility with respect to the RSI, which supplements the basic audit financial statements, is to apply certain limited procedures in accordance with generally accepted auditing standards. However, the RSI was not audited and, because the limited procedures do not provide us with sufficient evidence to express an opinion or provide any assurance, we do not express an opinion or provide any assurance on the RSI.

Our responsibility for the supplementary information accompanying the financial statements, as described by professional standards, is to evaluate the presentation of the supplementary information in relation to the financial statements as a whole and to report on whether the supplementary information is fairly stated, in all material respects, in relation to the financial statements as a whole.

Our Responsibility in Relation to *Government Auditing Standards*

As communicated in our engagement letter, part of obtaining reasonable assurance about whether the financial statements are free of material misstatement, we performed tests of the City's compliance with certain provisions of laws, regulations, contracts, and grant agreements, noncompliance with which could have a direct and material effect on the determination of financial statement amounts. However, the objective of our tests was not to provide an opinion on compliance with such provisions.

City of Marshall Required Communication

Our Responsibility in Relation to Title 2 U.S. Code of Federal Regulations Part 200, Uniform Administrative Requirements, Cost Principles, and Audit Requirements for Federal Awards (Uniform Guidance)

As communicated in our engagement letter, in accordance with the Uniform Guidance, we examined, on a test basis, evidence about the City's compliance with the types of compliance requirements described in the U.S. Office of Management and Budget (OMB) Compliance Supplement applicable to each of its major federal programs for the purpose of expressing an opinion on the City's compliance with those requirements. While our audit provided a reasonable basis for our opinion, it did not provide a legal determination on the City's compliance with those requirements.

In planning and performing our audit of compliance, we considered the City's internal control over compliance with the types of requirements that could have a direct and material effect on each major federal program to determine the auditing procedures that are appropriate in the circumstances for the purpose of expressing an opinion on compliance for each major federal program and to test and report on internal control over compliance in accordance with the Uniform Guidance, but not for the purpose of expressing an opinion on the effectiveness of internal control over compliance.

Planned Scope and Timing of the Audit

We conducted our audit consistent with the planned scope and timing we previously communicated to you.

Compliance with All Ethics Requirements Regarding Independence

The engagement team, others in our firm, as appropriate, our firm, and our network firms have complied with all relevant ethical requirements regarding independence.

Qualitative Aspects of Significant Accounting Practices

Significant Accounting Policies

Management has the responsibility to select and use appropriate accounting policies. A summary of the significant accounting policies adopted by the City is included in the notes to financial statements. There have been no initial selection of accounting policies and no changes to significant accounting policies or their application during 2019. No matters have come to our attention that would require us, under professional standards, to inform you about (1) the methods used to account for significant unusual transactions and (2) the effect of significant accounting policies in controversial or emerging areas for which there is a lack of authoritative guidance or consensus.

Significant Accounting Estimates

Accounting estimates are an integral part of the financial statements prepared by management and are based on management's current judgements. Those judgements are normally based on 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 markedly from management's current judgements. The most sensitive estimates affecting the financial statements are:

Depreciation – The City is currently depreciating its capital assets over their estimated useful lives, as determined by management, using the straight-line method.

**City of Marshall
Required Communication**

Qualitative Aspects of Significant Accounting Practices (Continued)

Significant Accounting Estimates (Continued)

Expense Allocation – Certain expenses are allocated to programs based on an estimate of the benefit to that particular program. Examples are salaries, benefits, and supplies.

Total Other Post Employment Benefits (OPEB) Liability, Deferred Outflows of Resources Related to OPEB and Deferred Inflows of Resources Related to OPEB – These balances are based on an actuarial study using the estimates of future obligations of the City for post employment benefits.

Net Pension Liability, Deferred Outflows of Resources Related to Pensions and Deferred Inflows of Resources Related to Pensions – These balances are based on an allocation by the pension plans using estimates based on contributions.

Allowance for Uncollectible Accounts – an allowance is used to reduce the balance of notes receivable that are estimated to be forgiven.

We evaluated the key factors and assumptions used to develop the accounting estimates and determined that they are reasonable in relation to the financial statements taken as a whole and in relation to the applicable opinion units.

Financial Statement Disclosures

Certain financial statement disclosures involve significant judgment and are particularly sensitive because of their significance to financial statement users. The financial statement disclosures are neutral, consistent, and clear.

Significant Difficulties Encountered during the Audit

We encountered no significant difficulties in dealing with management relating to the performance of the audit.

Uncorrected and Corrected Misstatements

For the purposes of this communication, professional standards require us to accumulate all known and likely misstatements identified during the audit, other than those that we believe are trivial, and communicate them to the appropriate level of management. Further, professional standards require us to also communicate the effects of uncorrected misstatements related to prior periods on the relevant classes of transactions, account balances or disclosures, and the financial statements taken as a whole and each applicable opinion unit.

Management did not identify and we did not notify them of any uncorrected financial statement misstatements. In addition, professional standards require us to communicate to you all material, corrected misstatements that were brought to the attention of management as a result of our audit procedures. None of the misstatements detected as a result of audit procedures and corrected by management were material, either individually or in the aggregate, to the financial statements taken as a whole.

City of Marshall Required Communication

Disagreements with Management

For purposes of this letter, professional standards define a disagreement with management as a matter, whether or not resolved to our satisfaction, concerning a financial accounting, reporting, or auditing matter, which could be significant to the City's financial statements or the auditor's report. No such disagreements arose during the course of our audit.

Representations Requested from Management

We have requested certain written representations from management, which are included in the management representation letter.

Management's Consultations with Other Accountants

In some cases, management may decide to consult with other accountants about auditing and accounting matters. Management has informed us that, and to our knowledge, there were no consultations with other accountants regarding auditing and accounting matters.

Other Significant Matters, Findings, or Issues

In the normal course of our professional association with the City, we generally discuss a variety of matters, including the application of accounting principles and auditing standards, operating and regulatory conditions affecting the City, and operating plans and strategies that may affect the risks of material misstatement. None of the matters discussed resulted in a condition to our retention as the City's auditor.

Other Information in Documents Containing Audited Financial Statements

We applied certain limited procedures to the 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.

With respect to the supplementary information accompanying the financial statements, 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.

