

**City of Mendota Heights  
Dakota County, Minnesota**

**Communications Letter**

**December 31, 2017**



**City of Mendota Heights  
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**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 Mendota Heights  
Mendota Heights, Minnesota

In planning and performing our audit of the financial statements of the governmental activities, business-type activities, each major fund, and the aggregate remaining fund information of the City of Mendota Heights, Minnesota, as of and for the year ended December 31, 2017, in accordance with 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 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.

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

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 significant deficiency identified is stated within this letter.



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 31, 2018, 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.

*BerganKDV Ltd.*

Minneapolis, Minnesota  
May 31, 2018

**City of Mendota Heights  
Significant Deficiency**

**LACK OF SEGREGATION OF ACCOUNTING DUTIES**

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 City's ability to initiate, record, process, and report financial data consistent with the assertions of management in the financial statements. This lack of segregation of accounting duties can be demonstrated in the following areas, which is not intended to be an all-inclusive list:

- The Finance Director has the ability to receipt City service revenue, prepares the deposit receipts, is responsible for coding, and prepares the Treasurer's report for the City Council.
- The Utility Billing Clerk enters consumption into the utility billing system, prepares and reviews utility bills, applies payments to customer accounts, and has the ability to make adjustments to customer accounts.

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 allows the ability to override many of the controls and segregation the City has in place.

The City has implemented certain controls to mitigate the risk due to the lack of segregation of accounting duties, including but not limited to reviewing adjustments to customer accounts before they are posted, having a non-finance employee prepare bank reconciliations and review of all journal entries. However, due to the number of staff needed to properly segregate all of the accounting duties, the cost of obtaining desirable segregation of accounting duties can often exceed benefits which could be derived. However, management and the City Council must remain aware of this situation and should continually monitor the accounting system, including changes that occur.

We recommend segregation or independent review be implemented whenever practical and cost effective.

## **City of Mendota Heights Required Communication**

We have audited the financial statements of the governmental activities, business-type activities, each major fund, and the aggregate remaining fund information of the City as of and for the year ended December 31, 2017. Professional standards require that we provide you with the following information related to our audit.

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

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

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.

### **PLANNED SCOPE AND TIMING OF THE AUDIT**

An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements; therefore, our audit involved judgment about the number of transactions to be examined and the areas to be tested.

Our audit included obtaining an understanding of the City and its environment, including internal control, sufficient to assess the risks of material misstatement of the financial statements and to design the nature, timing, and extent of further audit procedures. Material misstatements may result from (1) errors, (2) fraudulent financial reporting, (3) misappropriation of assets, or (4) violations of laws or governmental regulations that are attributable to the City or to acts by management or employees acting on behalf of the City.

### **QUALITATIVE ASPECTS OF ACCOUNTING PRACTICES**

Management is responsible for the selection and use of appropriate accounting policies. The significant accounting policies used by the City are described in the notes to financial statements. No new accounting policies were adopted and the application of existing policies was not changed during the year ended December 31, 2017. We noted no transactions entered into by the City during the year for which there is a lack of authoritative guidance or consensus. All significant transactions have been recognized in the financial statements in the proper period.

## **City of Mendota Heights Required Communication**

### **QUALITATIVE ASPECTS OF ACCOUNTING PRACTICES (CONTINUED)**

Accounting estimates are an integral part of the financial statements prepared by management and are based on management's knowledge and experience about past and current events and assumptions about future events. Certain accounting estimates are particularly sensitive because of their significance to the financial statements and because of the possibility that future events affecting them may differ significantly from those expected. The most sensitive estimates affecting the financial statements were:

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

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

Net Other Post Employment Benefits (OPEB) Obligation – This liability is based on an actuarial study using estimates of future obligations of the City for post-employment benefits.

Net Pension Liability and Deferred Outflows/Inflows of Resources Relating to Pension Activity – These balances are based on an allocation by the pension plan using estimates based on contributions.

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

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

### **DIFFICULTIES ENCOUNTERED IN PERFORMING THE AUDIT**

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

### **CORRECTED AND UNCORRECTED MISSTATEMENTS**

Professional standards require us to accumulate all known and likely misstatements identified during the audit, other than those that are clearly trivial, and communicate them to the appropriate level of management. We identified the following uncorrected misstatement of the financial statements. Management has determined its effect is immaterial, both individually and in the aggregate, to the financial statements taken as a whole.

- Depreciation expense

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.

**City of Mendota Heights  
Required Communication**

**DISAGREEMENTS WITH MANAGEMENT**

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

**MANAGEMENT REPRESENTATIONS**

We requested certain representations from management that are included in the management representation letter.

**MANAGEMENT CONSULTATIONS WITH OTHER ACCOUNTANTS**

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

**OTHER AUDIT FINDINGS OR ISSUES**

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

**OTHER MATTERS**

We applied certain limited procedures to the 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.

