

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

Communications Letter

December 31, 2018

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**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, 2018, 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 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 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 City's written response to the significant deficiency identified in our audit has not been subjected to audit procedures applied in the audit of the financial statements and, accordingly, we express no opinion on it.

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 28, 2019, 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.

Minneapolis, Minnesota
May 28, 2019

**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, 2018. 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.

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.

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.

**City of Mendota Heights
Required Communication**

QUALITATIVE ASPECTS OF SIGNIFICANT ACCOUNTING PRACTICES

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 2018. We noted no transactions entered into by the City during the year for which there is a lack of authoritative guidance or consensus. All significant transactions have been recognized in the financial statements in the proper period.

Accounting estimates 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/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.

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.

SIGNIFICANT DIFFICULTIES ENCOUNTERED DURING THE AUDIT

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

**City of Mendota Heights
Required Communication**

UNCORRECTED AND CORRECTED 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. Further, professional standards require us to also communicate the effect of uncorrected misstatements related to prior periods on the relevant classes of transactions, account balances or disclosures, and the financial statements as a whole. Management did not identify and we did not notify them of any uncorrected financial statement misstatements.

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 the audit.

REPRESENTATIONS REQUESTED FROM MANAGEMENT

We 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 auditors.

**City of Mendota Heights
Required Communication**

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.

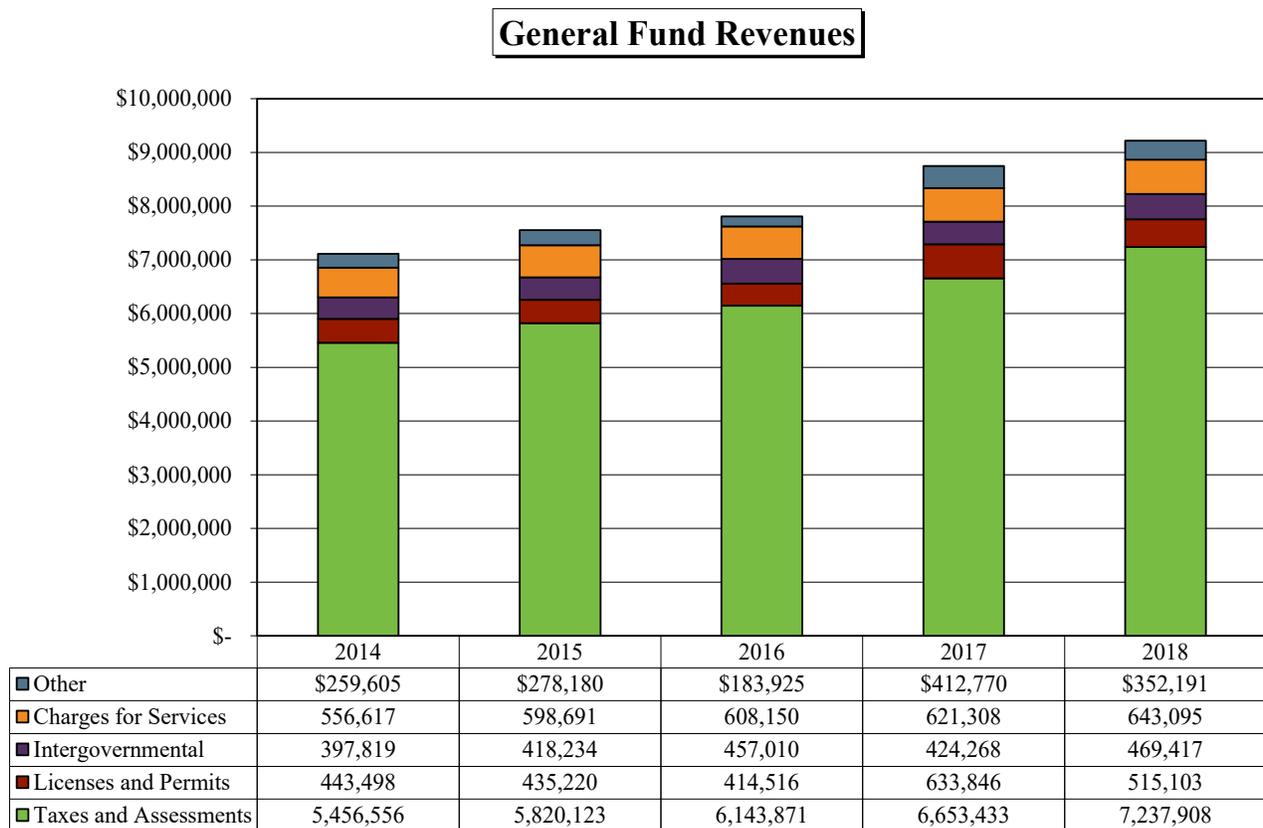
With respect to the supplementary information accompanying the financial statements, we made certain inquiries of management and evaluated the form, content and methods of preparing the information to determine that the information complies with accounting principles generally accepted in the United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

