

# Management Letter

**City of New Richland**  
New Richland, Minnesota

For the Year Ended  
December 31, 2017

Management, Honorable Mayor and City Council  
City of New Richland, Minnesota

We have audited the financial statements of the governmental activities, the business-type activities, the discretely presented component units, each major fund, and the aggregate remaining fund information of the City of New Richland, Minnesota (the City) as of and for the year ended December 31, 2017, which collectively comprise the City's basic financial statements and have issued our report thereon dated June 6, 2018. Professional standards require that we provide you with information about our responsibilities under generally accepted auditing standards and *Government Auditing Standards*, as well as certain information related to the planned scope and timing of our audit. We have communicated such information in our letter to you dated October 30, 2017. In our report, our opinion was qualified because the City not adopted GASB Statement No. 68, Accounting and Financial Reporting for Pensions, for the Volunteer Firefighters' Relief Association, in the governmental activities, and, accordingly, has not shown activity related to this standard. Professional standards also require that we communicate to you the following information related to our audit. Professional standards also require that we communicate to you the following information related to our audit.

**Our Responsibility under Auditing Standards Generally Accepted in the United States of America, *Government Auditing Standards***

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 financial statements does not relieve you or your management of your responsibilities.

Our responsibility is to plan and perform the audit to obtain reasonable, but not absolute, assurance that the financial statements are free of material misstatement. As part of our audit, we considered the internal control of the City. Such considerations were solely for the purpose of determining our audit procedures and not to provide any assurance concerning such internal control. We are responsible for communicating significant matters related to the audit that are, in our professional judgment, relevant to your responsibilities in overseeing the financial reporting process. However, we are not required to design procedures specifically to identify such matters.

**Significant Audit Findings**

In planning and performing our audit, we considered the City's internal control over financial reporting as a basis for designing our auditing procedures 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 over financial reporting. Accordingly, we do not express an opinion on the effectiveness of the City's internal control over financial reporting.

Our consideration of internal control over financial reporting was for the limited purpose described in the preceding paragraph and was not designed to identify all deficiencies in internal control over financial reporting that might be significant deficiencies or material weaknesses and therefore, there can be no assurance that all deficiencies, significant deficiencies, or material weaknesses have been identified. However, as described in the accompanying schedule of findings and responses, we identified certain deficiencies in internal control over financial reporting that we consider to be material weaknesses and other deficiencies 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 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 considered the deficiency described on the following pages as finding 2014-003 to be a material weakness.

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. We consider the deficiencies described below as findings 2017-001 and 2017-002 to be significant deficiencies.

**2017-001 Segregation of Duties**

*Condition:* During our audit we reviewed internal control procedures over payroll, disbursements, cash receipts and utility billing and found the City to have limited segregation of duties in these areas.

*Criteria:* There are four general categories of duties: authorization, custody, record keeping and reconciliation. In an ideal system, different employees perform each of these four major functions. In other words, no one person has control of two or more of these responsibilities.

*Effect:* The existence of this limited segregation of duties increases the risk of fraud.

**Internal Control Over Payroll**

*Cause:* As a result of the small number of staff, the Clerk/Treasurer controls and maintains the check stock, sets up and maintains employee records, runs the payroll, prepares the checks, signs checks using e-signatures in Banyon system, posts activity to the general ledger, reconciles bank accounts, prepares payroll tax returns, and maintains the payroll records.

*Recommendation:* While we recognize number of staff is not large enough to eliminate this deficiency it is important that the Council is aware of this condition and monitor all financial information. Additional controls might include review of payroll registers, earnings records, payroll reports, etc.

*Management Response:*

The City has already taken measures to attempt to comply even though the City is relatively small and the number of clerical/bookkeeping staff they can employ is limited. The Council has addressed this circumstance by active participation in the City's affairs. This includes approval of expenditures, regular review of financial statements and budget comparisons.

*Updated Response From Prior Year:*

The City is continuing to develop policies and procedures to provide compensating controls for the segregation of duties.

**Internal Control Over Disbursements**

*Cause:* As a result of the small number of staff, the Assistant Clerk sets up vendors in Banyon, opens the mail, prepares checks, mails checks, and maintains the purchase journal.

*Recommendation:* We recommend that when the Assistant Clerk prepares the checks, the Clerk/Treasurer be responsible for mailing them to vendors and vice versa. We also recommend the Clerk/Treasurer initial invoices when approved for payment. Additionally we recommend an individual separate from the Clerk/Treasurer review cancelled checks received with the bank statement and investigate items such as: void checks, inconsistencies in check sequence, possible alterations, and unusual payees. This individual should also review bank reconciliations for accuracy and timeliness of preparation. It is important that the Council is aware of this condition and monitor all financial information.

