City of Princeton
Mille Lacs County and
Sherburne County, Minnesota

Communications Letter

December 31, 2019

City of Princeton
Table of Contents

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

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

In planning and performing our audit of the financial statements of the governmental activities, business-type activities, the aggregate discretely presented component unit, each major fund, and the aggregate remaining fund information of , Minnesota, as of and for the year ended December 31, 2019, in accordance with the auditing standards generally accepted in the United States of America, 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 opinion 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.

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. However, as discussed below, we identified certain deficiencies in internal control that we consider to be significant deficiencies.

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.

We did not identify any deficiencies in internal control that we consider to be material weaknesses.

A significant deficiency is a deficiency, or 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 significant deficiency identified is stated within this letter.

During our audit, we also became aware of deficiencies in internal control other than significant deficiencies or material weaknesses, and other matters that is an opportunity for strengthening internal controls and operating efficiency. They is described in the accompanying letter under Other Deficiencies.

The City's written responses to the audit findings have not been subjected to audit procedures applied in the audit of the financial statements and, accordingly, we express no opinion on them.

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 June 17, 2020, on such statements.

This communication is intended solely for the information and use of management, the City Council, 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.

Bergan KDV, Ltd.

St. Cloud, Minnesota
June 17, 2020

City of Princeton
Significant Deficiency

Lack of Segregation of Accounting Duties

During the year ended December 31, 2019, the City had a lack of segregation of accounting duties due to a limited number of office employees. The lack of adequate segregation of accounting duties could adversely affect the Company's ability to initiate, record, process, and report financial data consistent with the assertions of management in the financial statements. Although this meets the definition of a significant deficiency, it may not be practical to correct since the costs of obtaining desirable segregation of accounting duties may exceed benefits that could be derived. This lack of segregation of accounting duties can be demonstrated in the following areas, which is not intended to be all-inclusive:

- The Finance Clerk inputs payroll information, such as employee hours worked, creates checks, and has custody of checks until distribution to department heads.
- The Finance Director receives the investment statements, records maturities, and issuances of new investments and posts entries into the accounting system for interest receivable, revenue, and market value changes in investments.
- The Finance Director records and maintains capital asset records.
- Bank reconciliations are completed by the Finance Director and not reviewed.
- The Finance Clerk generates and mails invoices, records payments in the City's accounting system, writes up deposits, and brings the deposits to the bank.

In addition to having responsibilities in the cycles listed above, the City's Finance Director has full general ledger access and the ability to write and post journal entries. While we believe this access is necessary to efficiently perform the financial duties required, this access has the ability to override many of the controls and segregation the City has in place.

Management is aware of this condition and will take certain steps to compensate for the lack of segregation. However, due to the small accounting staff needed to handle all of the accounting duties, the cost of obtaining desirable segregation of accounting duties can often exceed benefits which could be derived. Due to this reason, management has determined a complete segregation of accounting duties is impractical to correct.

We recommend management, along with the City Council remain aware of this situation, and continually monitor the accounting system including changes that occur.

City's Response

The City agrees with the auditor's analysis of the situation. It seems impossible to correct the current situation without additional personnel. Even having cursory review by someone outside of the Finance Department would not seem beneficial without significant training and exposure to the financial transactions. The City has taken measures to help reduce the exposure by requiring three different people at all times to sign or stamp every check. Also, review of this point on what will be an annual basis during the audit presentation, should remind both management and the City Council of the weakness and possible problems that could result.

City of Princeton
Other Deficiencies

Monitor Liquor Store Inventory

During our audit, we tested a sample of inventory at the City's liquor store. The amounts listed on the liquor store's inventory reports differed from the amounts on hand at the store for some items tested. Of the 52 items tested, 22 items differed from the inventory reports to the amount on hand; some items were understated while others were overstated, resulting in an overall projected difference to the inventory balance of $13,614.

We recommend the City and the Liquor Store Manager continue to monitor the inventory at the store, reconcile any variances on a regular basis and document adjustments to the inventory system.

City's Response

Spot checks will continue to be performed every other month by Finance Department personnel.

Even though the impact of the misstated inventory is not material or significant, it indicates that there is room for improvement in the recording of inventory purchases and sales. The City installed a new Point of Sale (POS) system to help improve accuracy in both purchases and sales of inventory product, which has improved our inventory count variances during 2019. Along with that system improvement, we purchased a handheld scanner that will make inventory counting easier and more accurate that will integrate into the new POS system.

Develop a Plan for Negative Fund Balances and Close Funds with Limited Activity
At December 31, 2019, twenty-three of the City's funds had a deficit fund balance: Economic Development Authority, Community Projects, Development Grants, Development Expenses, Fire Department Grants, Stormwater Management, Park Improvements, Western Area Improvements, 1999 Street and Utilities Improvements, Heritage Village, Northland/Old 18 Improvements, MN Industrial Coatings Expansion District, West Branch and 7th Avenue North, Roundabout Project, Arcadian Homes Utility Project, 2000 Street and Utility Improvements, Kwik Trip Redevelopment District, Casey's Redevelopment District, AERO Business Redevelopment District, Industrial Park Redevelopment District, Industrial Park Development, TIF 8-4 Chino Development, and West Branch TIF.

We also noted 15 of the City's funds had limited or no activity during 2019: Investigation Information Buy Fund, Felony Investigation, Development Grants, Stormwater Management, 1999 Industrial Park Improvements, 2002/2003 1st Street Improvements, 2nd and 7th Improvements, 1992 Street and Utilities, 1993 Street and Utilities, 1999 Street and Utilities Improvements, Heritage Village, Northland/Old 18 Improvements, West Branch and 7th Avenue North Projects, 2000 Street and Utility Improvements, and Industrial Park Development.

We recommend the City Council develop a plan to eliminate negative fund balances in these funds. In addition, the City should review the process of incurring project development costs for capital projects that may not come to fruition and develop a policy for funding start-up costs. We also recommend the City close funds that have fulfilled its purpose.

City's Response
Some of the funds with deficit balances are a timing issue and will correct themselves once all revenue and adjustments are made. In addition, in 2020, the City will work on developing a plan to eliminate fund deficits in other funds.

City of Princeton
Required Communication

We have audited the basic financial statements of the governmental activities, business-type activities, the aggregate 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 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 taken 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 Princeton
Required Communication

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 the year ended 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 were:

> Depreciation – The City is currently depreciating its capital assets over their estimated useful lives, as determined by management, using the straight-line method.
>
> 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 Relating to Pensions, and Deferred Inflows of Resources relating to Pensions – These balances are based on an allocation by the pension plans using estimates based on contributions.

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.

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.

City of Princeton
Required Communication

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 as a whole.

We identified the following uncorrected misstatement of the financial statements. Management has determined its effects are immaterial, both individually and in the aggregate, to the financial statements taken as a whole.

- Liquor inventory was overstated based on test count projections

In addition, 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.