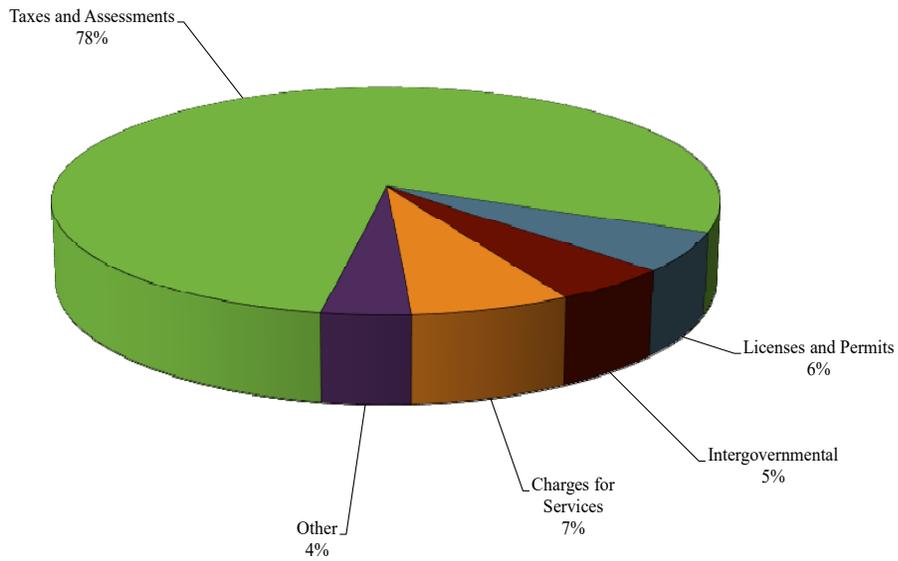


General Fund revenue increased \$472,089, or 5.4%, during the year, from \$8,745,625 in 2017 to \$9,217,714 in 2018. The largest fluctuation occurred in taxes and assessments, which increased \$584,475 due to an increase in the amount of taxes levied in 2018. Licenses and permits revenue decreased \$118,743, or 18.7% due to less commercial permit activity in 2018. All other revenue sources were consistent with the prior year.

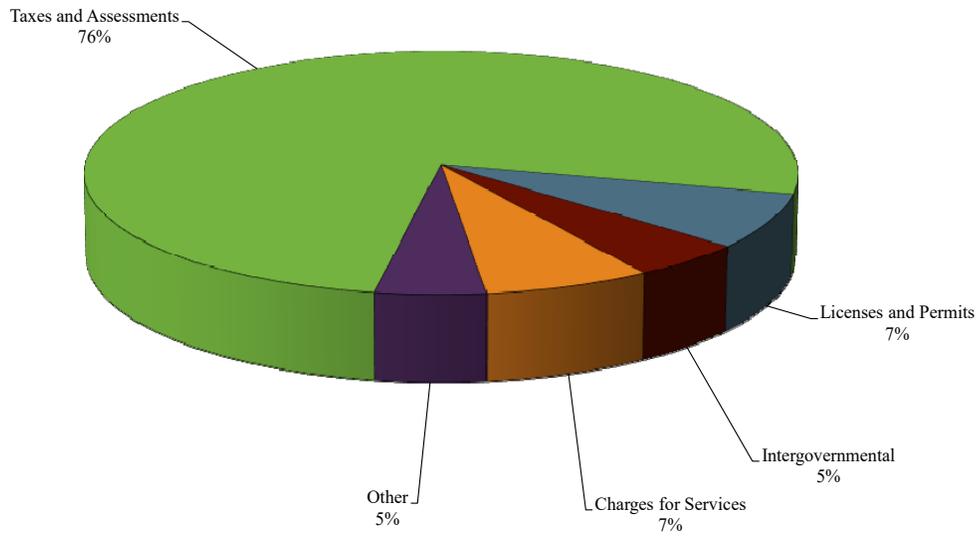
City of Mendota Heights Financial Analysis

GENERAL FUND REVENUES (CONTINUED)