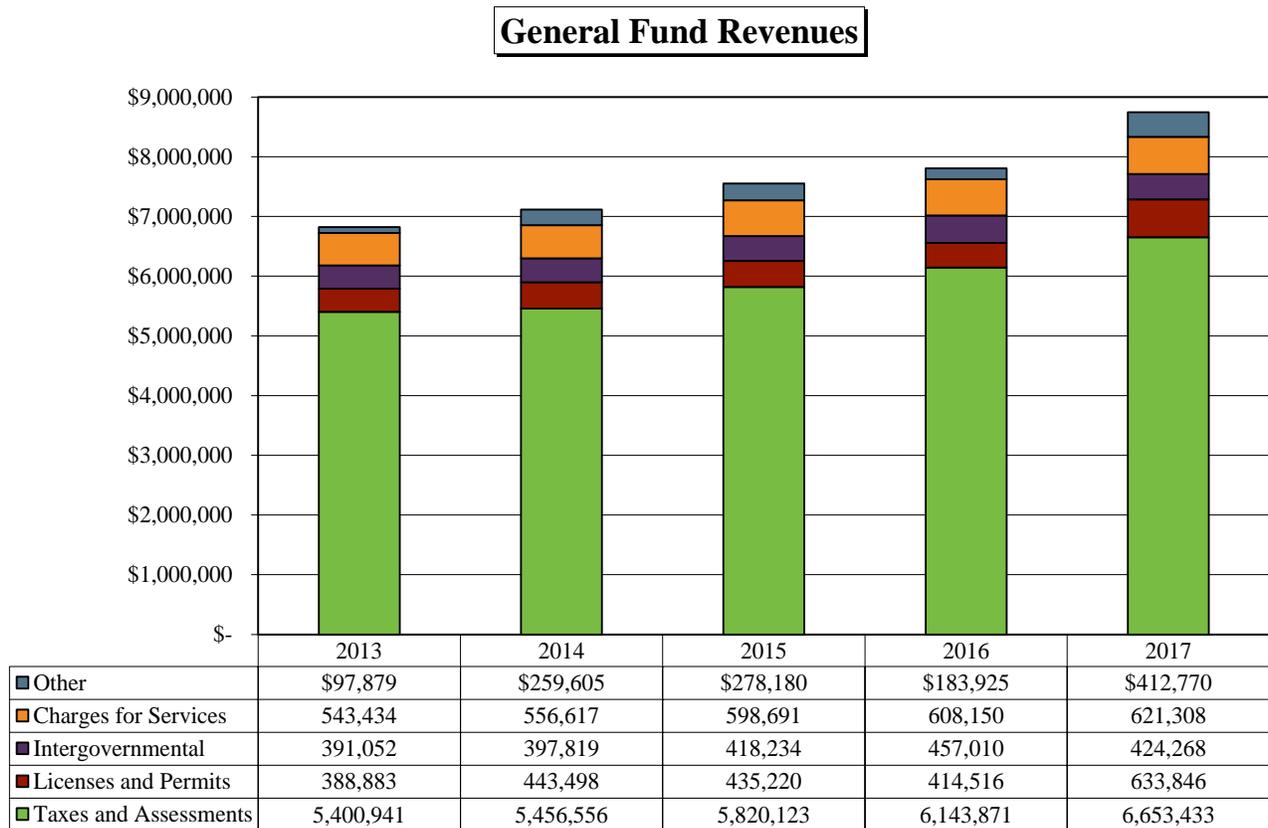
With respect to the supplementary information accompanying the financial statements, we made certain inquiries of management and evaluated the form, content and methods of preparing the information to determine that the information complies with accounting principles generally accepted in the United 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 Mendota Heights Financial Analysis

The following pages provide graphic representation of select data pertaining to the financial position and operations of the City for the past four 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 REVENUES

The General Fund revenues for the past five years are depicted in the following graph.

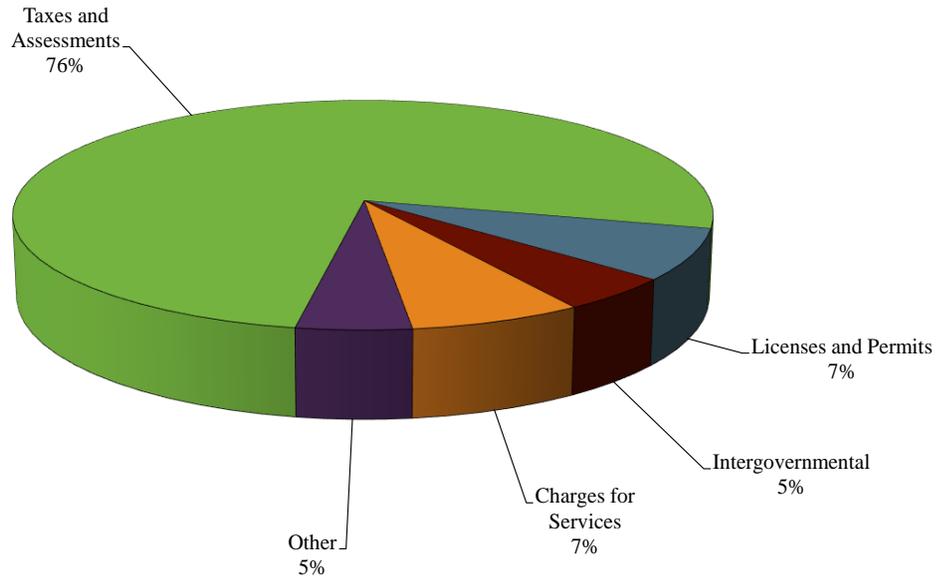


General Fund revenue increased \$938,153, or 12.0%, during the year, from \$7,807,472 in 2016 to \$8,745,625 in 2017. The largest fluctuation occurred in taxes and assessments, which increased \$509,562 due to an increase in the amount of taxes levied in 2017. Other General Fund revenue had the next largest variance of \$228,845 from 2016. This increase was primarily due to the City allocating dedicated cell tower revenue to the General Fund in 2017. Licenses and Permits increased \$219,330 from 2016. This increase was primarily due to an increase in building permit revenue.