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 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

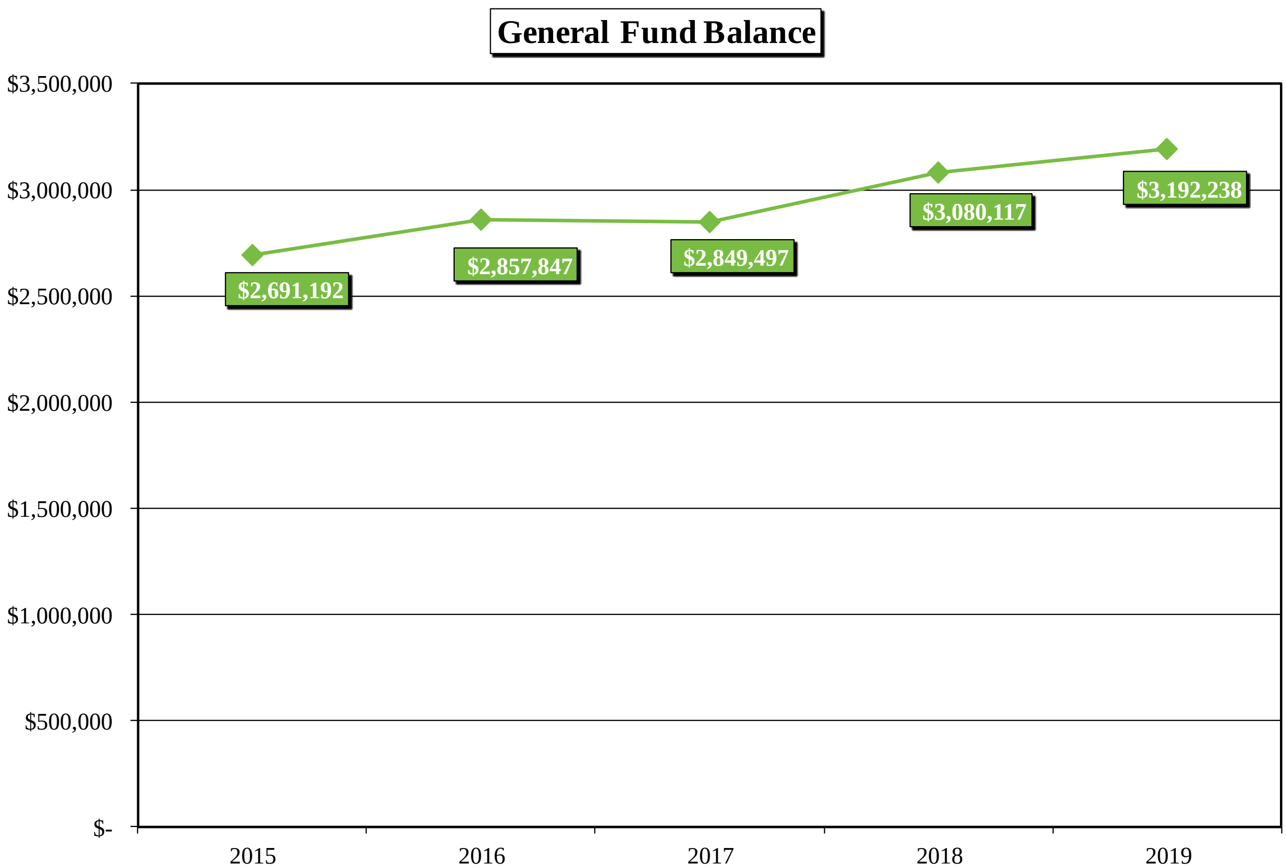
We applied certain limited procedures to the RSI that supplements the basic financial statements. Our procedures consisted of inquiries of management regarding the methods of preparing the information and comparing the information for consistency with management's responses to our inquiries, the basic 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.

The following pages provide graphic representation 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.

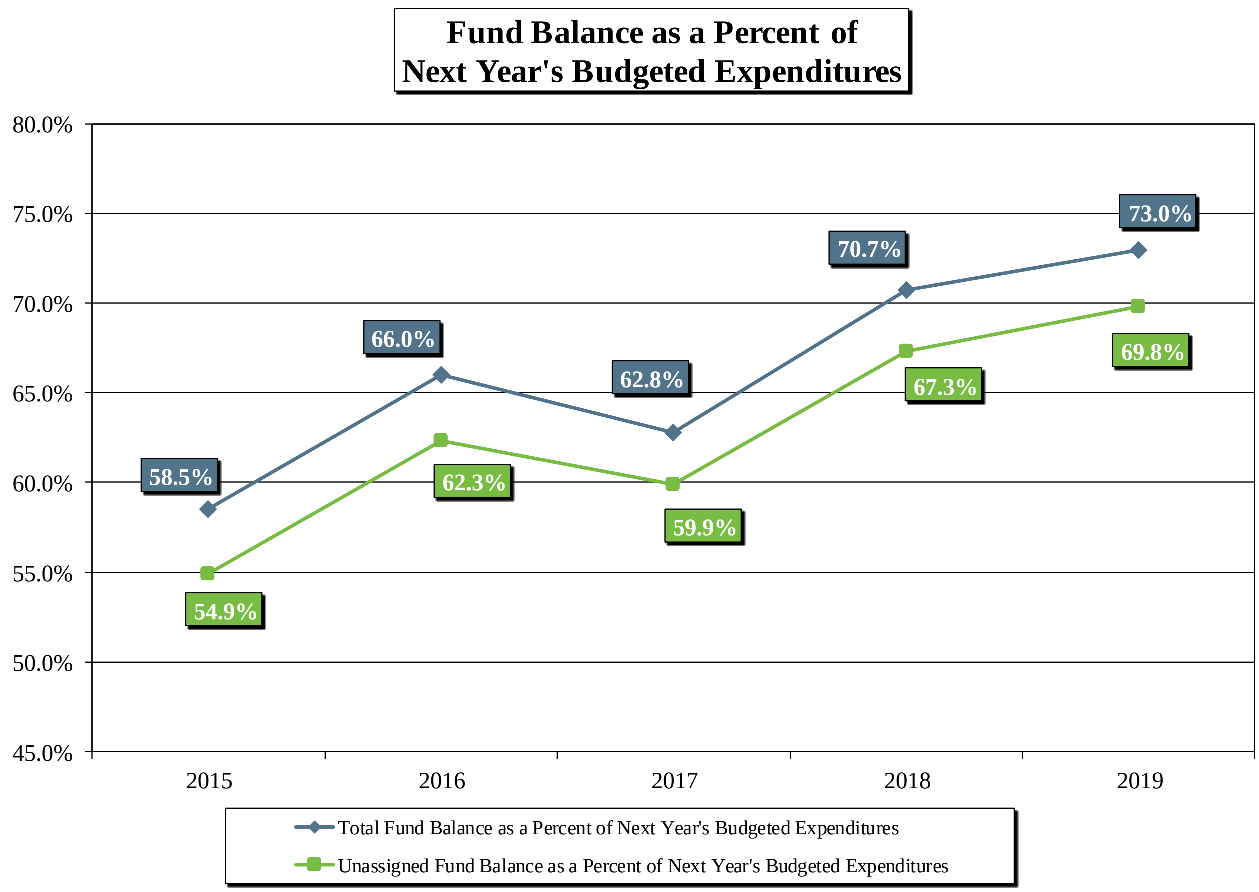
GENERAL FUND

As seen in the following graph, the General Fund balance has increased overall since 2015. Fund balance increased in 2019 by $112,121, or 3.6%. This increase will be reviewed on the following pages.



GENERAL FUND (CONTINUED)

The following graph shows the General Fund's total fund balance and unassigned fund balance as a percent of the following year's budgeted expenditures in the General Fund. Fluctuations in the percentage over the past five years are a result of fund operations. The increase in percentages for 2019 is due to an increase in fund balance from 2018. The current policy of the City is to have 30%-50% of the subsequent year's budgeted expenditures as unassigned fund balance; the City exceeds its policy range at December 31, 2019, by having $3,053,494 in unassigned fund balance at year-end, which is 69.8% of 2020 budgeted expenditures of $4,374,730. This amount is not considered excessive as future intergovernmental funding is uncertain. As General Fund expenditures increase, the fund balance will also need to increase to maintain current or targeted percentage levels.