*Management Response:*

The City has already taken measures to attempt to comply even though the City is relatively small and the number of clerical/bookkeeping staff they can employ is limited. The Council has addressed this circumstance by active participation in the City's affairs. This includes approval of expenditures, regular review of financial statements and budget comparisons.

*Updated Response From Prior Year:*

The City is continuing to develop policies and procedures to provide compensating controls for the segregation of duties.

**Internal Control Over Cash Receipts**

*Cause:* As a result of the small number of staff, the Assistant Clerk is responsible for setting up customers in Banyon, opening the mail, receiving and endorsing checks, preparing and taking the deposit to the bank, generating billing statements, and maintaining accounts receivable records.

*Recommendation:* While we recognize the number of staff is not large enough to eliminate this deficiency it is important that the Council is aware of this condition and monitors all financial information. We recommend that the Clerk/Treasurer be responsible for preparing deposit slips in order to improve segregation of reconciling activities related to cash receipts. Additional controls might include obtaining and reviewing monthly receipt information. It was also recommended that the city reconcile the accounts receivable back to the ambulance collections reports from the collections service.

*Management Response:*

The City has already taken measures to attempt to comply even though the City is relatively small and the number of clerical/bookkeeping staff they can employ is limited. The Council has addressed this circumstance by active participation in the City's affairs. This includes review of deposits, regular review of financial statements and budget comparisons.

*Updated Response From Prior Year:*

The City is continuing to develop policies and procedures to provide compensating controls for the segregation of duties.

**2017-001 Segregation of Duties (Continued)**

**Internal Control Over Utility Billing**

*Cause:* As a result of the small number of staff, the Assistant Clerk sets up new customers in the Banyon system, opens the mail, receives and endorses checks, prepares the deposit and takes it to the bank, generates billing statements, and maintains receivable subledgers.

*Recommendation:* While we recognize the number of staff is not large enough to eliminate this deficiency it is important that the Council is aware of this condition and monitors all financial information. We recommend that the Clerk/Treasurer be responsible for preparing deposit slips in order to improve segregation of reconciling activities related to utility billing. Additional controls might include reviewing quarterly billing registers, adjustments to accounts and employee billing registers.

*Management Response:*

The City has already taken measures to attempt to comply even though the City is relatively small and the number of clerical/bookkeeping staff they can employ is limited. The Council has addressed this circumstance by active participation in the City's affairs. This includes approval of expenditures, regular review of financial statements and budget comparisons.

*Updated Response From Prior Year:*

The City is continuing to develop policies and procedures to provide compensating controls for the segregation of duties.

**2017-002      Preparation of Financial Statements**

*Condition:*                    As in prior years, we were requested to draft the audited financial statements and related footnote disclosures as part of our regular audit services. Recent auditing standards require auditors to communicate this situation to the Council as an internal control deficiency. Ultimately, it is management’s responsibility to provide for the preparation of your statements and footnotes, and the responsibility of the auditor to determine the fairness of presentation of those statements. However, based on recent auditing standards, it is our responsibility to inform you that this deficiency could result in a material misstatement to the financial statements that could have been prevented or detected by your management. Essentially, the auditors cannot be part of your internal control process.

*Criteria:*                      Internal controls should be in place to ensure adequate internal control over safeguarding of assets and the reliability of financial records and reporting.

*Cause:*                         From a practical standpoint, we prepare the statements and determine the fairness of the presentation at the same time in connection with our audit. This is not unusual for us to do with organizations of your size.

*Effect:*                        The effectiveness of the internal control system relies on enforcement by management. The effect of deficiencies in internal controls can result in undetected errors. As in prior years, we have instructed management to review a draft of the auditor prepared financials in detail for accuracy; we have answered any questions that management might have, and have encouraged research of any accounting guidance in connection with the adequacy and appropriateness of classification of disclosures in your statements. We are satisfied that the appropriate steps have been taken to provide you with the completed financial statements.

*Recommendation:*        Under these circumstances, the most effective controls lie in management’s knowledge of the City’s financial operations. It is the responsibility of management and those charged with governance to make the decision whether to accept the degree of risk associated with this condition because of cost and other considerations. Regarding the specific situation listed above, we would offer the following specific recommendation: 1) Utilize a disclosure checklist to ensure all required disclosures are present and agree to work papers, and 2) Agree your Banyon year-end financial report to the fund of financial statements.