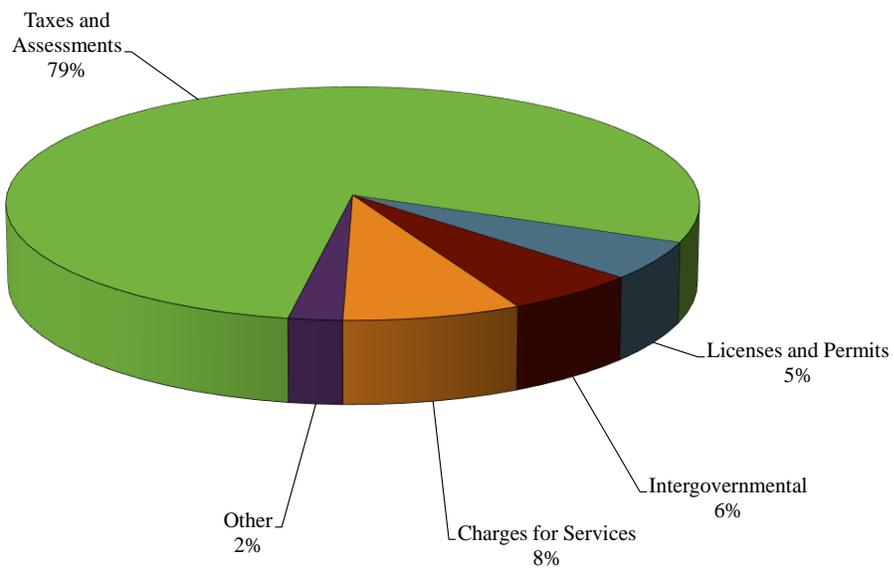
# City of Mendota Heights Financial Analysis

## GENERAL FUND REVENUES (CONTINUED)

**2017 General Fund Revenues**



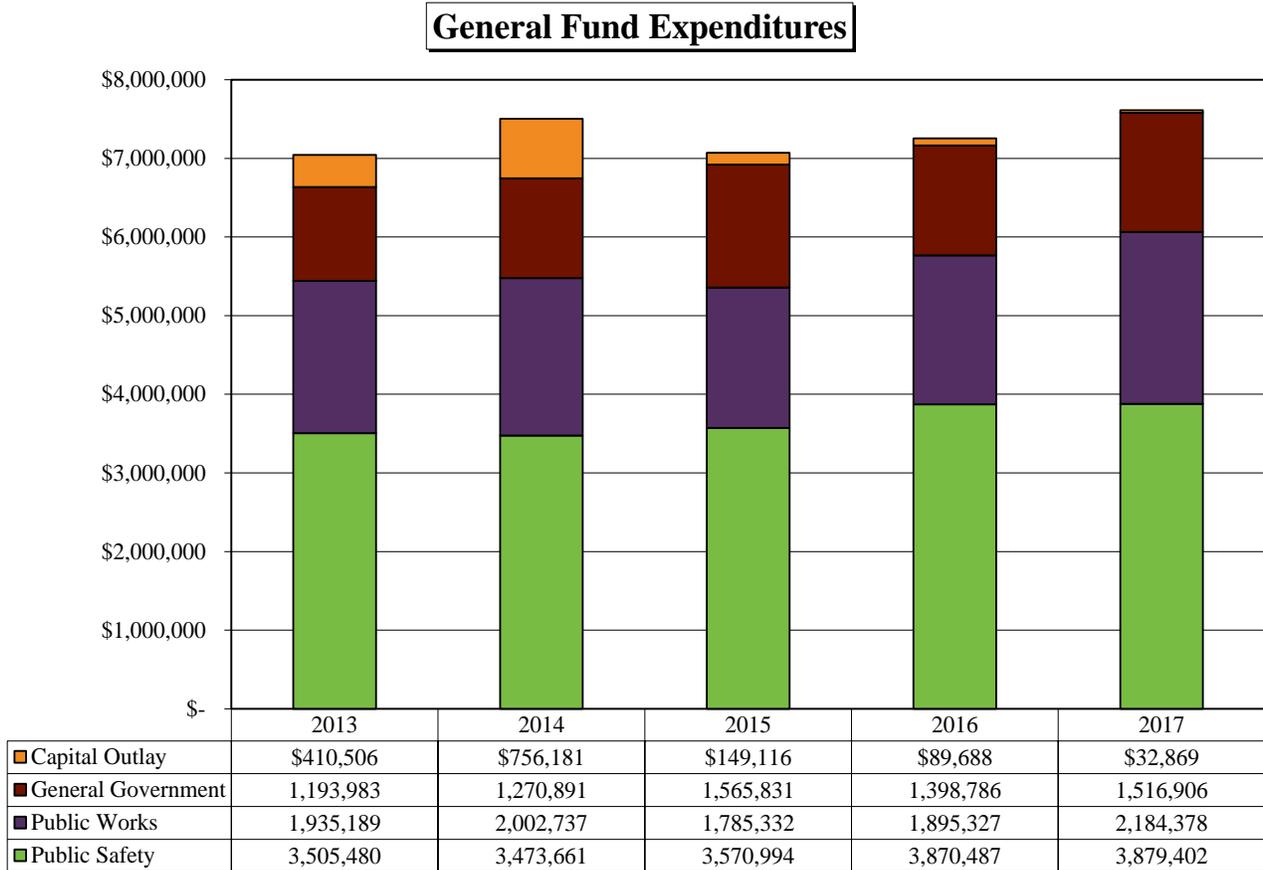
**2016 General Fund Revenues**



## City of Mendota Heights Financial Analysis

### GENERAL FUND EXPENDITURES

The General Fund expenditures for the past five years are depicted in the following graph.