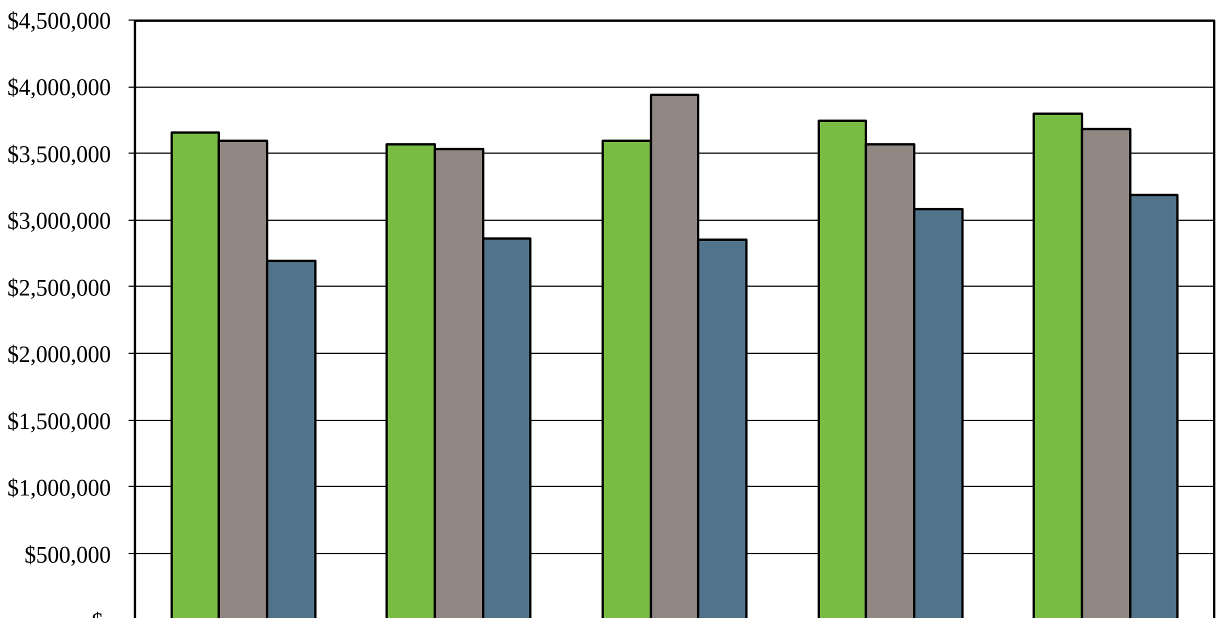


GENERAL FUND (CONTINUED)

The following graph summarizes the past five years of General Fund revenues, expenditures, and fund balance. Revenues, expenditures, and fund balance have increased overall over the last five years.

Revenue and expenditure detail is reviewed on the following pages.

General Fund Revenues, Expenditures and Fund Balance



	2015	2016	2017	2018	2019
Total Revenues	$3,657,031	$3,571,606	$3,597,917	$3,742,999	$3,800,021
Total Expenditures	3,590,970	3,532,127	3,941,467	3,568,501	3,681,770
Fund Balance	2,691,192	2,857,847	2,849,497	3,080,117	3,192,238

GENERAL FUND (CONTINUED)

Total revenues increased $57,022, or 1.5%, from 2018 to 2019, which was due to an increase in miscellaneous revenues of $20,984.

	2015	2016	2017	2018	2019
Revenues					
Property taxes	$ 2,008,054	$ 1,976,123	$ 2,006,291	$ 2,135,999	$ 2,120,859
Licenses and permits	271,459	176,330	174,525	180,854	202,079
Intergovernmental revenues					
Local government aid	838,687	843,732	845,730	888,633	891,888
Other than local government aid	161,202	168,649	183,179	102,116	116,447
Charges for services	235,107	254,624	230,937	266,156	275,628
Fines and forfeitures	25,731	21,917	22,205	28,987	31,882
Miscellaneous	116,791	130,231	135,050	140,254	161,238
Total revenues	$ 3,657,031	$ 3,571,606	$ 3,597,917	$ 3,742,999	$ 3,800,021

Total expenditures increased $113,269, or 3.2%, from 2018. The most significant increase was in public safety expenditures due to increased police and fire department personnel costs as well as the increase in PERA contribution rates. General government expenditures increased by $59,177, or 9.6% due to increased personnel costs. These increases were partially offset by a decrease in parks and recreation of $40,391 mainly due to a decrease in library maintenance and repair expenditures.

The other functions' expenditures were fairly consistent from 2018 to 2019.

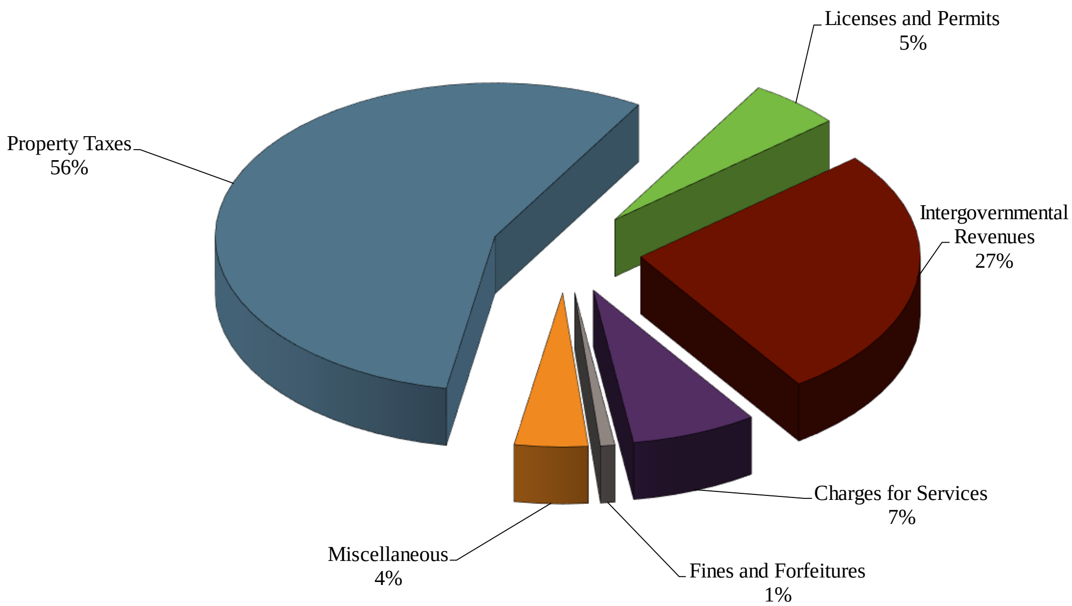
	2015	2016	2017	2018	2019
Expenditures					
General government	$ 607,486	$ 620,482	$ 691,689	$ 617,333	$ 676,510
Public safety	1,675,968	1,672,259	1,699,731	1,727,402	1,797,336
Cemetery	751	701	527	523	651
Public works	646,060	619,371	760,921	739,306	771,372
Parks and recreation	270,313	257,541	261,025	277,471	237,080
Economic development	51,201	22,124	37,143	16,739	7,617
Capital outlay	339,191	339,649	490,431	189,727	191,204
Total expenditures	$ 3,590,970	$ 3,532,127	$ 3,941,467	$ 3,568,501	$ 3,681,770

City of Princeton
Financial Analysis

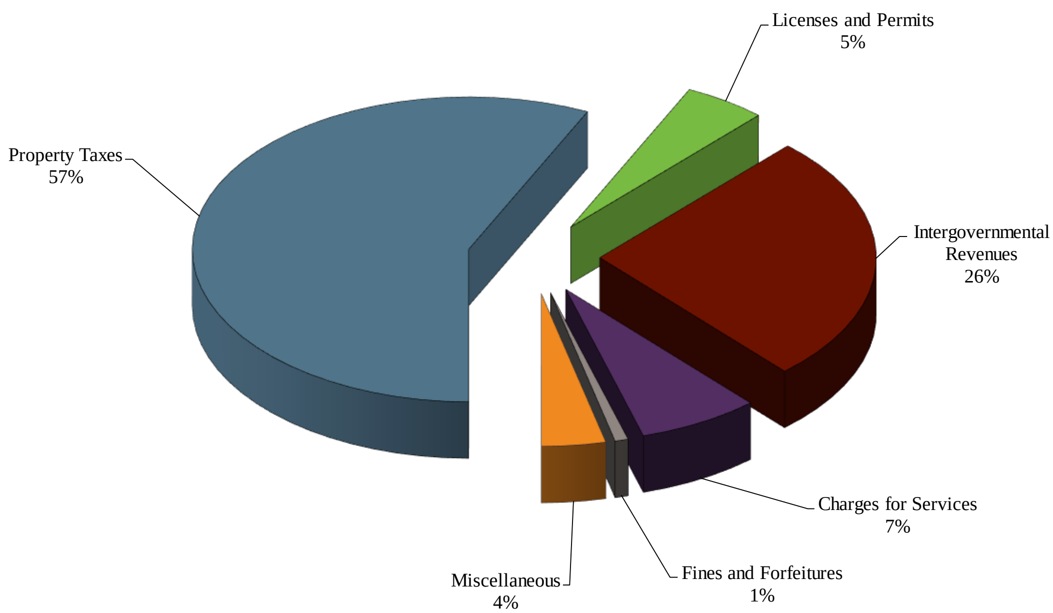
GENERAL FUND (CONTINUED)

The greatest sources of revenue are from property taxes and intergovernmental revenues for both years presented. General Fund revenues for 2019 were proportionately similar to those of 2018.