2018 General Fund Revenues



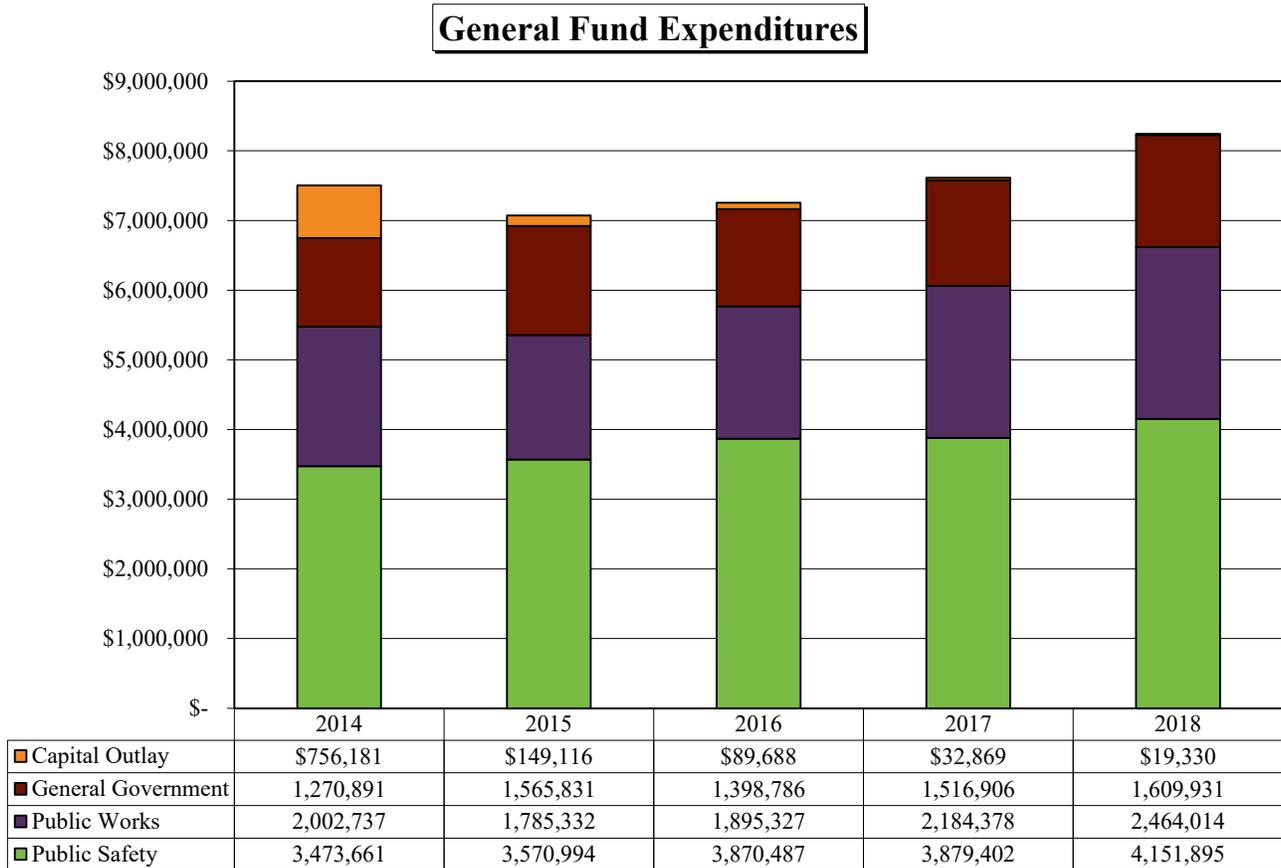
2017 General Fund Revenues



City of Mendota Heights Financial Analysis

GENERAL FUND EXPENDITURES

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

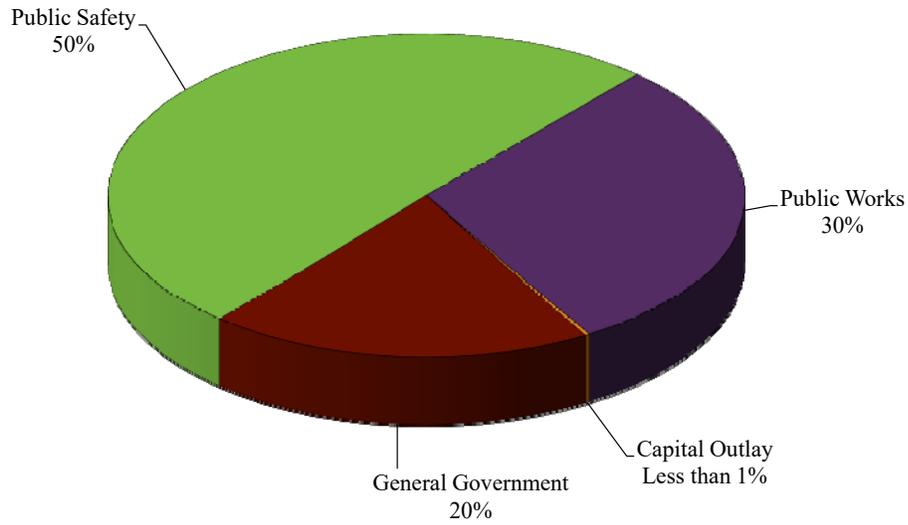


General Fund expenditures increased \$631,615, or 8.3%, from \$7,613,555 in 2017 to \$8,245,170 in 2018. Public works increased the most from 2017, increasing \$279,636, or 12.8%. This increase is due to increased salt and sand costs related to heavier snowfall in 2018. Public safety expenditures increased \$272,493, or 7.0% due to increased health insurance costs and cost of living adjustments. General government expenditures increased \$93,025, or 6.1% due to fiber lines being installed during 2018. Increased salaries and benefits as a result of a compensation study performed by the city impacted all departments to a certain extent.