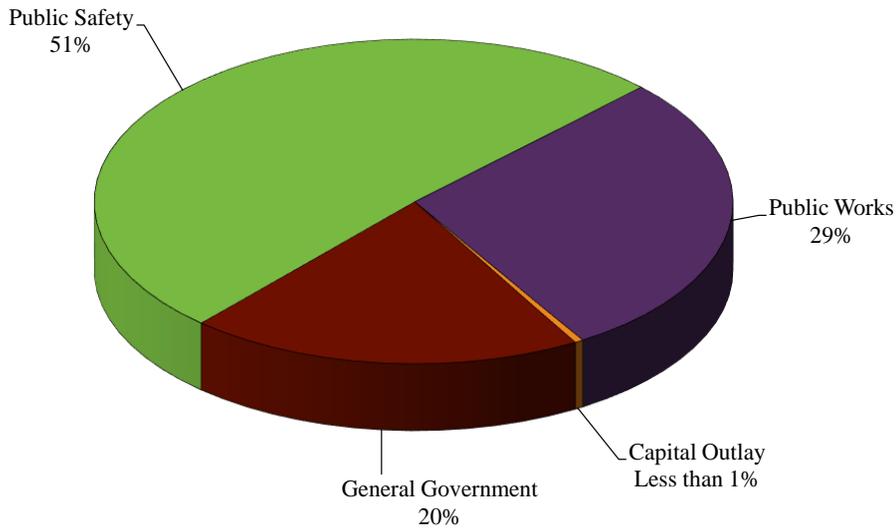


General Fund expenditures increased 5.0%, from \$7,254,288 in 2016 to \$7,613,555 in 2017. Public works increased the most from 2016, increasing \$289,051. This increase is a result of the City allocating its engineering costs to the General Fund during the year. General government expenditures increased \$118,120, primarily due to the City having increases in salary and benefits expenditures as a result of staffing changes.

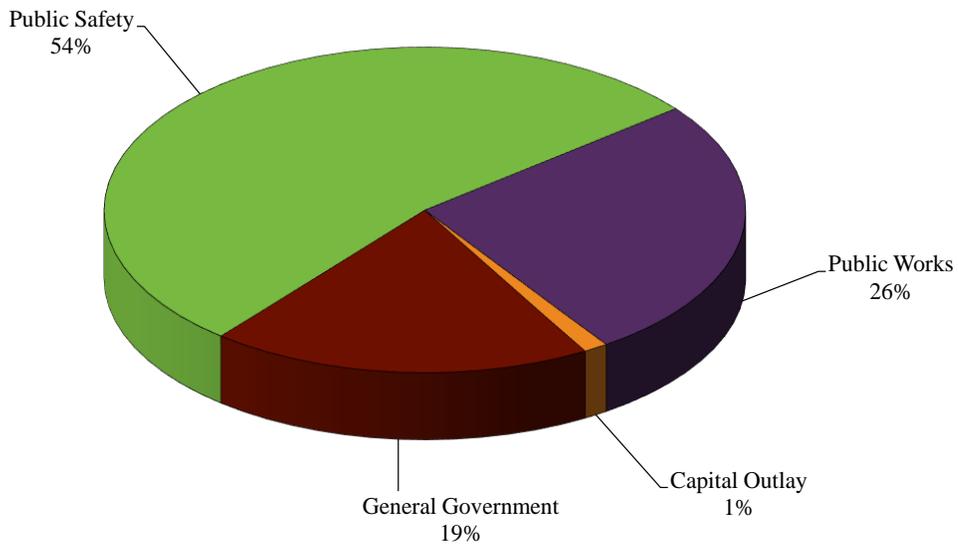
# City of Mendota Heights Financial Analysis

## GENERAL FUND EXPENDITURES (CONTINUED)

**2017 General Fund Expenditures**



**2016 General Fund Expenditures**



**City of Mendota Heights  
Financial Analysis**

**GENERAL FUND EXPENDITURES (CONTINUED)**

The table below presents a comparison of budget and actual General Fund revenues and expenditures by function. In total, the fund's expenditures were \$690,136, or 8.3%, under budgeted expenditures of \$8,303,691. The fund's revenue was \$497,684, or 6.0%, over budgeted revenues of \$8,247,941.

Public Safety expenditures were under budget by \$546,523. This was due to the police captain and sergeant positions remaining open during 2017. Public works expenditures were under budget \$139,752 due to budgeting for more supplies for winter street maintenance that ultimately wasn't needed.

License and Permit revenue was over budget by \$279,796. A conservative budget along with significant development resulted in higher than anticipated building permit revenue. Other revenue increased due to the City not budgeting for cable franchise fees, donations, and insurance claims. Additionally, the City had a conservative budget for interest income, fines, and forfeitures.