2019 General Fund Revenues



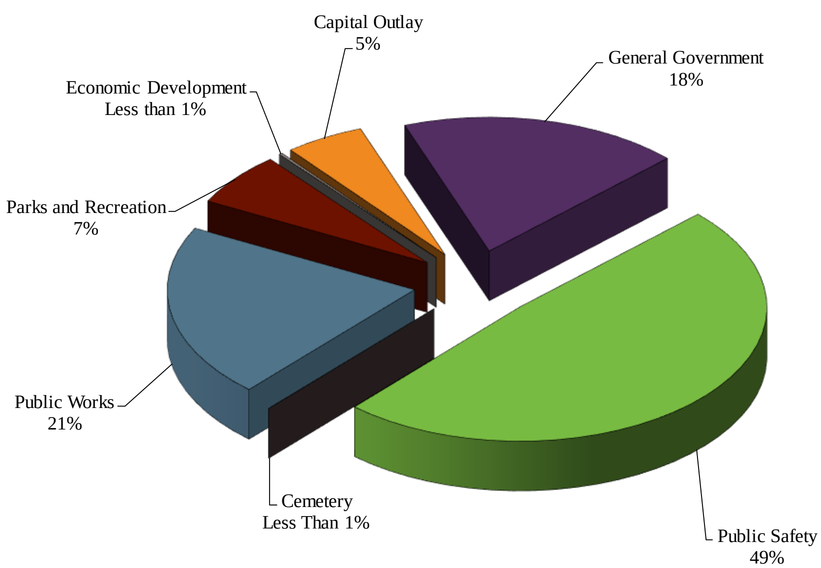
2018 General Fund Revenues



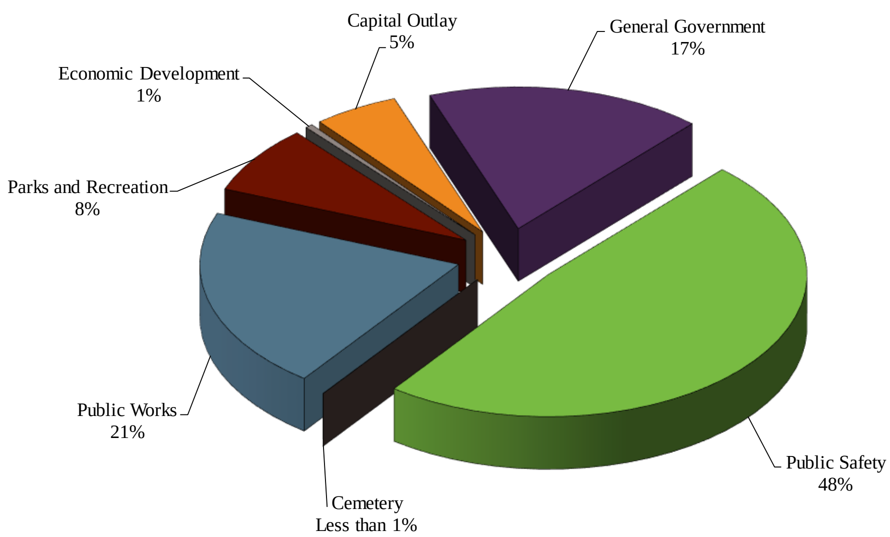
GENERAL FUND (CONTINUED)

Public safety, general government, and public works expenditures continue to make up the largest portion of General Fund expenditures. Overall, the allocation of expenditures by program remained consistent from 2018 to 2019.