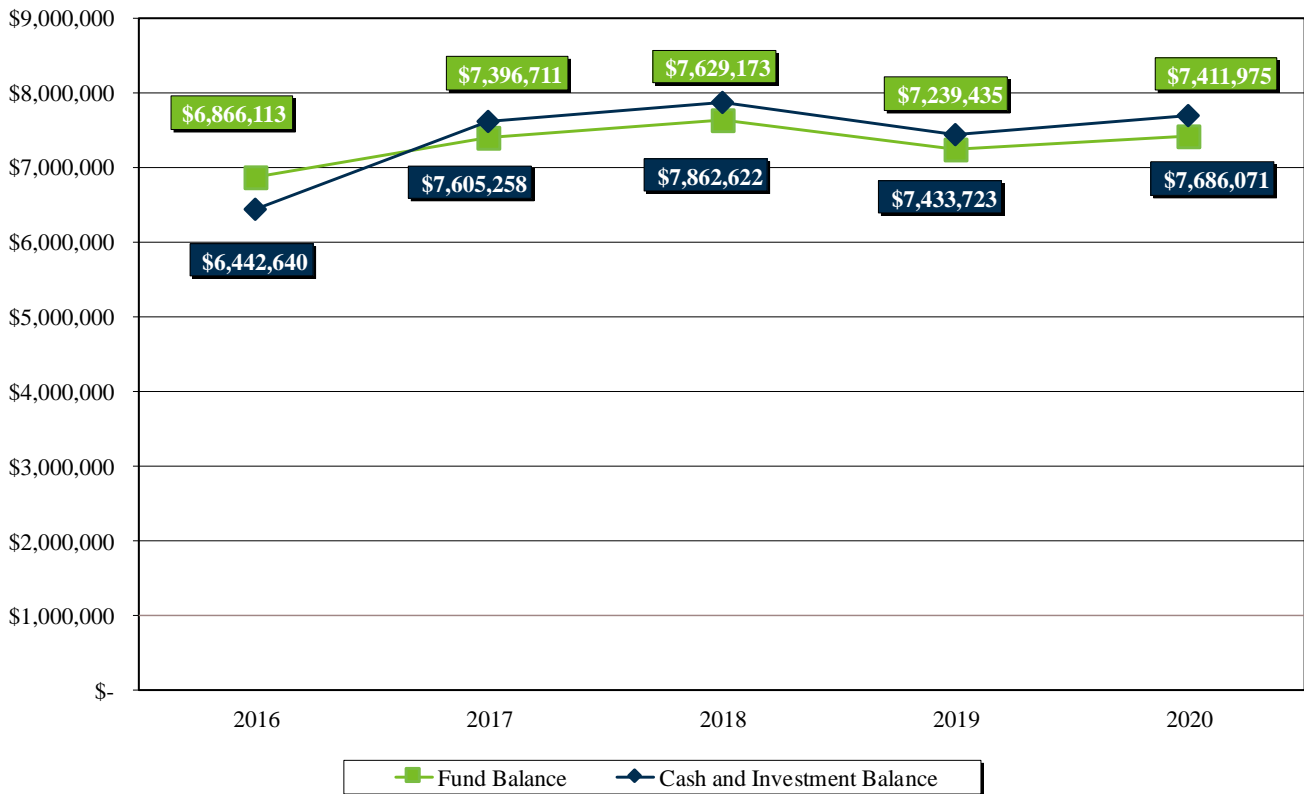
City of Marshall Financial Analysis

The following pages provide graphic representations of select data pertaining to the financial position and operations of the City for the past five years. Our analysis of each graph is presented to provide a basis for discussion of past performance and how implementing certain changes may enhance future performance. We suggest you view each graph and document if our analysis is consistent with yours. A subsequent discussion of this information should be useful for planning purposes.

General Fund – Fund Balance

The following graph illustrates the relationship between cash and investments and fund balance over the past five years. At December 31, 2020, the General Fund balance consisted of \$125,488 nonspendable, \$11,611 restricted, \$884,244 assigned, and \$6,390,632 unassigned. The total unrestricted fund balance represented over seven months of expenditures at current levels. The Office of the State Auditor has issued a statement of position recommending cities maintain an unreserved fund balance of approximately 35% to 50% of fund operating revenues, or no less than five months of operating expenditures. The City's fund balance policy for the General Fund is to maintain a minimum unrestricted fund balance of an amount not less than 5 months of the next year's budgeted expenditures. The City's unrestricted fund balance in the General Fund at December 31, 2020 was 55.7% of 2021 budgeted expenditures of \$12,280,619, which represented just over six and a half months of expenditures.

Cash and Investments and Fund Balance



On the following pages, we will discuss the revenues and expenditures of the General Fund and the variations in the fund balance.

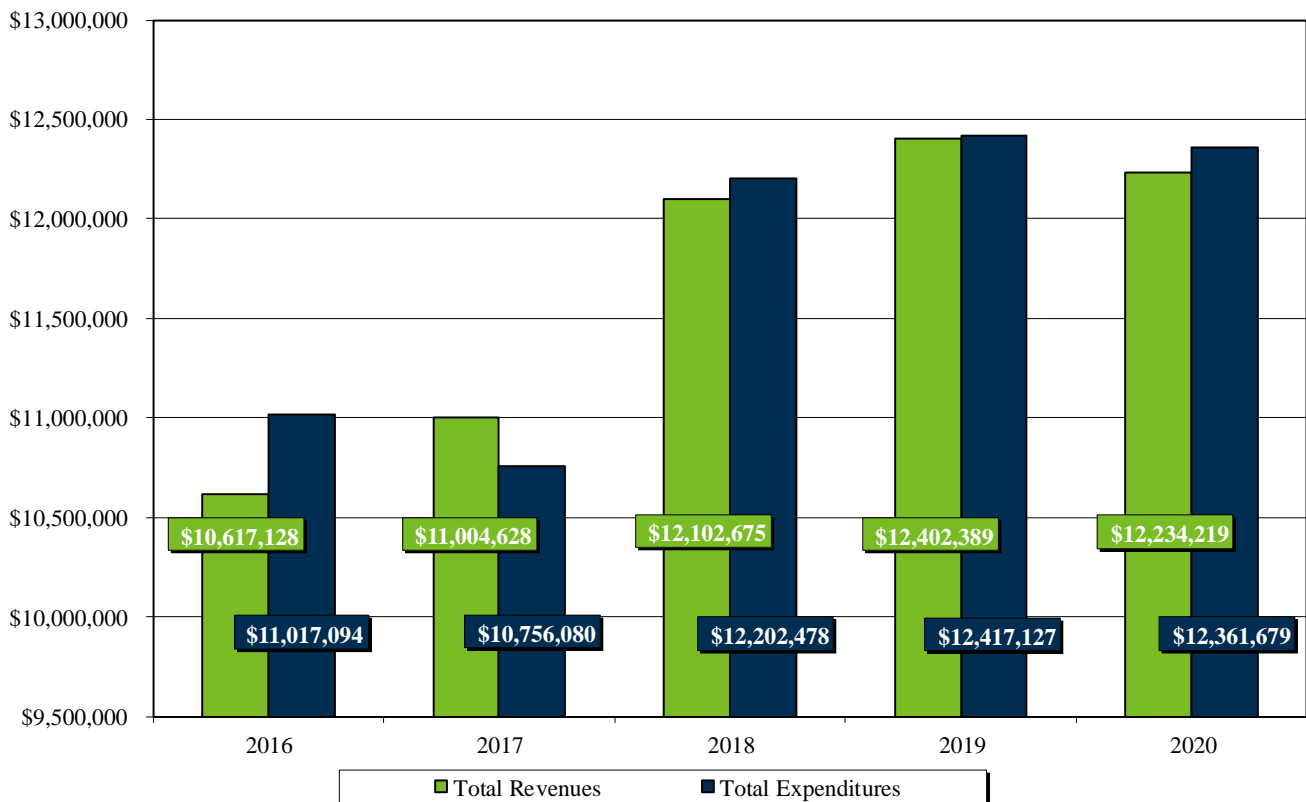
City of Marshall Financial Analysis

General Fund – Revenues and Expenditures

The following table and graph show the overall operations of the General Fund. Revenues have fluctuated over the five years shown from a high in 2019 of \$12,402,389 to a low of \$10,617,128 in 2016. In 2020, revenues were \$12,234,219, a decrease from the prior year of \$168,170. Overall from 2016 to 2020, revenues have increased \$1,617,091. Similarly, expenditures have fluctuated over the five years presented. In 2020, expenditures were \$12,361,679, a decrease from the prior year of \$55,448. Since 2016, expenditures have increased \$1,344,585.