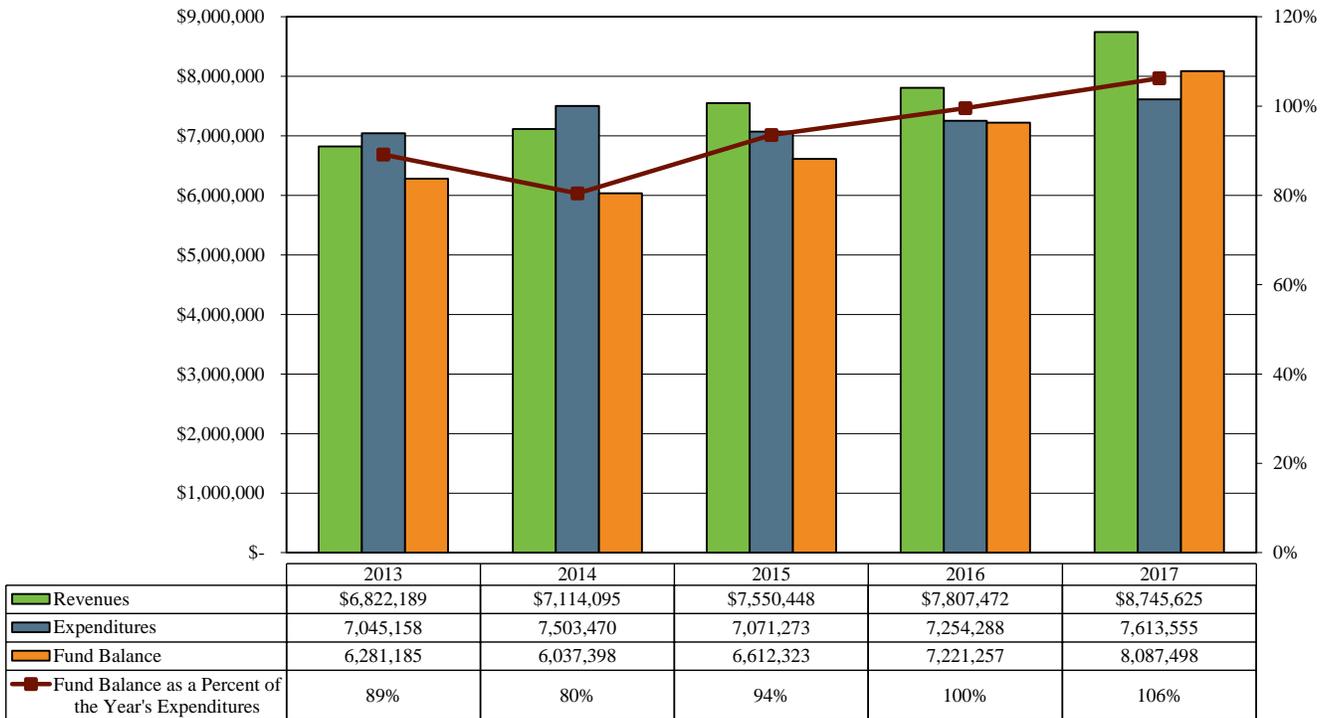
	Original and Final Budget	Amounts	Variance Final Budget - Over (Under)
Revenues			
Taxes and assessments	\$ 6,607,624	\$ 6,653,433	\$ 45,809
Licenses and permits	354,050	633,846	279,796
Intergovernmental	399,170	424,268	25,098
Charges for services	619,936	621,308	1,372
Other	267,161	412,770	145,609
Total revenues	<u>8,247,941</u>	<u>8,745,625</u>	<u>497,684</u>
Expenditures			
General government	1,481,036	1,516,906	35,870
Public safety	4,425,925	3,879,402	(546,523)
Public works	2,324,130	2,184,378	(139,752)
Capital outlay	72,600	32,869	(39,731)
Total expenditures	<u>8,303,691</u>	<u>7,613,555</u>	<u>(690,136)</u>
Other financing sources (uses)			
Transfers in	<u>55,750</u>	<u>47,550</u>	<u>(8,200)</u>
Net change in fund balances	<u>\$ -</u>	<u>\$ 1,179,620</u>	<u>\$ 1,179,620</u>

## City of Mendota Heights Financial Analysis

### GENERAL FUND OPERATIONS

The bar chart below highlights General Fund results for the last five years.