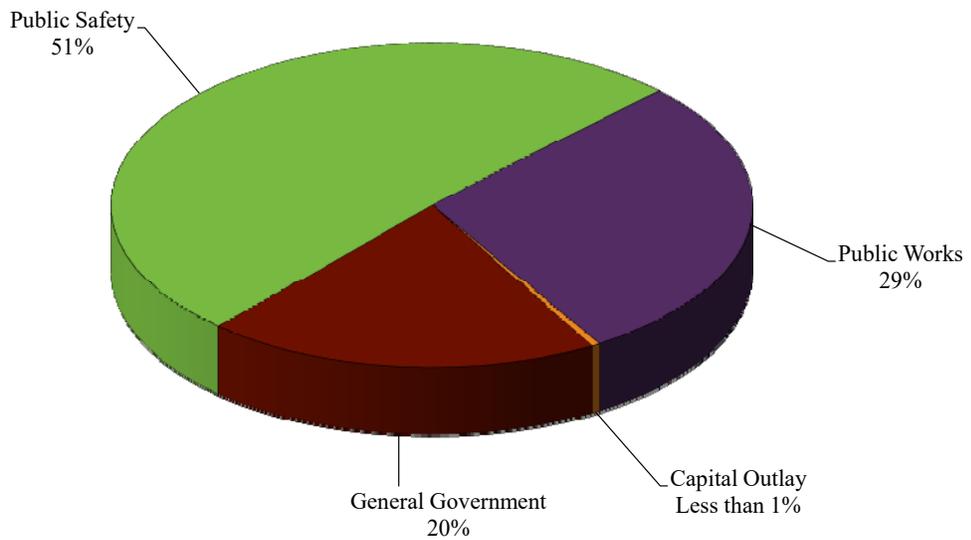
City of Mendota Heights Financial Analysis

GENERAL FUND EXPENDITURES (CONTINUED)

2018 General Fund Expenditures



2017 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 \$687,548, or 7.7%, under budgeted expenditures of \$8,932,718. The fund's revenue was \$340,746, or 3.8%, over budgeted revenues of \$8,876,968.

Public Safety expenditures were under budget by \$562,517. This was due to the police staffing turnover causing vacancies and variations in personnel levels. General government expenditures were under budget \$110,537 due to budgeting for more computer support time from LOGIS than what was actually needed.

License and Permit revenue was over budget by \$150,353. A conservative budget resulted in higher than anticipated building permit revenue. Other revenue was over budget by \$121,191 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.