	2016	2017	2018	2019	2020
Revenues	\$ 10,617,128	\$ 11,004,628	\$ 12,102,675	\$ 12,402,389	\$ 12,234,219
Expenditures	11,017,094	10,756,080	12,202,478	12,417,127	12,361,679
Proceeds from the sale of capital assets	31,585	29,945	5,160	-	-
Net transfers	302,022	252,105	327,105	(375,000)	300,000
Net change in fund balance	\$ (66,359)	\$ 530,598	\$ 232,462	\$ (389,738)	\$ 172,540

Revenues and Expenditures



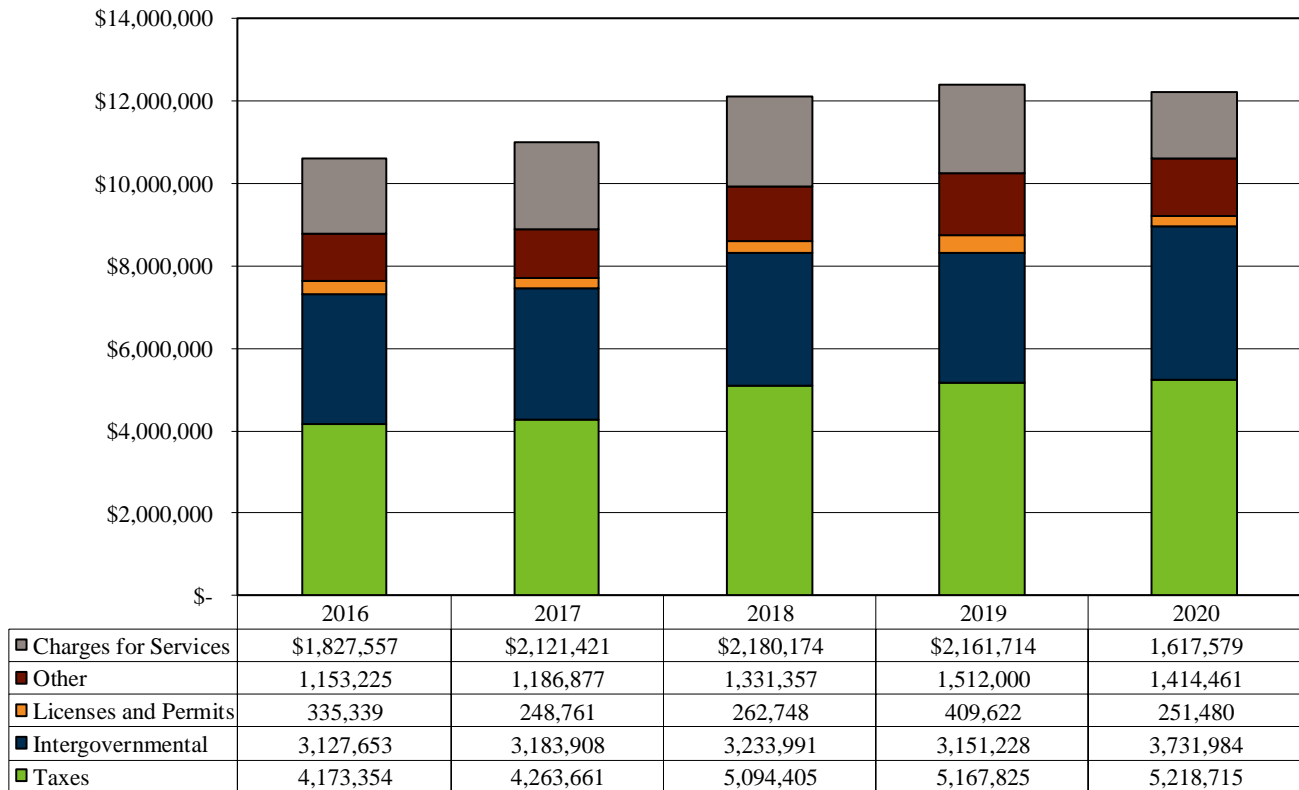
City of Marshall Financial Analysis

General Fund – Revenues

The following graph presents comparisons of revenues by type, illustrating the majority of revenue for the City is from taxes, intergovernmental sources, and charges for services. These three sources represent 42.7%, 30.5%, and 13.2% of total General Fund revenues, respectively. Other revenues include items such as licenses and permits, fines and forfeitures, special assessments, investment earnings, and other miscellaneous items.

Revenues of the General Fund decreased from 2019 to 2020 by \$168,170. Charges for services decreased \$544,135 due in large part to the effects of COVID-19 on community education and pool revenue along with a decrease in administration and engineering revenue. Licenses and permits decreased \$158,142 with less building activity and related permit revenue in 2020. The other revenue category decreased \$97,539 due in part to less revenue from both fines and investment earnings. These decreases were offset by an increase in intergovernmental revenue of \$580,756 due primarily to Federal funding received for the Coronavirus Aid, Relief, and Economic Security Act (CARES).