2019 General Fund Expenditures

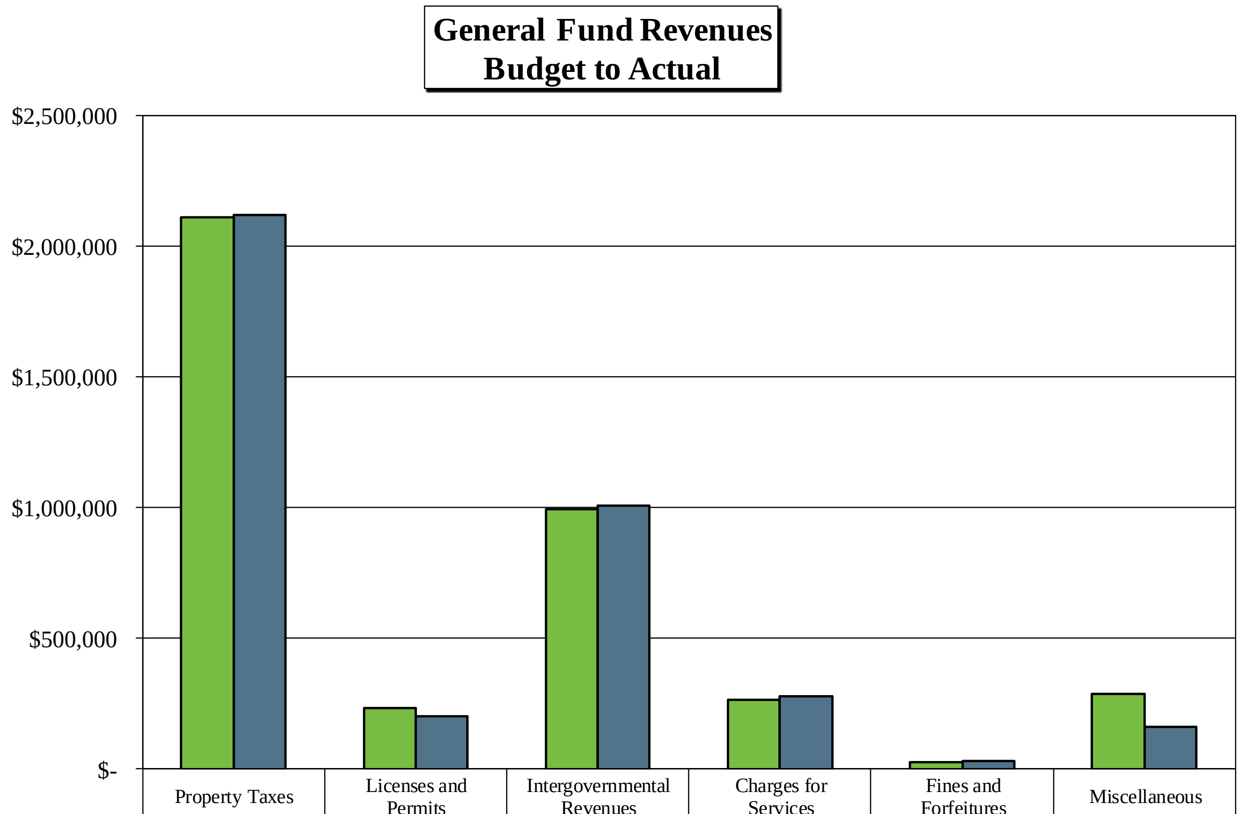


2018 General Fund Expenditures



GENERAL FUND BUDGET TO ACTUAL

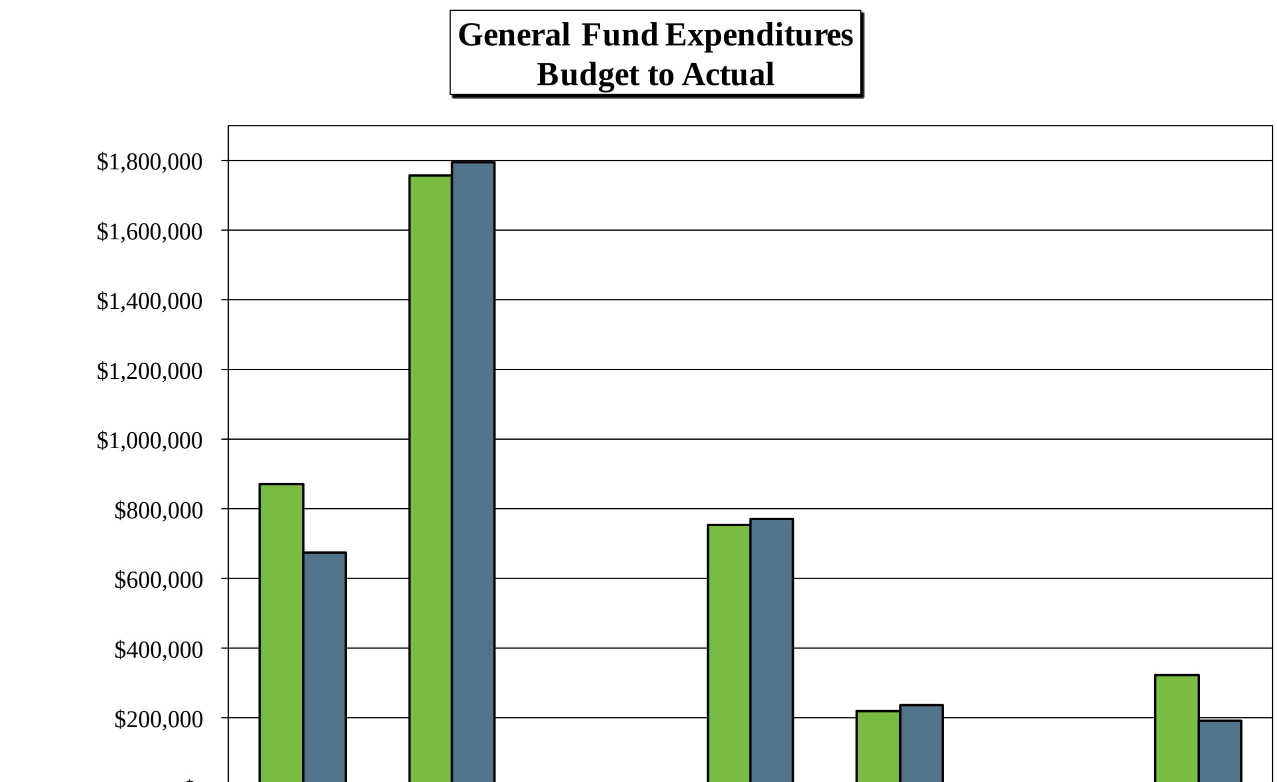
The chart below compares actual revenues to amounts budgeted in the General Fund for 2019. Actual General Fund revenues were under budget by $110,009 or 2.8% due to tax increment excess revenues budgeted in the general fund and reallocated to the Capital Improvement Fund.



	Property Taxes	Licenses and Permits	Intergovernmental Revenues	Charges for Services	Fines and Forfeitures	Miscellaneous
Budgeted Revenues	$2,109,240	$230,585	$993,590	$264,485	$27,000	$285,130
Actual Revenues	2,120,859	202,079	1,008,335	275,628	31,882	161,238

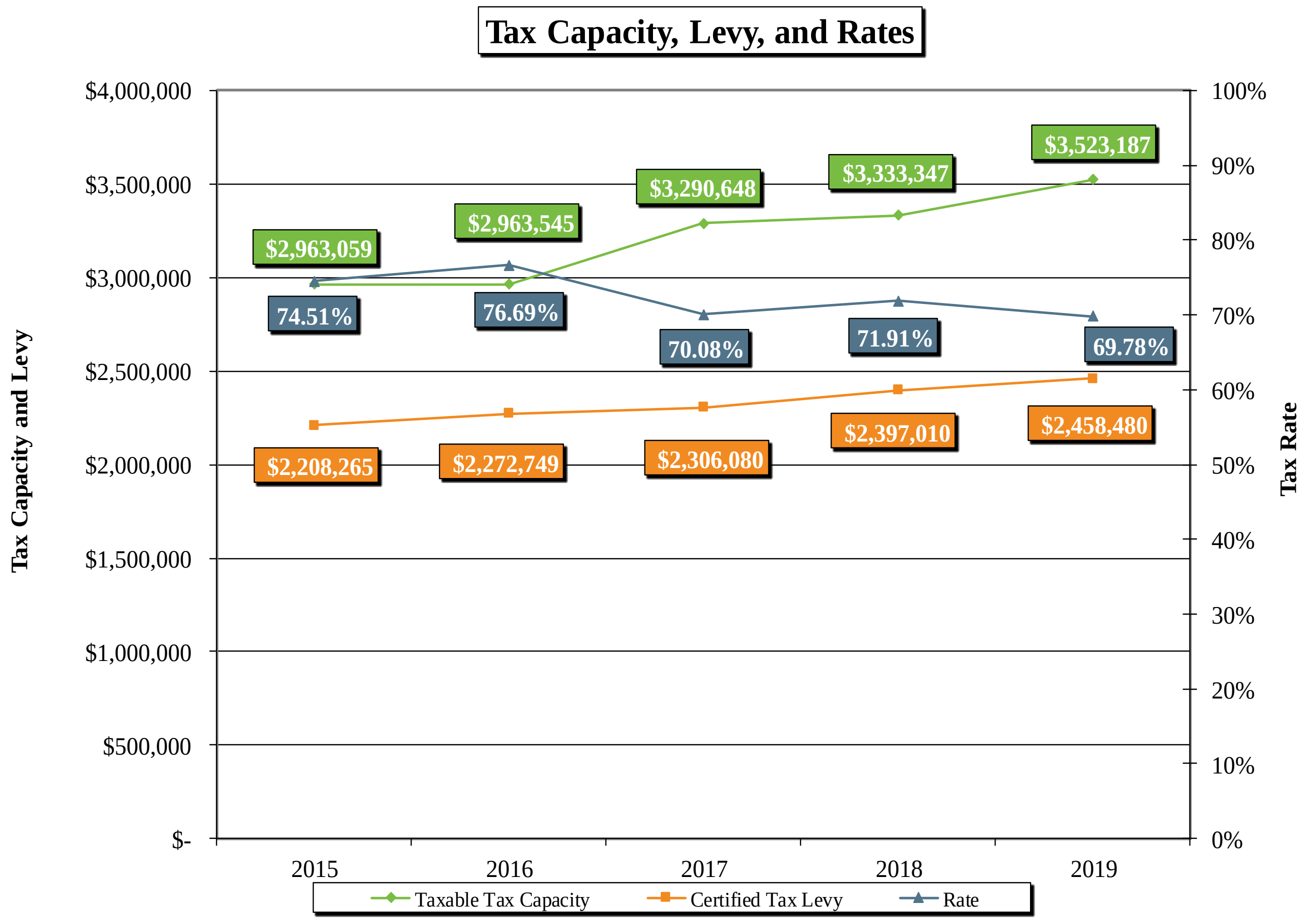
GENERAL FUND BUDGET TO ACTUAL (CONTINUED)

The chart below compares General Fund budgeted and actual expenditures for 2019. Actual General Fund expenditures were under budget by $243,370 or 6.2%. General government expenditures were under budget by $195,460 due primarily to the City budgeting for insurance and other general expenditures in general government; however, these expenditures are allocated across the various functions. Capital outlay expenditures were $130,321 under budget due to the City budgeting conservatively for capital purchases and carrying over purchases to subsequent years. All other functions were in line with budget.