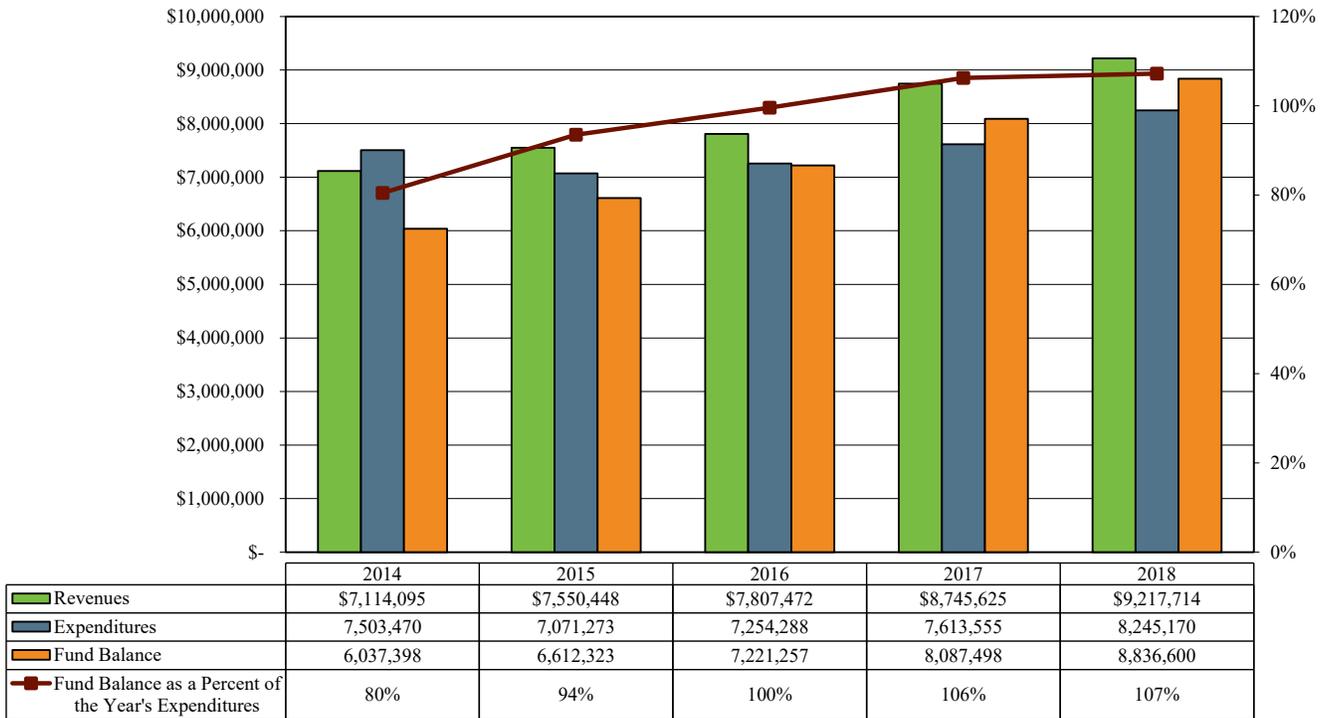
	Original and Final Budget	Amounts	Variance Final Budget - Over (Under)
Revenues			
Taxes and assessments	\$ 7,189,437	\$ 7,237,908	\$ 48,471
Licenses and permits	364,750	515,103	150,353
Intergovernmental	440,902	469,417	28,515
Charges for services	650,879	643,095	(7,784)
Other	231,000	352,191	121,191
Total revenues	8,876,968	9,217,714	340,746
Expenditures			
General government	1,735,518	1,609,931	(125,587)
Public safety	4,714,412	4,151,895	(562,517)
Public works	2,482,788	2,464,014	(18,774)
Capital outlay	-	19,330	19,330
Total expenditures	8,932,718	8,245,170	(687,548)
Other financing sources (uses)			
Transfers in	55,750	47,550	(8,200)
Transfers out	-	(270,992)	(270,992)
Total other financing sources (uses)	55,750	(223,442)	(279,192)
Net change in fund balances	\$ -	\$ 749,102	\$ 749,102

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



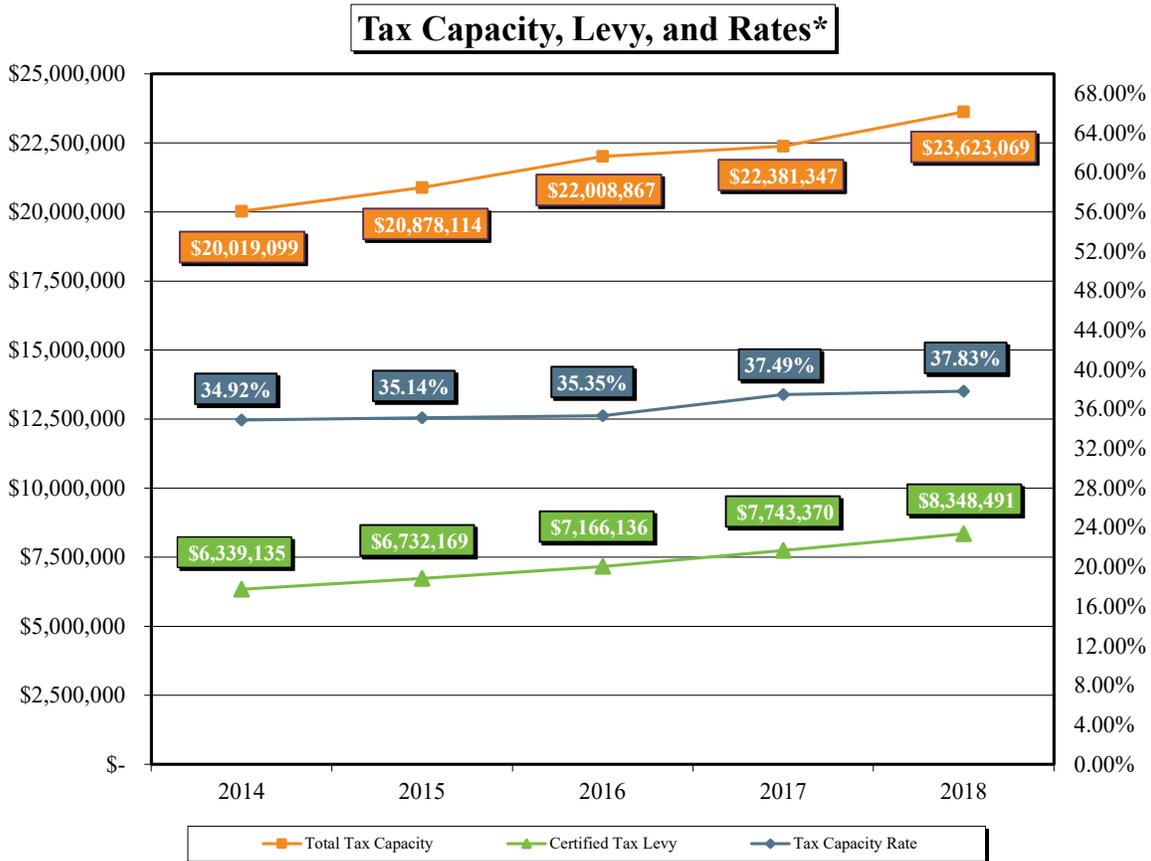
As shown in the chart, the City's fund balance increased to its highest point in the five years presented. The amount of fund balance as a percentage of the current year's expenditures is also at the highest point in the five previous years. In 2017, the City implemented a policy in accordance with GASB 54 whereby the General Fund's unassigned fund balance is at least 75% of the subsequent year's budgeted expenditures. As of December 31, 2018, the City's unassigned General Fund balance of \$8,412,047 was 90.8% of 2019 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 2014 to 2018 by \$3,603,970 or 18.0%. In 2018, the City's tax capacity increased \$1,241,722.