General Fund Revenues



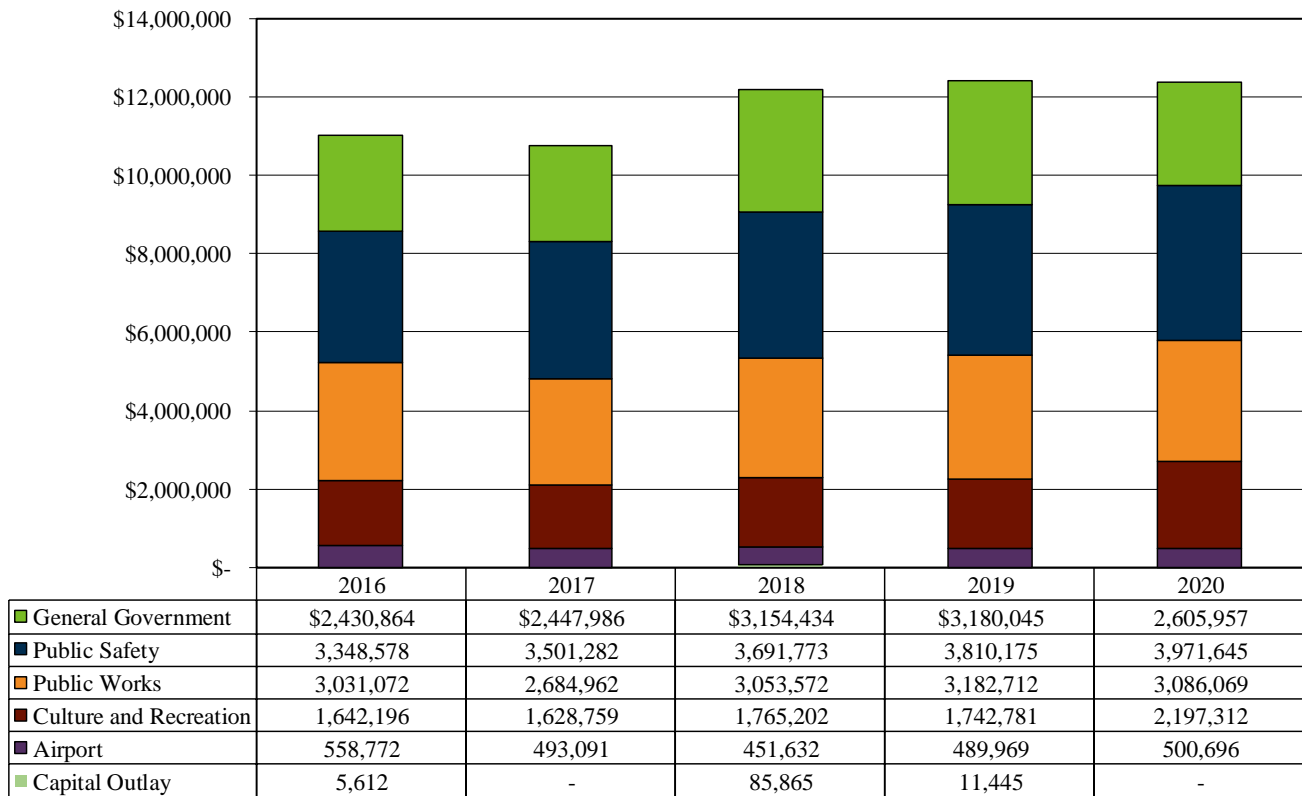
City of Marshall Financial Analysis

General Fund – Expenditures

The graph below represents the breakdown of expenditures by department. Public safety continues to comprise the largest portion of General Fund expenditures, representing 32.1%. Overall, General Fund expenditures decreased \$55,448 from 2019.

General government expenditures decreased \$574,088 due primarily to change in classification of the library appropriation, which is now included in the culture and recreation program. As a result, culture and recreation expenditures increased by \$454,531 compared to the prior year. Public works decreased \$96,643 compared to the prior year due in part to a decrease in repair and maintenance costs, fuel expenditures, and professional fees particularly related to snow removal. Public safety increased \$161,470 as a result of wage increases with changes in staffing and an added captain position in 2020.

General Fund Expenditures



**City of Marshall
Financial Analysis**

General Fund – Budgetary Comparison

	Original Budget	Final Budget	Actual Amounts	Variance With Final Budget - Over (Under)
Revenues				
Taxes	\$5,390,747	\$5,390,747	\$5,218,715	\$ (172,032)
Licenses and permits	291,990	291,990	251,480	(40,510)
Special assessments	-	-	1,203	1,203
Intergovernmental	3,137,512	3,137,512	3,731,984	594,472
Charges for services	2,229,746	2,229,746	1,617,579	(612,167)
Fines and forfeitures	111,450	111,450	77,870	(33,580)
Investment earnings	125,000	125,000	137,228	12,228
Miscellaneous	1,128,118	1,128,118	1,198,160	70,042
Total revenue	12,414,563	12,414,563	12,234,219	(180,344)
Expenditures				
General government	2,746,226	2,746,226	2,605,957	(140,269)
Public safety	4,048,032	4,048,032	3,971,645	(76,387)
Public works	3,019,446	3,019,446	3,086,069	66,623
Culture and recreation	2,596,167	2,596,167	2,197,312	(398,855)
Airport	496,566	496,566	500,696	4,130
Total expenditures	12,906,437	12,906,437	12,361,679	(544,758)
Excess of revenue over (under) expenditures	(491,874)	(491,874)	(127,460)	364,414
Other Financing Sources (Uses)				
Net transfers	300,000	300,000	300,000	-
Total other financing sources (uses)	300,000	300,000	300,000	-
Net change in fund balances	\$ (191,874)	\$ (191,874)	\$ 172,540	\$ 364,414

Overall, actual revenues were \$180,344, or 1.5%, under budget. Charges for services were \$612,167 under budget as the result of the effects of COVID-19 on programming, particularly community education and pool revenue. Administration and engineering revenue was also well under budget for the public works department. Tax revenue was \$172,032 under budget, primarily the result of franchise fees coming in under budget. Intergovernmental revenue was \$594,472 over budget as a result of receiving CARES funding that was not part of the budget. Other revenue categories were relatively consistent with the budget.

Overall, actual expenditures were less than budgeted amounts by \$544,758, or 4.2%. Similar to the revenue side, culture and recreation was well under budget by \$398,855 as a result of the effects of COVID-19. General government was \$140,269 under budget with noted variances in expenditures for lodging taxes, information technology maintenance agreements, electric utilities, and adult community center program wages.