	General Government	Public Safety	Cemetery	Public Works	Parks and Recreation	Economic Development	Capital Outlay
Budgeted Expenditures	$871,970	$1,757,965	$-	$754,435	$219,245	$-	$321,525
Actual Expenditures	676,510	1,797,336	651	771,372	237,080	7,617	191,204

TAX CAPACITY, LEVY, AND RATES



The chart above graphs the tax capacity, certified tax levy, and City tax rate for 1899 through 2019.

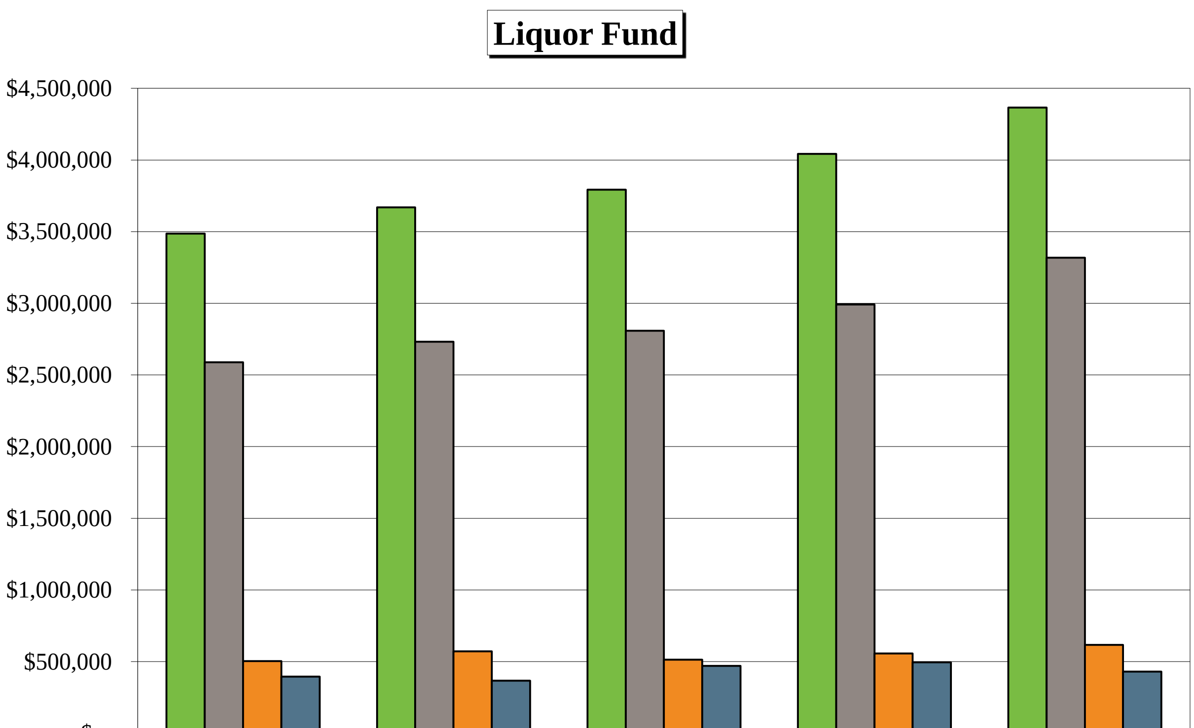
Comparing 1899 through 2019, the City's taxable tax capacity has increased approximately 18.9% in five years. This overall increase is common for Minnesota cities due to the increasing market values over the last several years. The City's certified levy over this same five-year time frame has increased at a lower rate, 11.3%, resulting in a decrease in the tax capacity rate.

LIQUOR FUND

The graphs below and on the following page summarize liquor store operations over the past five years. Sales have increased steadily over the past five years. In 2019, sales increased $322,537, or 8.0%. Cost of sales also increased from 2018, increasing $327,592, or 10.9%.

The gross profit percentage decreased in 2019 as a result of the cost of sales increasing at a faster rate than sales as product purchase prices have risen. The graph on the following page shows the gross profit percentage over the last five years including the 2019 percentage of approximately 24.0%.

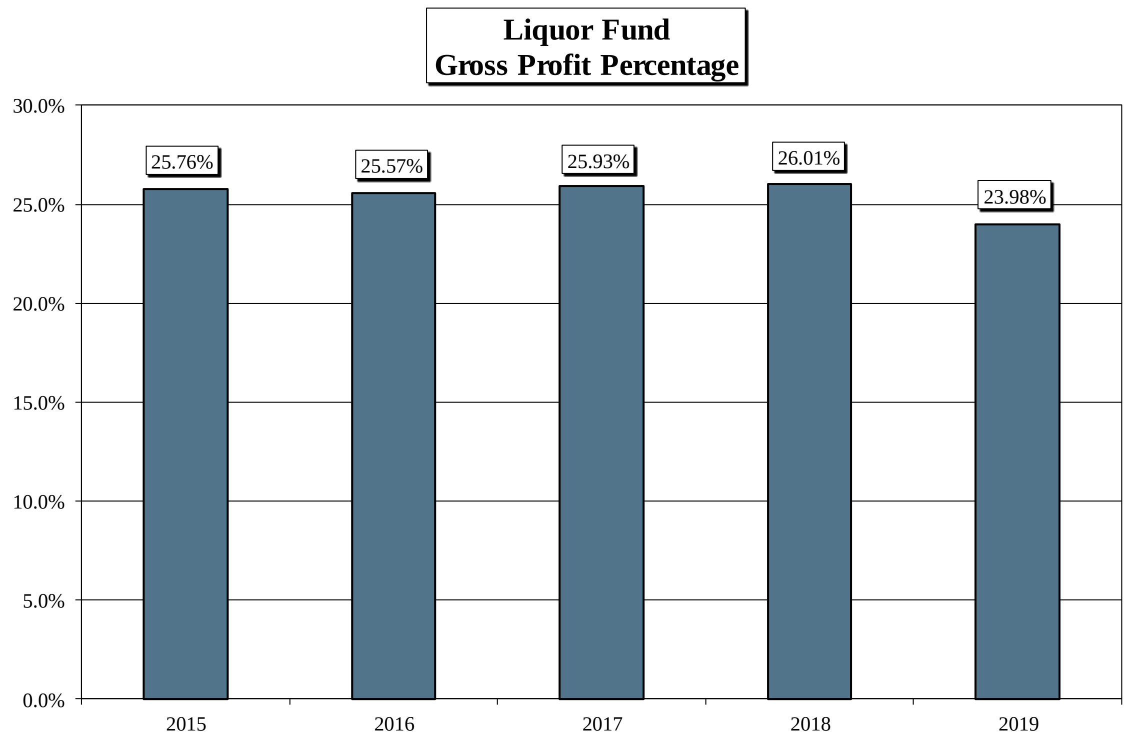
In 2019, operating expenses increased $59,467 due to an increase in service charges from various credit card companies as well as other inflationary increases. The net position balance has continually increased in the five years presented due to the positive operations of the Fund. The net position balance at December 31, 2019, was $5,741,143 as shown on the following page.

