

City of Woodbury

Audit and Investment Commission Minutes June 23, 2023

Pursuant to due call and notice thereof, a meeting of the Audit and Investment Commission was held at Woodbury City Hall, 8301 Valley Creek Road, on the 23rd day of June 2023.

Item 1: Call to Order / Roll Call

Chair Lehman called the meeting to order at 7:30 a.m.

Upon roll call, the following members of the Audit and Investment Commission were present: Gracie George, Cody Groth, Jeanine Kuwik, John Lehman, Ross Tollefson, and Annmarie Weiser.

Absent: Frank Gilbertson, Alec Sonsteby

Others present: Angela Gorall, Assistant City Administrator; Jason Schirmacher, CFO/Controller; Kim Wilson, Council Member; Mary Van Milligan, Public Works Director (Virtual); Roxy Nowicki, Recording Secretary, Matt Mayer, Auditor, BerganKDV; Ryan Engelstad, BerganKDV; Mark Panny, Carollo (Virtual)

Item 2: Approval of Minutes – March 24, 2023

Moved by Member Lehman and seconded by Member Tollefson to approve the March 24, 2023 minutes.

Voting in favor: All present Voting Against: None Absent: Frank Gilbertson, Alec Sonsteby

Item 3: City of Woodbury Audit Results

Independent Auditor's Report: Mr. Mayer stated he will be retiring from BerganKDV and introduced his colleague, Ryan Englestad. Mr. Mayer stated the audit is represented by three different documents – the Annual Comprehensive Financial Report (ACFR), which is the official financial statement of the City, a Communications Letter and a Compliance Report. He stated that there were some typographical errors in the ACFR where a neighboring city's name was listed instead of Woodbury, but it does not take away from the accuracy of the data. Replacement copies have been provided.

Mr. Englestad began his presentation by talking about the audit process. It is the City's responsibility to make sure there is fair presentation of the financial information and appropriate maintenance of internal controls. It is BerganKDV's role as auditor to design an audit approach that adheres to the relevant professional standards. With a combination of gaining an understanding of the controls that are in place and various substantive testing procedures, it gets the auditors in a position where they can provide reasonable assurance that there will not be material misstatements that would go undetected as part of the process. The term reasonable assurance is used very intentionally as part of the standards, it is meant to

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provide a high level of confidence (90-95 percent) that there will not be any material misstatements that would go undetected.

As part of the audit, the auditors render an opinion on the financial statements and in regards to compliance. The type of opinion that is provided to the City is an unmodified or clean opinion. That is the optimal result when it comes to financial statements.

Mr. Englestad stated there were no findings when it came to the Legal Compliance Report that is required by the Minnesota Office of the State Auditor to ensure that the City is complying with all the statutes that apply to municipalities. There were also no material weaknesses or significant deficiencies pertaining to internal control.

Mr. Englestad continued by stating that any time an entity incurs more than \$750,000 in expenditures tied to Federal grants within a fiscal year, there is a requirement for a separate compliance audit. The total grant expenditures for the City for 2022 were about \$1.8 - \$1.9 million. The focus of the testing was on the grant from the Department of Transportation in the amount of approximately \$800,000 related to a street project. There were no compliance findings or internal control matters to report.

Member Tollefson asked about two significant risks that were mentioned - one is management override and revenue recognition. He asked if these unmanageable risks are always present. Mr. Englestad stated that as prescribed by the audit standards, it is required to consider those two as significant risks as part of every audit engagement that is performed, and everything checked out fine. Member Lehman stated that in the future it may be beneficial to state that this is standard operating procedure.

General Fund Budget - Mr. Mayer stated that there are two metrics in evaluating the success of the general fund for the year: (1) compliance with the budget as established by the City Council, and (2) financial health as measured by the City's fund balance policy.

General Fund Budget – Budget to Actual – Mr. Mayer stated in an appropriate governance model, the City Council approves the budget as part of the year-end process. That budget is a directive to Administration on how the City should be run for the next year. Council has the responsibility to establish and monitor it, and the City has the responsibility to execute it. Mr. Mayer further reviewed the results and a short discussion ensued about the investment income which was reflected in the Fines, Forfeitures and Other category.

Mr. Mayer continued talking about expenditures. City Council authorized spending in the General Fund of \$44.4 million. The City kept spending significantly below that by approximately \$2.7 million. Most of the variances are negative with the exception of Debt Service and Capital Outlay, which means that the main operating functions of the City all came in within the parameters set by City Council. A significant portion of the negative variances are personnel related. Rather than a \$1.9 million drop in fund balance, there was actually a \$2.5 million increase in fund balance. The City out-performed by approximately \$4.4 million.

After a short discussion, Mr. Mayer continued with his presentation.