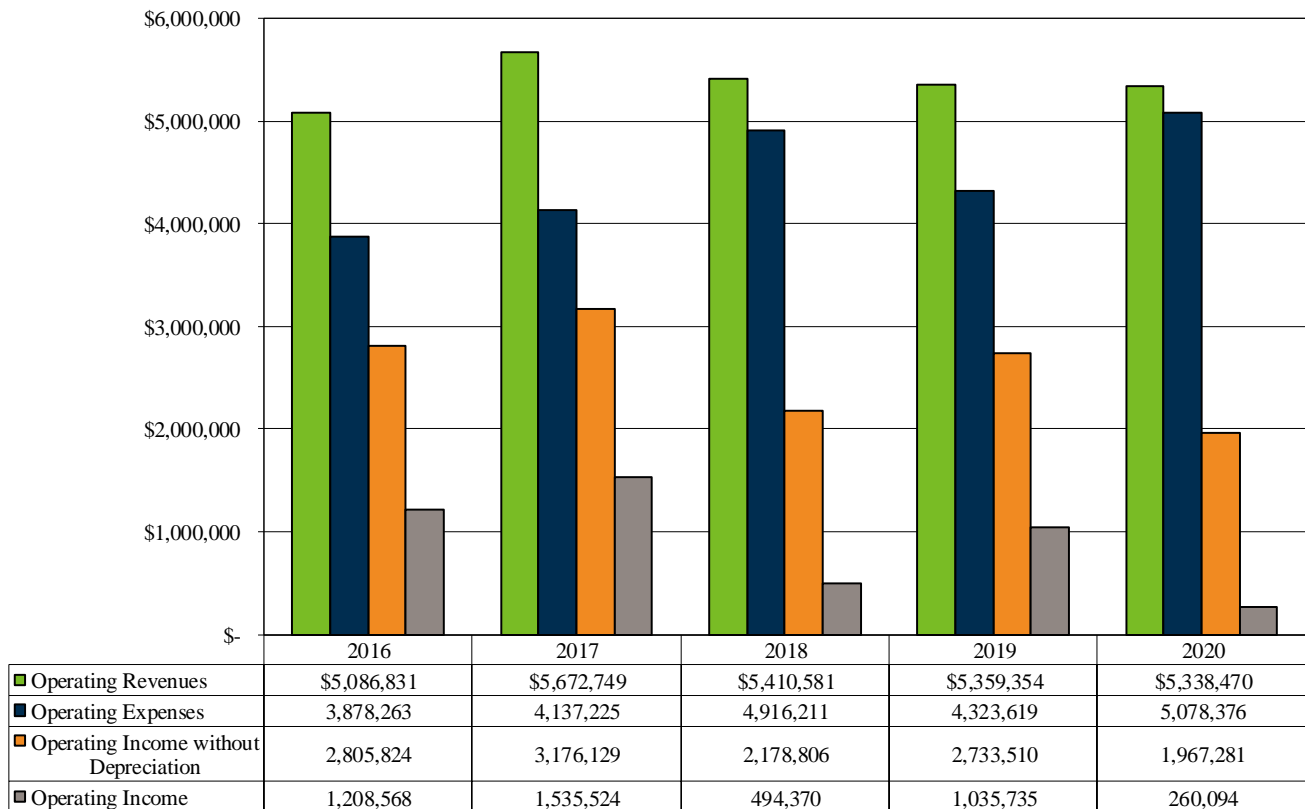
City of Marshall Financial Analysis

Wastewater Treatment Enterprise Fund

The following graph illustrates the current operations of the Wastewater Treatment Fund for the past five years. Operating income is shown with and without depreciation below.

Operating revenue decreased \$20,884, or 0.4%, from 2019 while operating expenses increased by \$754,757, or 17.5%. The increase is primarily due to increased professional services expenses related to the timing of significant planning activity for the wastewater treatment upgrades. The net effect of the decreased revenues and increased expenses is operating income of \$260,094, which is a decrease of \$775,641 compared to 2019.

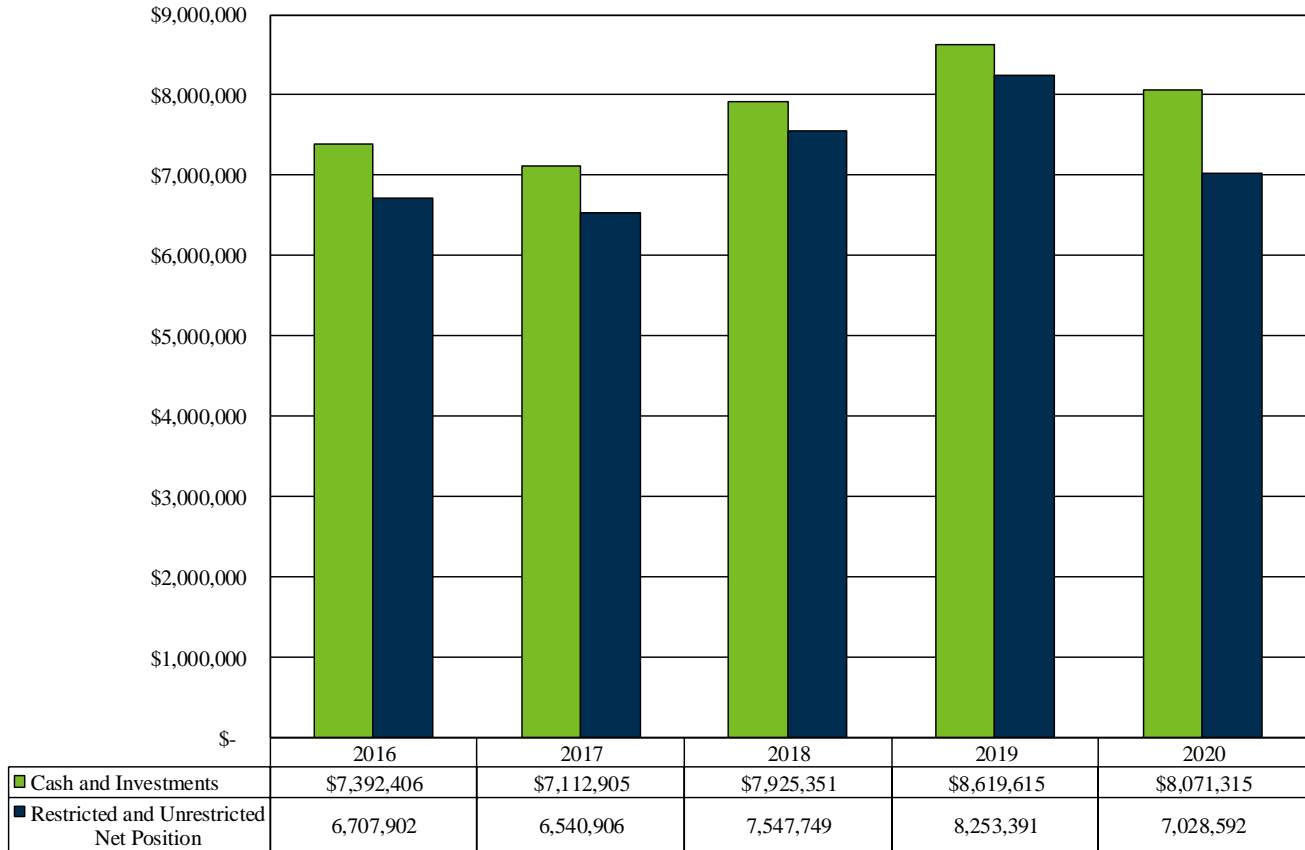
Wastewater Treatment Operations



**City of Marshall
Financial Analysis**

Wastewater Treatment Enterprise Fund (Continued)

Wastewater Treatment Fund



The above graph shows the cash and investment balances and restricted and unrestricted net position balances as of December 31 for the last five years. The cash and investment balance decreased \$548,300 during 2020 while the restricted and unrestricted net position for the Wastewater Treatment Fund decreased \$1,224,799 during the same time period. This was due to significant funds being spent for construction of the wastewater treatment upgrades during 2020. Unrestricted net position as of December 31, 2020 was \$5,034,918.