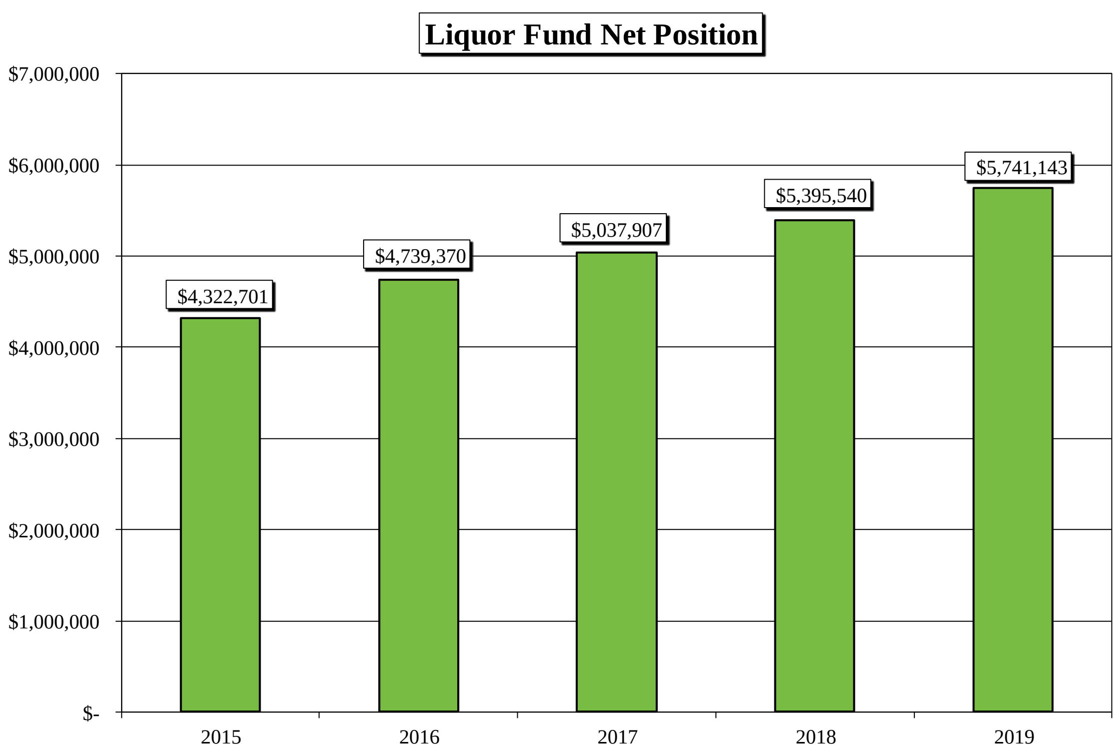


	2015	2016	2017	2018	2019
Sales	$3,486,943	$3,669,974	$3,792,103	$4,042,580	$4,365,117
Cost of Sales	2,588,629	2,731,436	2,808,954	2,990,980	3,318,572
Operating Expenses	503,695	570,932	513,661	557,057	616,524
Operating Income	394,749	367,671	469,523	494,553	430,296

City of Princeton
Financial Analysis

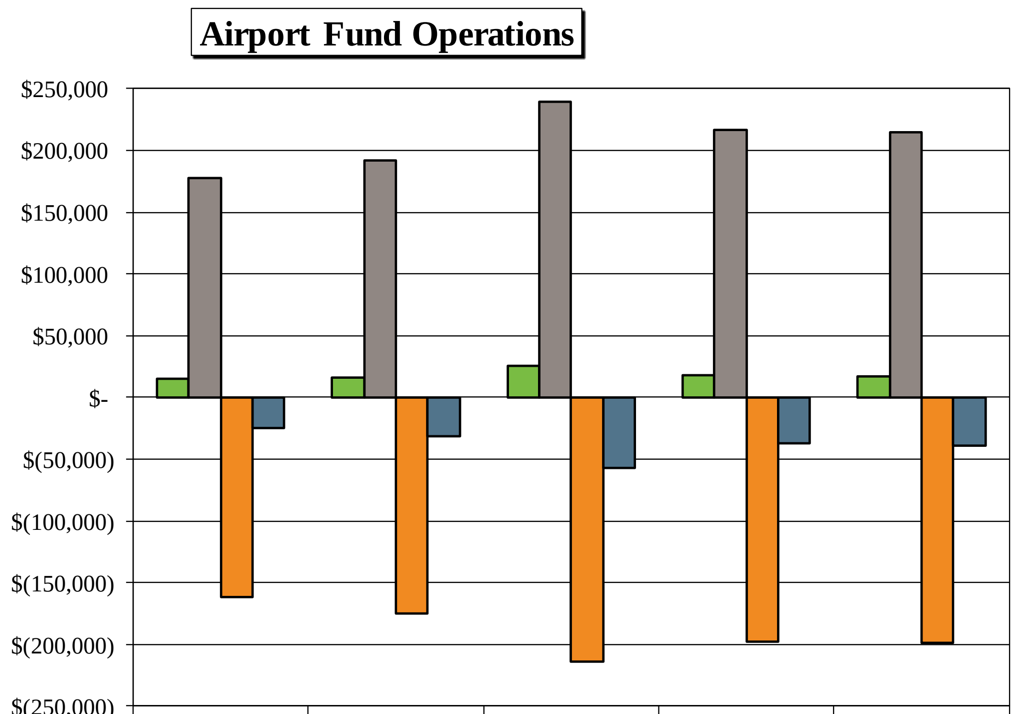
LIQUOR FUND (CONTINUED)





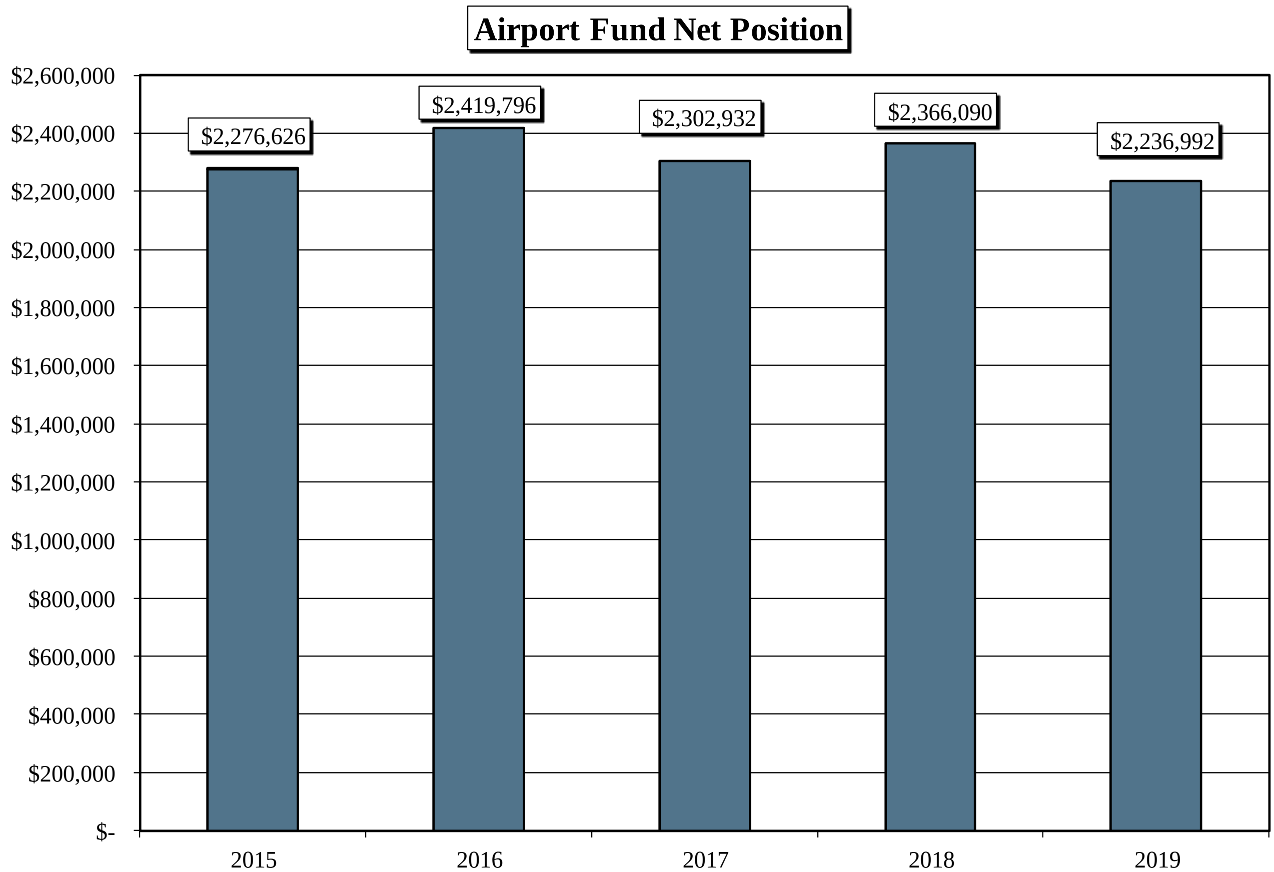
AIRPORT FUND

In 2019, gross profit and operating revenues decreased $1,429, while operating expenses decreased $1,389. After an operating loss of $198,331, nonoperating grant revenues of $55,033 and transfers in of $14,200, the Airport Fund net position experienced a decrease in 2019 of $129,098 to $2,236,992 as shown on the following page.