**General Fund Operations**



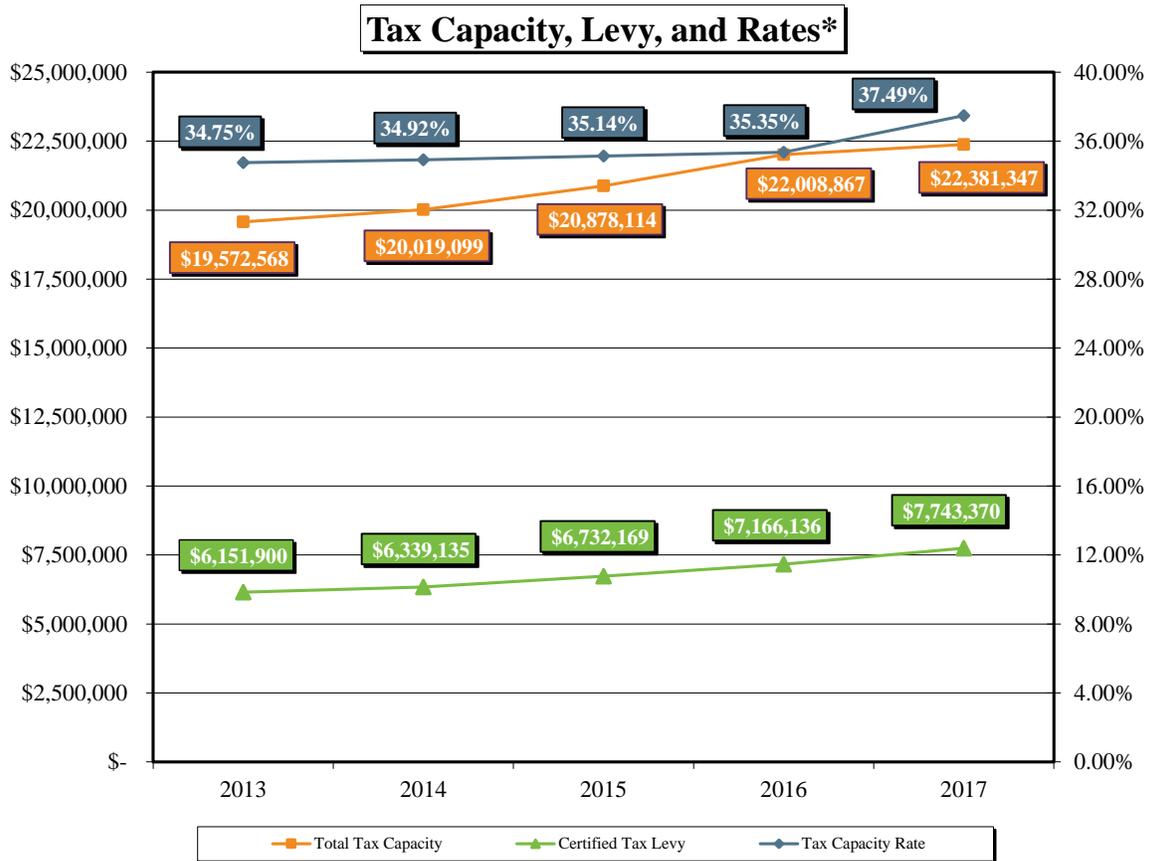
As shown in the chart, the City's fund balance increased to its highest point in the five years presented. The amount of fund balance as a percentage of the current year's expenditures is also at the highest point in the five previous years. In 2017, the City implemented a policy in accordance with GASB 54 whereby the General Fund's unassigned fund balance is at least 75% of the subsequent year's budgeted expenditures. As of December 31, 2017, the City's unassigned General Fund balance of \$7,796,760 was 89.7% of 2018 budgeted expenditures.

## City of Mendota Heights Financial Analysis

### TAX CAPACITY, LEVY, AND RATES

The chart below graphs the tax capacity, certified tax levy, and City tax rate for 2013 through 2017. The tax capacity is based on total tax capacity, prior to adjustments for captured Tax Increment Financing (TIF) and fiscal disparities. The certified tax levy amount is also prior to fiscal disparity adjustments.

With improving market values, the City's tax capacity increased from 2013 to 2017 by \$2,808,779 or 14.4%. In 2017, the City's tax capacity increased \$372,480.



\* Property tax data was obtained from the League of Minnesota Cities Property Tax Data Tables for 2013-2016 ([www.lmc.org](http://www.lmc.org)). 2017 data obtained from Dakota County.

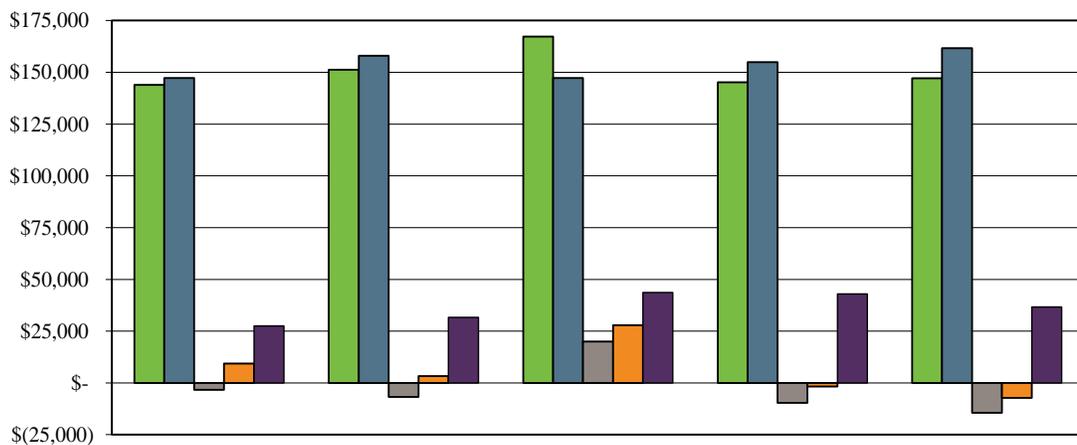
**City of Mendota Heights  
Financial Analysis**

**ENTERPRISE FUNDS**

**Par 3 Golf Course Fund**

Expenses exceeded revenues in four of the five years presented. The City reported an operating loss in 2017 of \$14,485 after having an operating loss of \$9,656 in 2016. Excluding depreciation, the Fund had an operating loss of \$7,242 for 2017, decreasing unrestricted net position in the current year.