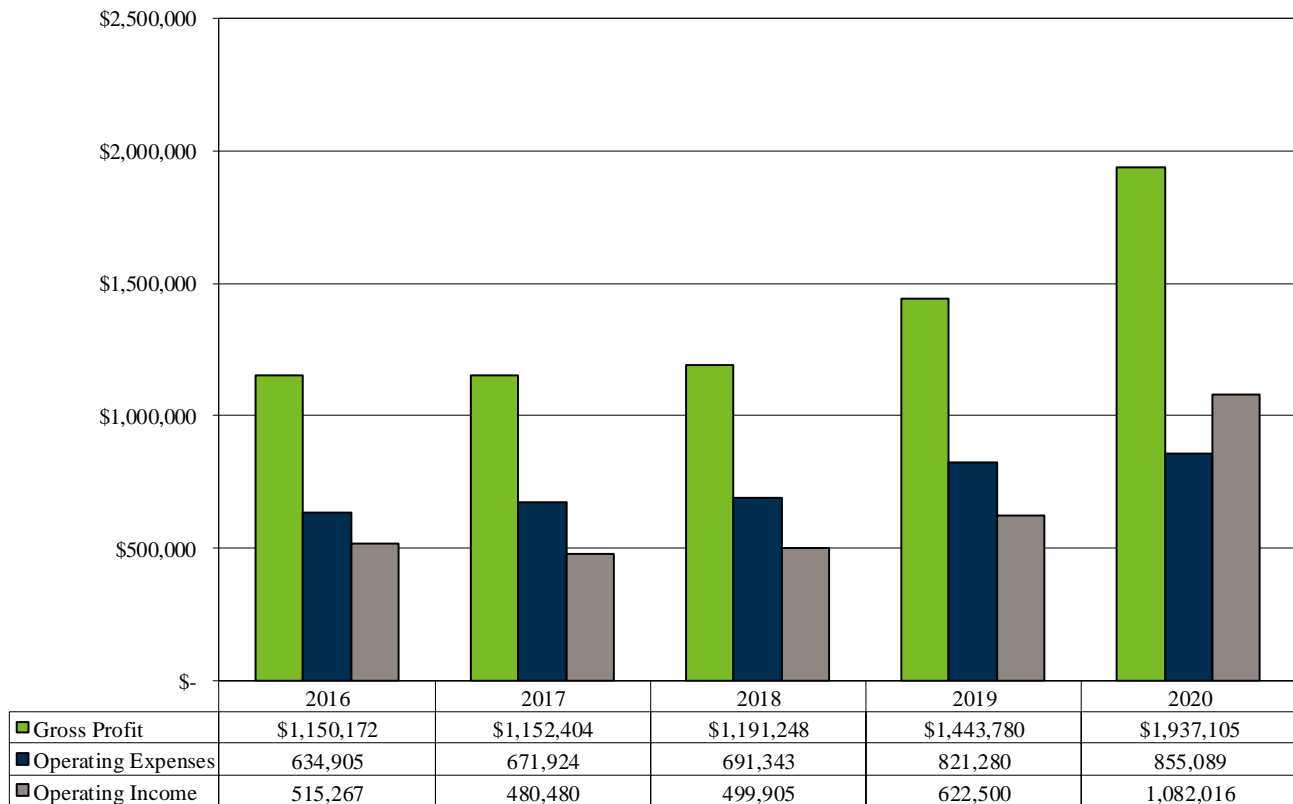
City of Marshall Financial Analysis

Municipal Liquor Store Enterprise Fund

The following graph illustrates the current operations of the Municipal Liquor Store Fund for the past five years.

The Municipal Liquor Store Fund has shown an operating income in each of the five years presented. In 2020, the Fund showed an operating income of \$1,082,016. This is an increase in operating income of \$459,516, or 73.8%, when compared to 2019. The Fund experienced an increase in gross profit of \$493,325 while liquor store expenses increased \$33,809. Revenues likely increased due to the effects of COVID-19 on local bars and establishments along with management monitoring gross profit more closely and adjusting sales price based on current gross profit. The Fund was able to transfer \$300,000 to the General Fund in 2020.

Municipal Liquor Store Operations

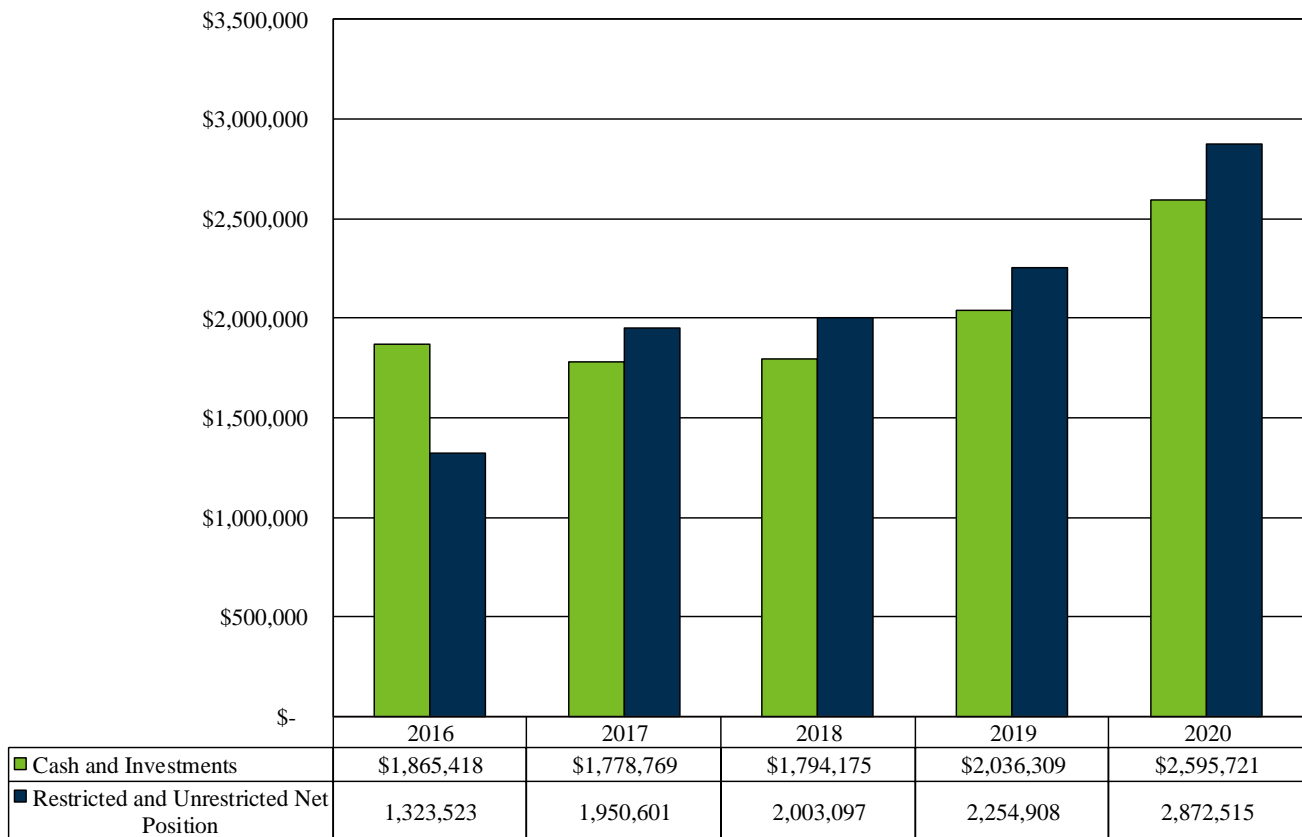


**City of Marshall
Financial Analysis**

Municipal Liquor Store Enterprise Fund (Continued)

The graph below shows the cash and investment balances and restricted and unrestricted net position balances as of December 31 for the last five years. The Municipal Liquor Store Fund cash and investment balance increased \$730,303 while the restricted and unrestricted net position increased \$1,548,992 since 2016 based on strong operations. Unrestricted net position as of December 31, 2020 was \$1,151,843.