General Fund Budget – Fund Balance – This is the financial health of the City as measured by the reserve funds that are available at the end of the year. In 2022, the fund balance was \$19.2 million, which is the highest over the course of the five-year period. He went on to say that a

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better way to look at fund balance is as a percentage of spending. The City policy is to have an unassigned fund balance of at least 30 percent going into the next year. That has been exceeded each year. 2022 ended with 40.2 percent fund balance.

Mr. Mayer stated that the main revenue stream of the General Fund is the property tax levy, which does not come in until May or June of the subsequent year. From a cash flow standpoint, the General Fund is going to need at least these level of resources to get through the first four to five months of the year until the first property tax payment comes in.

General Fund – Revenues and Other Sources – Revenue for the 2022 fiscal year, along with transfers, was approximately 7.5 percent higher than it was in 2021. A big chunk of that was transfers in; if you factor those transfers out of the equation, there was only approximately a \$700,000 increase in revenue year over year. The levy did go up approximately \$2.7 million; that was offset significantly by the negative adjustment to the investment portfolio.

General Fund – Revenues by Source – For the 2022 fiscal year, because of the negative impact of the other revenue, the property tax reestablished itself as the most significant revenue stream of 75 percent of the dollars coming in to the General Fund.

General Fund – Expenditures by Function – Spending for the year was up approximately 15 percent year over year, about \$5.5 million in the General Fund. Public Safety continues to be the main priority of the General Fund operation, and with EMS rolled into that, rather than having a separate fund, that will most likely establish a new benchmark.

The Enterprise activity is business-type oriented. The analysis is different for these funds in that they look at whether these funds are generating operating income. Operating income in the public sector is not so much for wealth building, shareholder performance or return on investment as it is for just covering the cost of doing business. The intent is that the user fees are sufficient to cover the cost of providing the particular service.

Enterprise Activities – Sports Center – Revenue is starting to come back since the Covid shutdown in 2020. Operating expenses continue to increase, but they are somewhat exaggerated this year because the pension expense related to this fund is factored in. This fund is positively cash flowing from operations and the user fees, rental income, etc. are appropriately set to cover the cost of doing business in this fund.

Ms. Gorall stated that performance measures were recently presented to Council. These can be found on the City's website at <http://www.woodburymn.gov/190/Performance-Reporting>. This site is full of data and you can find out more detail about all of the departments.

Street Lighting Fund – This fund is relatively static, although it did take a step back this year. This is one fund that started to feel the effects of inflation, specifically on utilities. Revenue has been flat each of the last five years, while those expenses have started to tick up.

Water and Sewer Utility Fund - Water usage was down last year by approximately one percent. There was a change to the rate structure which helped the revenue stream and also new customers coming online. One of the main expenses of this fund is a payment to the Met Council for processing of waste, their fees went up fairly significantly.

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Mr. Schirmacher noted expenses are being incurred for the water treatment plant, some will be reimbursed from the 3M settlement and state grants, and some will get capitalized.

Storm Water Fund – There is a steady increase in revenue in this fund. This fund does not have a consistent operating expense, it is mostly one-time maintenance projects, such as pond dredging or street sweeping. It was a little more active year in 2022. This fund does have reasonable reserves in place.

Eagle Valley Golf Course – This fund has done incredibly well. Mr. Mayer stated they work with approximately 100-110 cities across four or five states and this may be one of the last golf courses that is actually presented as an enterprise fund. A lot of golf courses are struggling and have basically been moved into governmental operations as part of Parks and Recreation, whereas at Woodbury, it is a stand-alone operation and is doing very well. A discussion ensued about the fund balance in the Eagle Valley Golf Course Fund.

Tax Capacity, Levy and Rates – Tax capacity is an artificial number created by the state that is calculated based on the market value. The tax capacity rate went from 33.6 percent in 2018 down to 32.2 percent in 2022. The growth of the levy has stayed in line with the growth of the tax base.

After a short discussion, Mr. Mayer continued with his presentation.

Government Funds – Revenue Per Capita – Mr. Mayer stated the Office of the State Auditor puts out a report each year that provides per capita revenue for municipalities, he further reviewed Woodbury in comparison to comparable cities. A short discussion on demographics ensued.

Government Funds – Expenditures Per Capita – Expenditures are divided into three categories:

1. Current expenditures which is the everyday operating costs of running the City (a typical city in the peer group spent \$739 per capita and Woodbury spent \$639).
2. Capital, which is the investment in roads, equipment and infrastructure, which fluctuates year to year based on project costs and project needs (a typical City in the peer group was at \$317 per capita and Woodbury was at \$257).
3. Debt Service, which is the payment of principal and interest on outstanding debt (a typical city in the peer group spent \$144 per capita and Woodbury spent \$74).

A question was asked about the peer group population size of 20,000 – 100,000 being such a big span. Mr. Mayer stated that is the data received from the state. The City may want to consider identifying cities to be included in the peer group.