* Property tax data was obtained from the League of Minnesota Cities Property Tax Data Tables for 2014-2017 (www.lmc.org). 2018 data obtained from Dakota County.

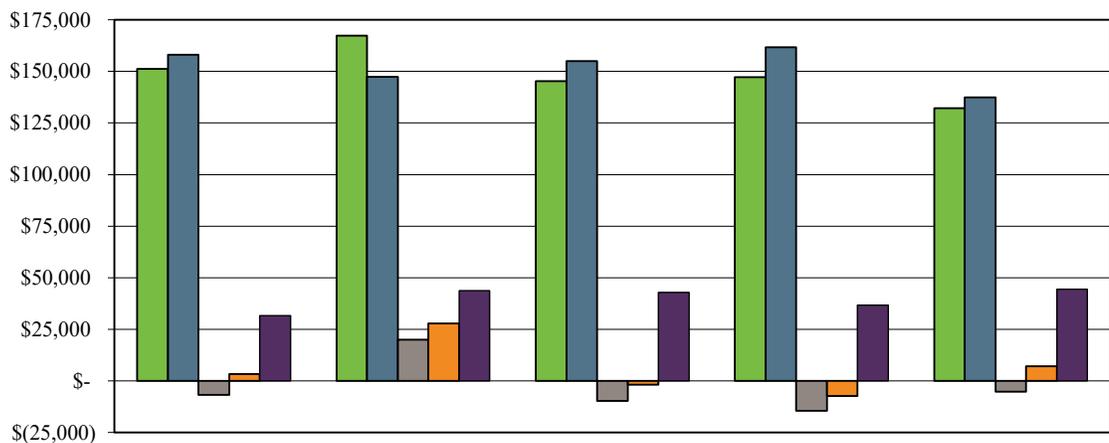
**City of Mendota Heights
Financial Analysis**

ENTERPRISE FUNDS

Par 3 Golf Course Fund

Expenses exceeded revenues in four of the five years presented. The City reported an operating loss in 2018 of \$5,258 after having an operating loss of \$13,438 in 2017. Excluding depreciation, the Fund had an operating income of \$7,099 for 2018, increasing unrestricted net position in the current year.