Municipal Liquor Store Fund

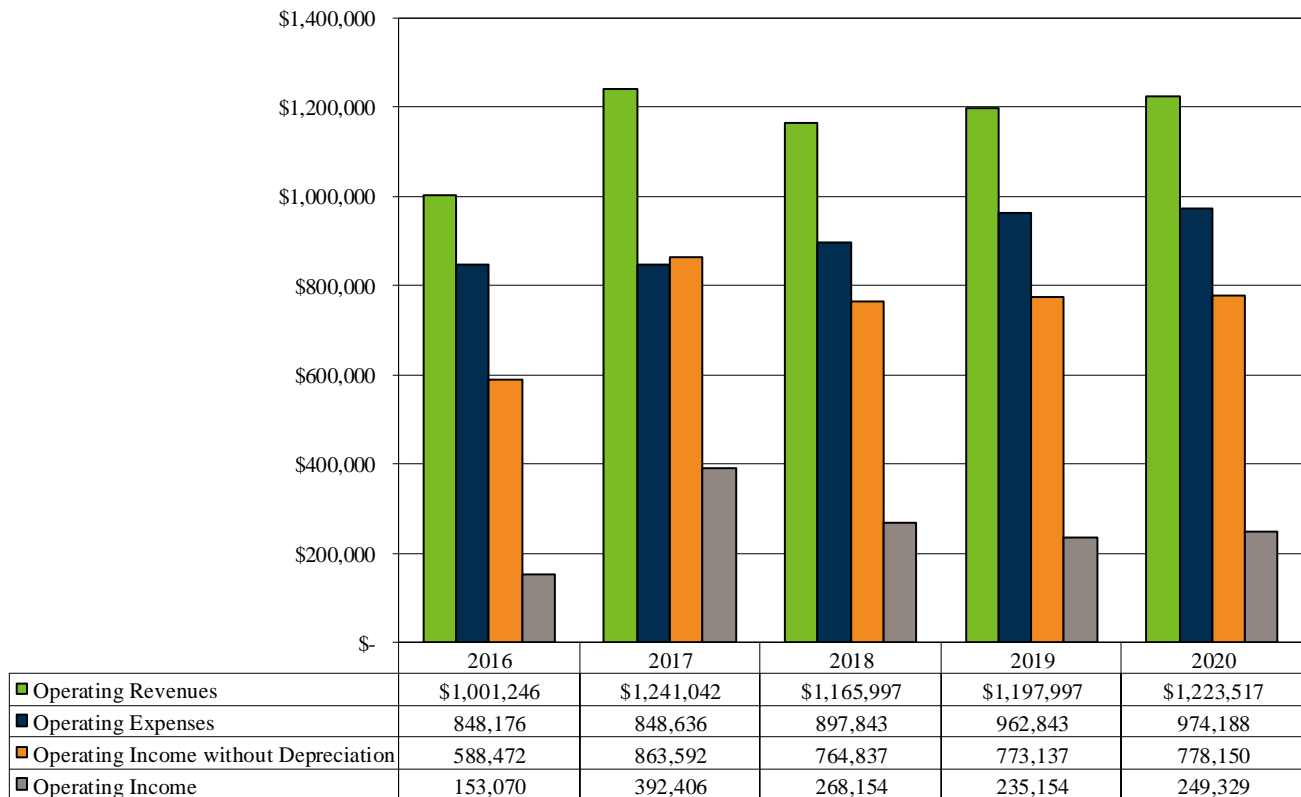


City of Marshall Financial Analysis

Surface Water Management Enterprise Fund

The following graph illustrates the current operations of the Surface Water Management Fund for the past five years. For all five years shown, the City's Surface Water Management Fund has generated an operating income. Operating revenue increased \$25,520 or 2.1% while expenses increased \$11,345 or 1.2% compared to 2019. The net effect of the changes in revenues and expenses is operating income of \$249,329.

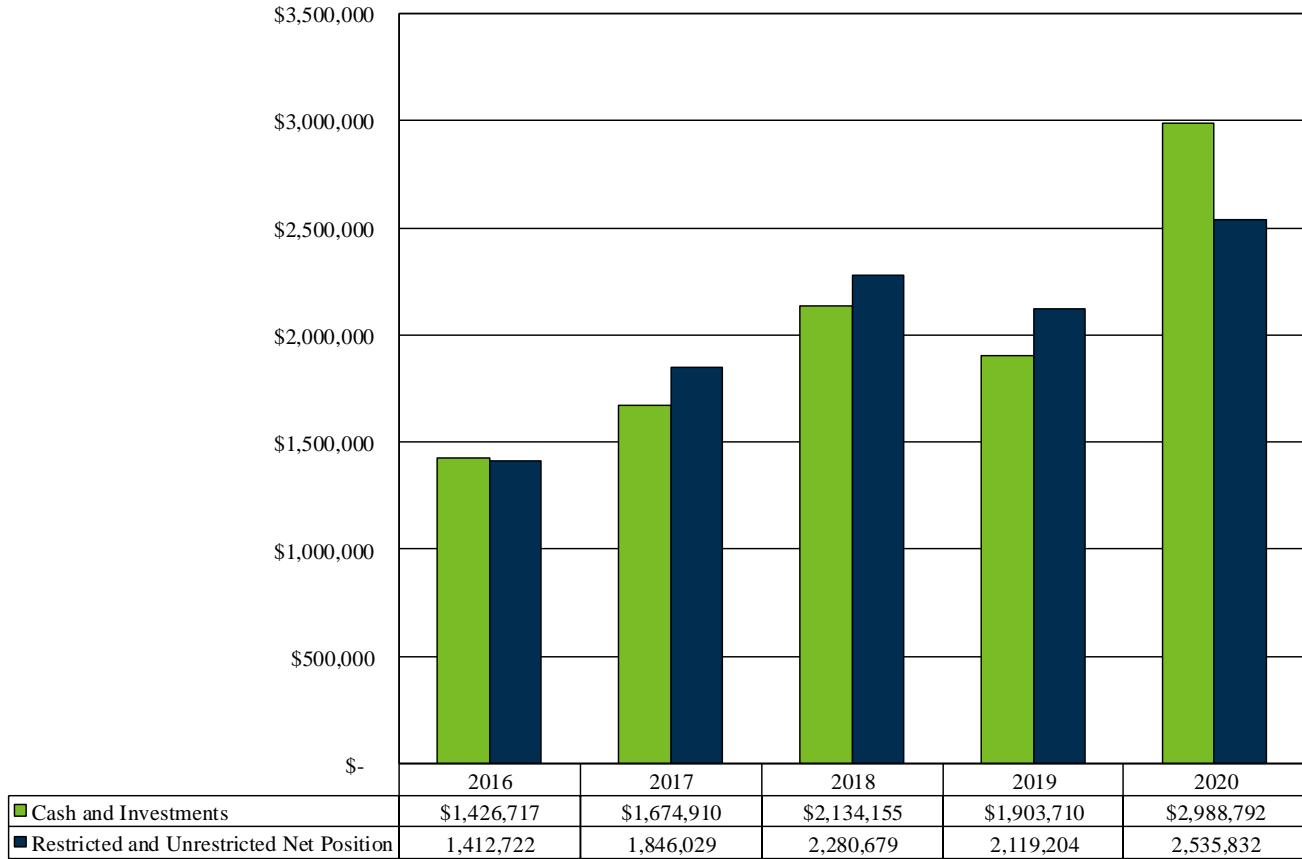
Surface Water Management Operations



**City of Marshall
Financial Analysis**

Surface Water Management Enterprise Fund (Continued)

Surface Water Management Fund



As of December 31, 2020, the Surface Water Management Fund had a net cash and investment balance of \$2,988,792. This is an increase of \$1,085,082 compared to 2019 which related to the issuance of bonds in 2020. Restricted and unrestricted net position at year-end 2020 was \$2,535,832 an increase of \$416,628 compared to 2019. Unrestricted net position as of December 31, 2020 was \$2,252,604.