Mr. Mayer thanked the commission members for the opportunity to present. Mr. Lehman thanked Mr. Mayer for his stewardship over the years.

A motion was made to accept the 2022 audit results as presented by Bergan KDV. Moved by Member Kuwik, seconded by Member Groth.

Voting in favor: All present Voting Against: None Absent: Frank Gilbertson, Alec Sonsteby

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Item 4: Review of 2024 Utility Rates and Recommendation with Carollo

Mr. Schirmacher stated that the Water and Sewer Fund Balance Policy was brought to the Commission for review in March of 2023. The proposed rates are being brought to the Commission prior to being presented to Council. He then introduced Mark Panny from Carollo who is working with the City on the proposed rates.

Mr. Panny then began his presentation by reviewing the modeling assumptions:

- Reserve Targets
- Conceptual Drinking Water Supply Plan
- Growth and Demand
- Inflation

Member Tollefson asked what was used to anchor inflation estimates, as he thought they were higher than what he has seen elsewhere. Mr. Panny stated that for 2024, they have updated the model with the latest City budget, which is more than six percent. He said it is in line with what they have seen across the industry as far as increases in energy and chemical costs. It is higher than historical standards. Prior to 2021, they would use three or four percent, but now it is much greater than that. There is uncertainty with what inflation will be in 2025 and beyond.

Member Kuwik asked if they had a sense with what the trend would be regarding the Met Council Environmental Services (MCES) increase. Mr. Schirmacher stated the 6.8 percent number came directly from MCES and is a direct pass through to MCES, so that will be neutral as far as revenues and expenses go.

After a short discussion, Mr. Panny continued with his presentation talking about the two-day per week watering restrictions that were enacted. Overall, they are anticipating a 7.6 percent decrease in total sales in 2024.

A short discussion ensued about enforcement of restrictions. Ms. Gorall stated the City is taking an educational approach – sent out postcards, put in newsletters, social media. The City does have citation enforcement ability – but they want to take an educational approach first. The City is reaching out to management companies of commercial properties to educate them.

Mr. Panny continued with his presentation talking about the five-year forecast of water and sewer cash flow. In 2024, water rate increase of eight percent and sewer increase of four percent for the non-Met Council charges. Watering restrictions projected to reduce sales revenues by approximately four to five percent in 2024 (approximately \$800,000). For 2025 and beyond, they are projecting that rates will keep pace with cost escalation. That is sufficient to cover operating and capital expenses for 2024. For 2027 and beyond, revenues are enough to meet operating expenses, but may need to take another look at rate increases for capital expenses.

After a short discussion on rate proposals, Mr. Panny continued with his presentation talking about the reserve forecast.

Mr. Panny then presented the calculated water rate schedule and sewer rate schedule for 2024. He then presented the rate increase for a typical customer for water and sewer – forecasted to increase by approximately seven percent. For a typical customer, the quarterly bill is \$131.40, which would increase to \$140.48. For a non-irrigation commercial customer, a typical account is \$237.35 and would increase to \$254.90.

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A short discussion ensued on revenue generated from commercial versus residential. Mr. Panny then continued by presenting the bill impact for residential customers in context with neighboring agencies. Both in 2023 and 2024, Woodbury's typical customer would be below the regional average.

Chair Lehman asked when the last time the water and sewer rates increased. Mr. Schirmacher stated they increased in 2023, but the increase was smaller than this proposed increase, which is due to watering restrictions and the new policy. After a short discussion, Mr. Schirmacher stated these rates are being presented as a floor, and he would welcome the conversation if the Commission has an opinion on if rates should be increased a little more to smooth out those further future increases. It is not being proposed at this time, but he would welcome any feedback from the Commission.

Member Groth had a question on slide 6 which showed all the rate increases and the tiers. He asked if there is a way to incentivize people who are trying to conserve water and increasing the rates in Tier 2 and higher. Mr. Schirmacher stated that with quarterly billing, it's hard for residents to realize how much they are watering since the bill is delayed from when the watering actually happens. The City is exploring the possibility of going to monthly billing in the future and, at that time, they will consider redoing the tiers.

After a short discussion regarding higher rates for higher tiers and monthly billing, Ms. Gorall asked if there were any objections to the policy changes.

Member Tollefson stated it does make a lot of sense. The question for Council would be if they want to consider that smoothing where you would take an incremental increase as you go to bridge where you think you need to be for PFAS as you learn more. Just something for thought, but he thinks the eight percent makes sense.

After a short discussion, Member Groth stated he had two suggestions:

1. There should be something that shows commercial versus residential split.
2. There should be some type of a chart that shows how much of residential and commercial are in what tier mid-summer versus the winter

Chair Lehman thanked Mr. Panny and Ms. Van Milligen.

Meeting adjourned at 9:15 a.m.

Approved by the Audit and Investment Commission on September 22, 2023.