Par 3 Golf Course Fund



	2014	2015	2016	2017	2018
■ Operating Revenues	\$151,214	\$167,300	\$145,245	\$147,187	\$132,066
■ Operating Expenses	157,963	147,299	154,901	161,672	137,324
■ Operating Income (Loss)	(6,749)	20,001	(9,656)	(14,485)	(5,258)
■ Operating Income (Loss) Excluding Depreciation	3,332	27,882	(1,775)	(7,242)	7,099
■ Unrestricted Net Position	31,630	43,691	42,934	36,739	44,364

**City of Mendota Heights
Financial Analysis**

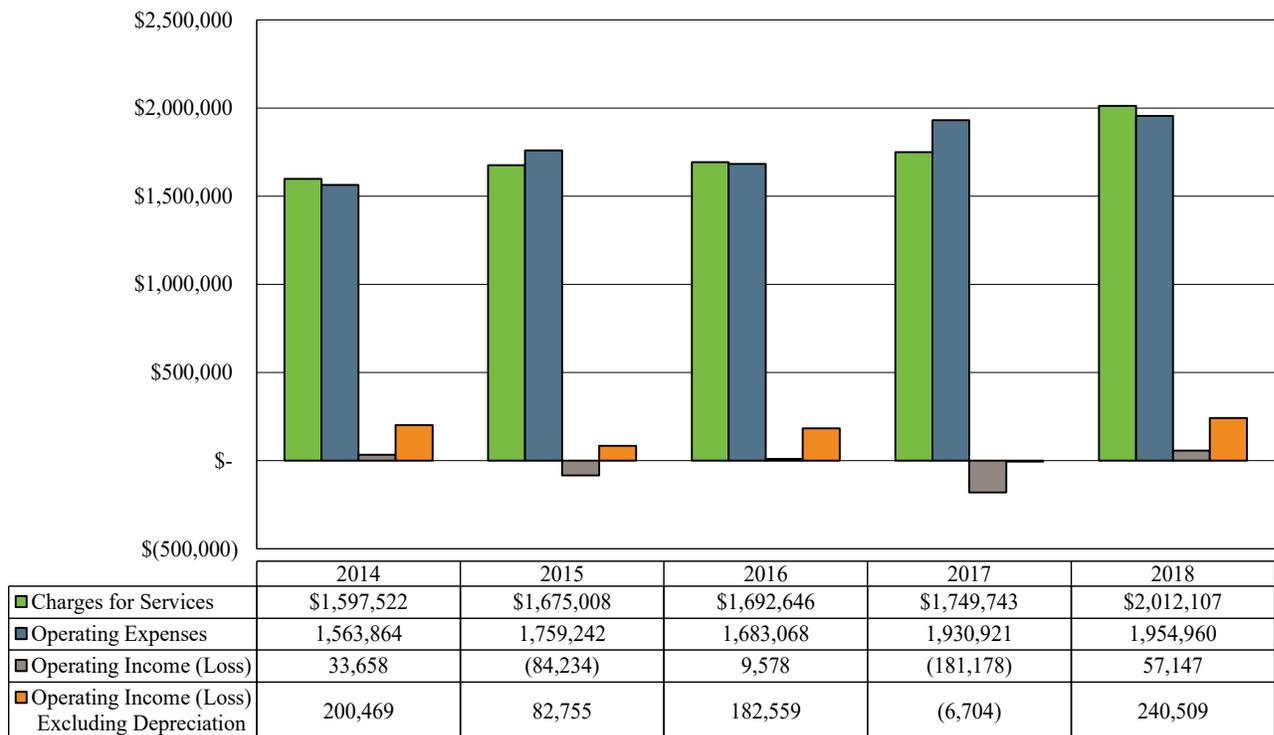
ENTERPRISE FUNDS (CONTINUED)

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 income of \$57,147 for 2018, which included recognition of \$183,362 of depreciation expense. Revenues exceeded expenses in three of the five years presented, with modest operating income in 2014, 2016, and 2018. Net position of the fund increased \$295,359 after factoring in nonoperating revenues, and net transfers.