City of Marshall Financial Analysis

Governmental Activities

The tables below and on the following page illustrate the City's various sources of revenue and expenditures per capita over a three-year period in comparison to 2019 data for Minnesota cities ranked by various sizes.

Governmental Funds Revenue Per Capita with State-Wide Averages by Population Class						
Year Population	State-Wide*			City of Marshall**		
	December 31, 2019			2018	2019	2020
	2,500-10,000	10,000-20,000	20,000-100,000	13,783	13,835	13,851
Property taxes	\$ 514	\$ 489	\$ 512	\$ 607	\$ 650	\$ 651
Tax increments	30	28	44	54	22	26
Franchise fees and other taxes	44	50	50	34	35	27
Special assessments	54	38	53	116	99	59
Licenses and permits	40	35	51	19	30	18
Intergovernmental revenues	342	297	201	487	660	452
Charges for services	134	108	115	177	178	139
Other	88	78	79	249	190	181
Total revenue	\$ 1,246	\$ 1,123	\$ 1,105	\$ 1,743	\$ 1,864	\$ 1,553

* State-wide data obtained from the Office of the State Auditor's *2019 Minnesota City Finances Report*. Comparative data for 2020 is not yet available.

** Population was estimated based on latest available data.

The City traditionally receives sizeable intergovernmental revenues, including Local Government Aid and, thus, has consistently produced higher revenues intergovernmental revenues per capita compared to the state averages. Property taxes and the other revenue category have also consistently been above the state averages, due in large part to payments in lieu of taxes from Marshall Municipal Utilities.

City of Marshall Financial Analysis

Governmental Activities (Continued)

Governmental Funds Expenditures Per Capita with State-Wide Averages by Population Class						
Year	State-Wide*			City of Marshall**		
	December 31, 2019			2018	2019	2020
Population	2,500-10,000	10,000-20,000	20,000-100,000	13,783	13,835	13,851
Current						
General government	\$ 152	\$ 128	\$ 107	\$ 229	\$ 250	\$ 191
Public safety	300	282	306	280	288	298
Public works	146	149	119	222	230	281
Parks and recreation	104	124	106	178	252	289
Other	74	75	95	43	60	122
Total current	<u>\$ 776</u>	<u>\$ 758</u>	<u>\$ 733</u>	<u>\$ 952</u>	<u>\$ 1,080</u>	<u>\$ 1,181</u>
Capital outlay and construction	<u>\$ 436</u>	<u>\$ 376</u>	<u>\$ 358</u>	<u>\$ 586</u>	<u>\$ 489</u>	<u>\$ 601</u>
Debt service						
Principal	\$ 168	\$ 182	\$ 88	\$ 245	\$ 321	\$ 261
Interest and fiscal	43	41	28	82	77	82
Total debt service	<u>\$ 211</u>	<u>\$ 223</u>	<u>\$ 116</u>	<u>\$ 327</u>	<u>\$ 398</u>	<u>\$ 343</u>

* State-wide data obtained from the Office of the State Auditor's *2019 Minnesota City Finances Report*. Comparative data for 2020 is not yet available.

** Population was estimated based on latest available data.

The City's current, capital outlay, and debt service expenditures were all higher than the state-wide average for a city of a comparable population. Current expenditures increased in 2020 as expected related to the spending of CARES funding. Capital outlay and construction costs per capita also increased in 2020 in relation to the ongoing construction projects including City Hall. Debt service expenditures per capita were fairly consistent from 2018 through 2020. Overall, governmental expenditures increased \$158 per capita when comparing 2019 to 2020.

City of Marshall Emerging Issue

Executive Summary

The following is an executive summary of financial and business related updates to assist you in staying current on emerging issues in accounting and finance. This summary will give you a preview of the new standards that have been recently issued and what is on the horizon for the near future. The most recent and significant update includes:

- **Accounting Standard Update – GASB Statement No. 87 – Leases** – GASB has issued GASB Statement No. 87 relating to accounting and financial reporting for leases. This new statement establishes a single model for lease accounting based on the principle that leases are financing of the right to use an underlying asset.

The following is an extensive summary of the current update. As your continued business partner, we are committed to keeping you informed of new and emerging issues. We are happy to discuss this issue with you further and their applicability to your City.

Accounting Standard Update – GASB Statement No. 87 – Leases

The objective of this Statement is to better meet the information needs of financial statement users by improving accounting and financial reporting for leases by governments. This Statement increases the usefulness of governments' 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. It establishes a single model for lease accounting based on the foundational principle that leases are financings of the right to use an underlying asset. 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.

A lease is defined as a contract that conveys control of the right to use another entity's nonfinancial asset (the underlying 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.

A short-term lease is 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.

City of Marshall
Emerging Issue

Accounting Standard Update – GASB Statement No. 87 – *Leases* (Continued)

A lessee should recognize a lease liability and a lease asset at the commencement of the lease term, unless the lease is a short-term lease or it transfers ownership of the underlying asset. The lease liability should be measured at the present value of payments expected to be made during the lease term (less any lease incentives). The lease asset should be measured at the amount of the initial measurement of the lease liability, plus any payments made to the lessor at or before the commencement of the lease term and certain direct costs. A lessee should reduce the lease liability as payments are made and recognize an outflow of resources (for example, expense) for interest on the liability. The lessee should amortize the lease asset in a systematic and rational manner over the shorter of the lease term or the useful life of the underlying asset. The notes to financial statements should include a description of leasing arrangements, the amount of lease assets recognized, and a schedule of future lease payments to be made.

A lessor should recognize a lease receivable and a deferred inflow of resources at the commencement of the lease term, with certain exceptions for leases of assets held as investments, certain regulated leases, short-term leases, and leases that transfer ownership of the underlying asset. A lessor should not derecognize the asset underlying the lease. The lease receivable should be measured at the present value of lease payments expected to be received during the lease term. The deferred inflow of resources should be measured at the value of the lease receivable plus any payments received at or before the commencement of the lease term that relate to future periods. A lessor should recognize interest revenue on the lease receivable and an inflow of resources (for example, revenue) from the deferred inflows of resources in a systematic and rational manner over the term of the lease. The notes to financial statements should include a description of leasing arrangements and the total amount of inflows of resources recognized from leases.

GASB Statement No. 87 is effective for fiscal years beginning after June 15, 2021.

Information provided above was obtained from www.gasb.org.