**Par 3 Golf Course Fund**



	2013	2014	2015	2016	2017
■ Revenues	\$143,895	\$151,214	\$167,300	\$145,245	\$147,187
■ Operating Expenses	147,269	157,963	147,299	154,901	161,672
■ Operating Income (Loss)	(3,374)	(6,749)	20,001	(9,656)	(14,485)
■ Operating Income (Loss) Excluding Depreciation	9,362	3,332	27,882	(1,775)	(7,242)
■ Unrestricted Net Position	27,570	31,630	43,691	42,934	36,739

**City of Mendota Heights  
Financial Analysis**

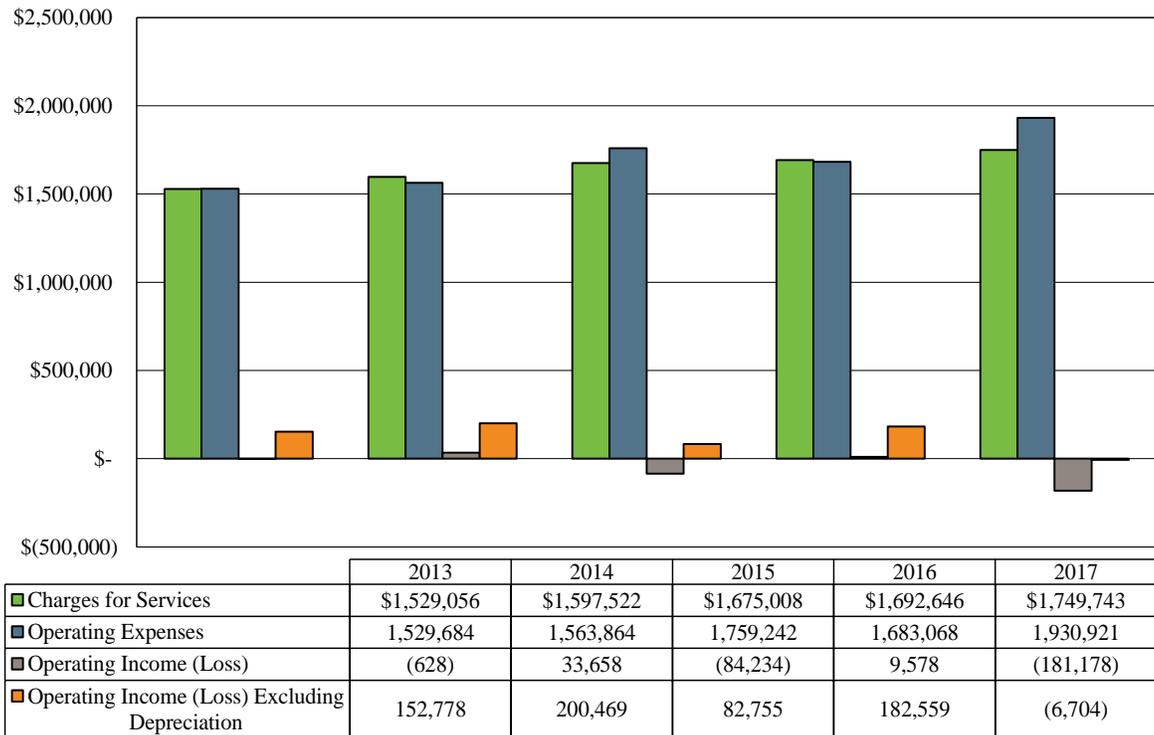
**ENTERPRISE FUNDS (CONTINUED)**

**Sewer Utility Fund**

The following graph presents a five-year history of the Sewer Utility Fund. Due to the nature and cost of Sewer Utility Fund assets, it is often difficult to establish sewer rates that are sufficient to cover the current year's use of the assets represented by depreciation expense. Ideally, Sewer Utility Fund revenues should cover all operating expenses, including depreciation.

The Sewer Utility Fund had an operating loss of \$181,178 for 2017, which included recognition of \$174,474 of depreciation expense. Expenses exceeded revenues in three of the five years presented, with modest operating income in 2014 and 2016. Net position of the fund decreased \$16,297 after factoring in nonoperating revenues, and net transfers.