Sewer Fund

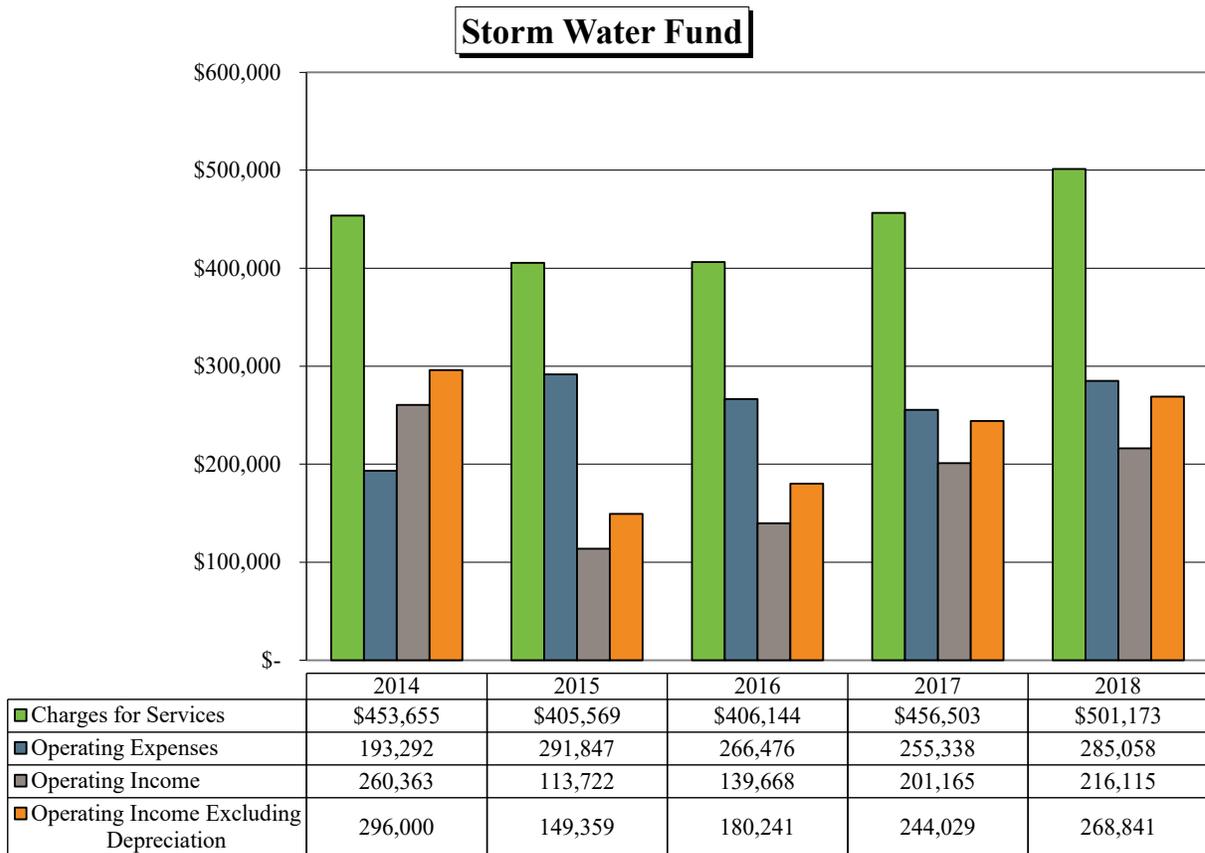


**City of Mendota Heights
Financial Analysis**

ENTERPRISE FUNDS (CONTINUED)

Storm Water Fund

The Storm Water Fund had operating income of \$216,115, which included recognition of depreciation expense of \$52,726. Operating expenses increased \$29,720, from \$255,338 in 2017 to \$285,058 in 2018. This increase was primarily due to the City dredging a pond in 2018. Net position increased \$72,365 in 2018 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. 84 – Fiduciary Activities** – GASB has issued GASB Statement No. 84 relating to accounting and financial reporting for fiduciary activities. This new statement establishes clarity to determine when a government has fiduciary responsibility for a certain activity.
- **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 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. 84 – *FIDUCIARY ACTIVITIES*

The objective of this Statement is to improve guidance regarding the identification of fiduciary activities for accounting and financial reporting purposes and how those activities should be reported.

This Statement establishes criteria for identifying fiduciary activities of all state and local governments. The focus of the criteria generally is on (1) whether a government is controlling the assets of the fiduciary activity and (2) the beneficiaries with whom a fiduciary relationship exists. Separate criteria are included to identify fiduciary component units and postemployment benefit arrangements that are fiduciary activities. An activity meeting the criteria should be reported in a fiduciary fund in the basic financial statements. Governments with activities meeting the criteria should present a statement of fiduciary net position and a statement of changes in fiduciary net position. An exception to that requirement is provided for a business-type activity that normally expects to hold custodial assets for three months or less.

GASB Statement No. 84 describes four fiduciary funds that should be reported, if applicable: (1) pension (and other employee benefit) trust funds, (2) investment trust funds, (3) private-purpose trust funds, and (4) custodial funds. Custodial funds generally should report fiduciary activities that are not held in a trust or equivalent arrangement that meets specific criteria.

This Statement also provides for recognition of a liability to the beneficiaries in a fiduciary fund when an event has occurred that compels the government to disburse fiduciary resources. Events that compel a government to disburse fiduciary resources occur when a demand for the resources has been made or when no further action, approval, or condition is required to be taken or met by the beneficiary to release the assets.

**City of Mendota Heights
Emerging Issues**

ACCOUNTING STANDARD UPDATE – GASB STATEMENT NO. 84 – *FIDUCIARY ACTIVITIES* (CONTINUED)

GASB Statement No. 84 is effective for reporting periods beginning after December 15, 2018. Earlier application is encouraged.

Information provided above was obtained from 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.

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.

**City of Mendota Heights
Emerging Issues**

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

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.