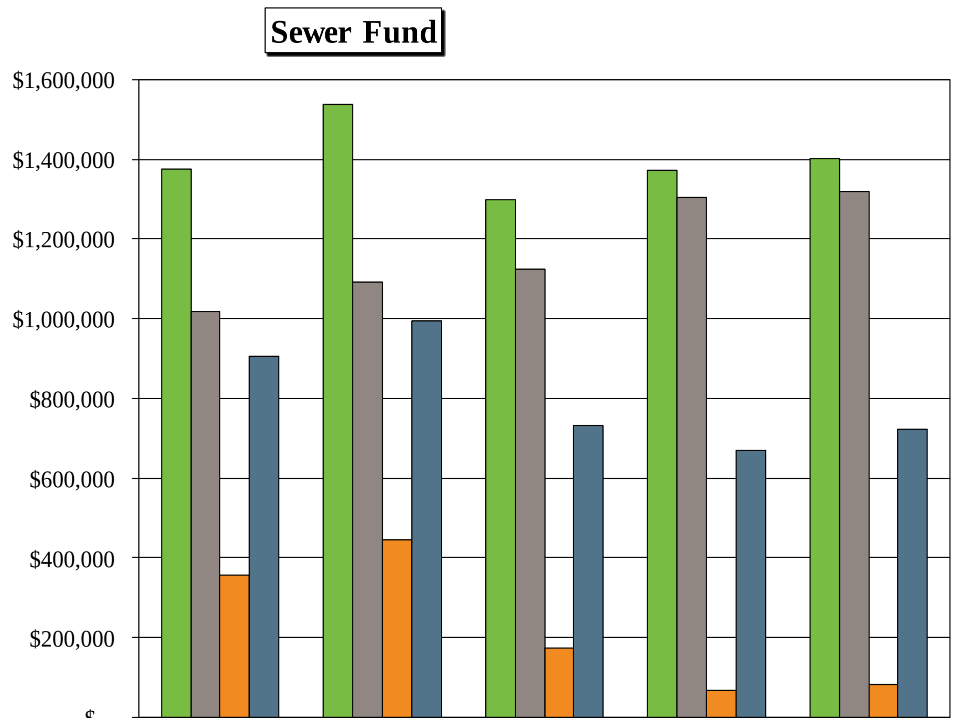
	2015	2016	2017	2018	2019
Gross Profit and Operating Revenues	$15,491	$16,029	$25,395	$18,350	$16,921
Operating Expenses	177,347	191,679	239,197	216,641	215,252
Operating Loss with Depreciation	(161,856)	(175,470)	(213,802)	(198,291)	(198,331)
Operating Loss without Depreciation	(24,495)	(31,666)	(57,564)	(37,250)	(38,817)

AIRPORT FUND (CONTINUED)



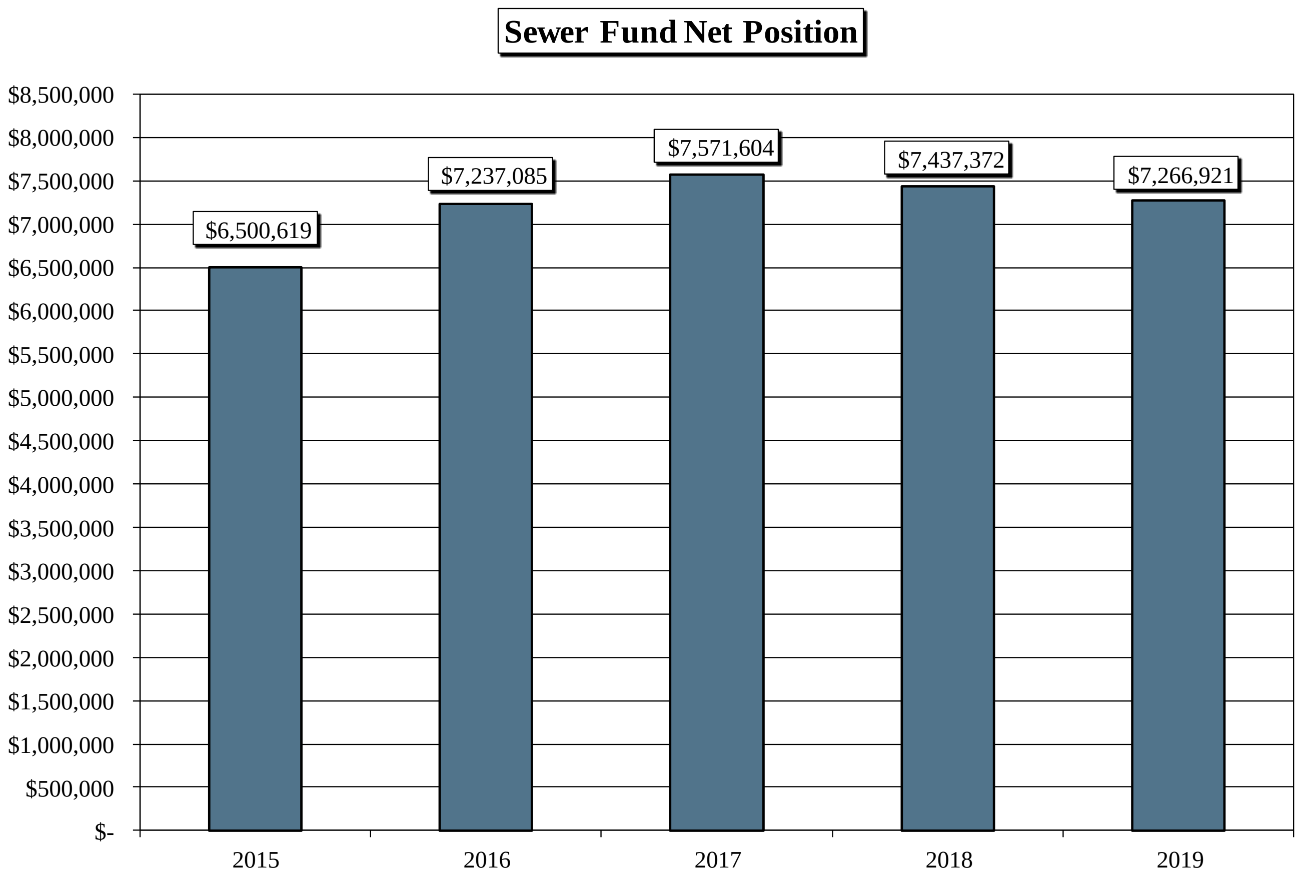
SANITARY SEWER FUND

The Sanitary Sewer Fund reported operating income again in 2019. Operating revenues increased $26,920 due to increased usage. Operating expenses increased $13,369, or 1.0%, from the prior year. As shown on the following page, net position in the sewer fund decreased $170,451, which is mainly due to the fund's positive operations as noted below, offset by interest payments made on long-term debt.



	2015	2016	2017	2018	2019
Operating Revenues	$1,376,736	$1,536,698	$1,299,237	$1,374,025	$1,400,945
Operating Expenses	1,018,537	1,091,516	1,125,314	1,305,135	1,318,504
Operating Income with Depreciation	358,199	445,182	173,923	68,890	82,441
Operating Income without Depreciation	904,779	995,748	731,049	670,642	723,267

SANITARY SEWER FUND (CONTINUED)



City of Princeton
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 these issues 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.

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 reporting periods beginning after June 15, 2021.

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