**Sewer Fund**

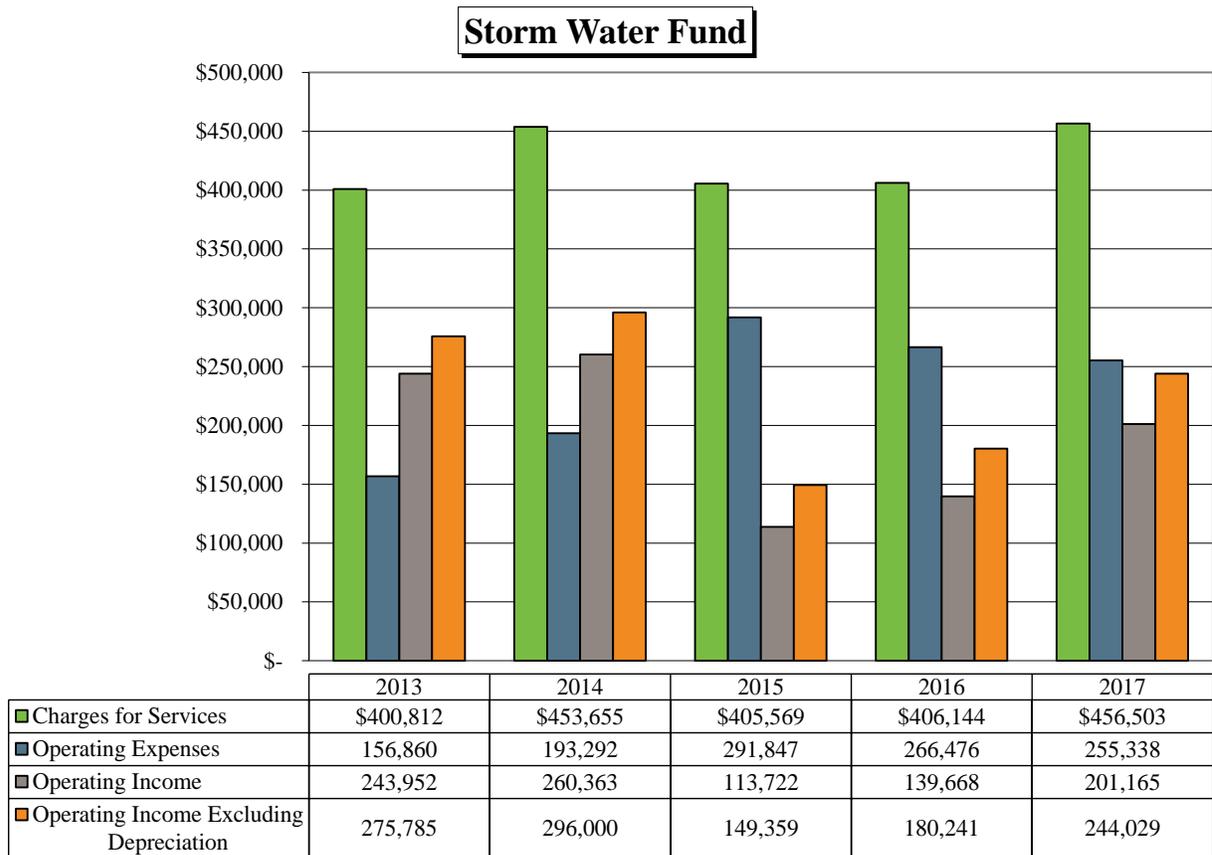


**City of Mendota Heights  
Financial Analysis**

**ENTERPRISE FUNDS (CONTINUED)**

**Storm Water Fund**

The Storm Water Fund had operating income of \$201,165, which included recognition of depreciation expense of \$42,864. Operating expenses decreased \$11,138, from \$266,476 in 2016 to \$255,338 in 2017. This decrease was primarily due to less engineering costs in 2017. Net position increased \$86,678 in 2017 after factoring in nonoperating revenues and transfers out. The fund has shown operating income for all years presented.



## **City of Mendota Heights Emerging Issues**

### **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 updates include:

- **Accounting Standard Update – GASB Statement No. 75 – Accounting and Financial Reporting for Postemployment Benefits Other Than Pensions** – GASB has issued GASB Statement No. 75 relating to accounting and financial reporting for postemployment benefits other than pensions. This new statement requires governments in all types of OPEB plans to present more extensive note disclosures and required supplementary information (RSI) about their OPEB liabilities.
- **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 are extensive summaries of the current updates. 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. 75 – ACCOUNTING AND FINANCIAL REPORTING FOR POSTEMPLOYMENT BENEFITS OTHER THAN PENSIONS**

The primary objective of this Statement is to improve accounting and financial reporting by state and local governments for postemployment benefits other than pensions (other postemployment benefits or OPEB). It also improves information provided by state and local governmental employers about financial support for OPEB that is provided by other entities. This Statement results from a comprehensive review of the effectiveness of existing standards of accounting and financial reporting for all postemployment benefits (pensions and OPEB) with regard to providing decision-useful information, supporting assessments of accountability and interperiod equity, and creating additional transparency.

This Statement replaces the requirements of Statements No. 45, *Accounting and Financial Reporting by Employers for Postemployment Benefits Other Than Pensions*, as amended, and No. 57, *OPEB Measurements by Agent Employers and Agent Multiple-Employer Plans*, for OPEB. Statement No. 74, *Financial Reporting for Postemployment Benefit Plans Other Than Pension Plans*, establishes new accounting and financial reporting requirements for OPEB plans.

## City of Mendota Heights Emerging Issues

### **ACCOUNTING STANDARD UPDATE – GASB STATEMENT NO. 75 – ACCOUNTING AND FINANCIAL REPORTING FOR POSTEMPLOYMENT BENEFITS OTHER THAN PENSIONS (CONTINUED)**

GASB Statement No. 75 requires governments to report a liability on the face of the financial statements for the OPEB that they provide:

- Governments that are responsible only for OPEB liabilities related to their own employees and that provide OPEB through a defined benefit OPEB plan administered through a trust that meets specified criteria will report a *net OPEB liability*—the difference between the total OPEB liability and assets accumulated in the trust and restricted to making benefit payments.
- Governments that participate in a cost-sharing OPEB plan that is administered through a trust that meets the specified criteria will report a liability equal to their *proportionate share of the collective OPEB liability* for all entities participating in the cost-sharing plan.
- Governments that do not provide OPEB through a trust that meets specified criteria will report the *total OPEB liability* related to their employees.

GASB Statement No. 75 carries forward from Statement No. 45 the option to use a specified alternative measurement method in place of an actuarial valuation for purposes of determining the total OPEB liability for benefits provided through OPEB plans in which there are fewer than 100 plan members (active and inactive). This option was retained in order to reduce costs for smaller governments.

GASB Statement No. 75 requires governments in all types of OPEB plans to present more extensive note disclosures and required supplementary information (RSI) about their OPEB liabilities. Among the new note disclosures is a description of the effect on the reported OPEB liability of using a discount rate and a healthcare cost trend rate that are one percentage point higher and one percentage point lower than assumed by the government. The new RSI includes a schedule showing the causes of increases and decreases in the OPEB liability and a schedule comparing a government's actual OPEB contributions to its contribution requirements.

Information provided above was obtained from [www.gasb.org](http://www.gasb.org).

### **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.

**City of Mendota Heights  
Emerging Issues**

**ACCOUNTING STANDARD UPDATE – GASB STATEMENT NO. 87 – LEASES  
(CONTINUED)**

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.

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 December 15, 2019. Earlier application is encouraged.

Information provided above was obtained from [www.gasb.org](http://www.gasb.org).