*Management Response:*

The City is aware of the control deficiency, which is an unavoidable consequence of the financial restrictions of small cities. Each year, the City has a presentation from our auditor to the Council after the audit is performed. Management recognizes that it is not economically feasible to fully correct this finding; it is aware of the deficiency and is relying on oversight by management and the Council to monitor the deficiency. The Clerk/Treasurer may attend future classes dealing with governmental financial/accounting practices.

*Updated Response From Prior Year:*

The City plans on reviewing the disclosure checklist in the future and compare the Banyon financial information to the report.

## 2017-003 Material Audit/Accounting Adjustments

- Condition:* During our audit, material adjustments were needed to adjust accounts receivable, interfund activity, and debt activity.
- Criteria:* The financial statements are the responsibility of the City's management.
- Cause:* City staff has not prepared a year-end trial balance reflecting all necessary accounting entries.
- Effect:* It is likely that if a misstatement were to occur, it would not be detected by the City's system of internal control. The audit firm cannot serve as a compensating control over this deficiency.
- Recommendation:* We recommend that management review each journal entry, obtain an understanding of why the entry was necessary and modify current procedures to insure that future corrections are not needed.

### *Management Response:*

Management thoroughly reviews journal entries prepared for the audit and asks questions throughout the year in an attempt to eliminate as many adjusting entries as possible.

## **Compliance and Other Matters**

As part of obtaining reasonable assurance about whether the City's financial statements are free of material misstatement, we performed tests of its compliance with certain provisions of laws, regulations, contracts, and grant agreements and other matters, noncompliance with which could have a direct and material effect on the determination of financial statement amounts. However, providing an opinion on compliance with those provisions was not an objective of our audit. The results of our tests disclosed no instances of noncompliance or other matters that are required to be reported in accordance with *Government Auditing Standards* or Minnesota statutes.

## **Monthly Depreciation Estimates**

The City records monthly depreciation expense estimates. This provides Council and management with current and updated operational information for the City's enterprise funds. The amount of this estimate for the coming year for the Water Utility fund is \$5,800 per month, for the Sewer Utility fund it is \$15,400 per month and for the Cedar Pointe Housing fund it is \$1,440.

## **Written Policies and Procedures**

The City is continually developing written policies and procedures to outline job descriptions and should continue to develop and adopt various policies as management deems appropriate. This will be an important part of the City's internal control, and will be helpful if there is staff turnover.

## **Difficulties Encountered in Performing the Audit**

We encountered no significant difficulties in dealing with management in performing and completing our audit. For purposes of this letter professional standards define 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.

## **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 Note 1 to the financial statements. No new accounting policies were adopted and the application of existing policies were 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.

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 made relate to estimated historical cost of the capital assets, depreciation on capital assets and the liability for the City's pensions.

- Management's estimate of capital asset basis is based on estimated historical cost of the capital assets and depreciation is based on the estimated useful lives of capital assets.
- Management's estimate of allowance for doubtful accounts is based on past collection and write-off experience.
- Management's estimate of its pension liability is based on several factors including, but not limited to, anticipated investment return rate, retirement age for active employees, life expectancy, salary increases and form of annuity payment upon retirement.

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

The disclosures in the financial statements are neutral, consistent, and clear. Certain financial statement disclosures are particularly sensitive because of their significance to financial statement users.

## **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. Management has corrected all such misstatements. We proposed three journal entries that we consider to be audit entries or corrections of management decisions. They related to the following situations:

- A material audit entry was required to adjust due to other fund.
- A material audit entry was required to adjust debt activity.
- A material audit entry was required to adjust ambulance revenue and receivables.

We also assisted in preparing a number of year-end accounting entries. These were necessary to adjust the City's records at year end to correct ending balances. The City should establish more detailed processes and procedures to reduce the total number of entries in each category. The City will receive better and timelier information if the preparation of year-end entries is completed internally.

## **Management Representations**

We have requested certain representations from management that are included in the management representation letter dated June 6, 2018.

## **Management Consultations with Other Independent 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 governmental unit’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 required supplementary information (RSI) (Management’s Discussion and Analysis, the Schedules of Employer’s Share of the Net Pension Liability and the Schedules of Employer’s Contributions), which is information 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.

We were engaged to report on the supplementary information (combining and individual fund financial statements), which accompany the financial statements but are not RSI. With respect to this supplementary information, 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.

We were not engaged to report on the introductory, which accompany the financial statements but are not RSI. We did not audit or perform other procedures on this other information and we do not express an opinion or provide any assurance on it.

**Financial Position and Results of Operations**

Our principal observations and recommendations are summarized on the following pages. These recommendations resulted from our observations made in connection with our audit of the City’s financial statements for the year ended December 31, 2017.

**General Fund**

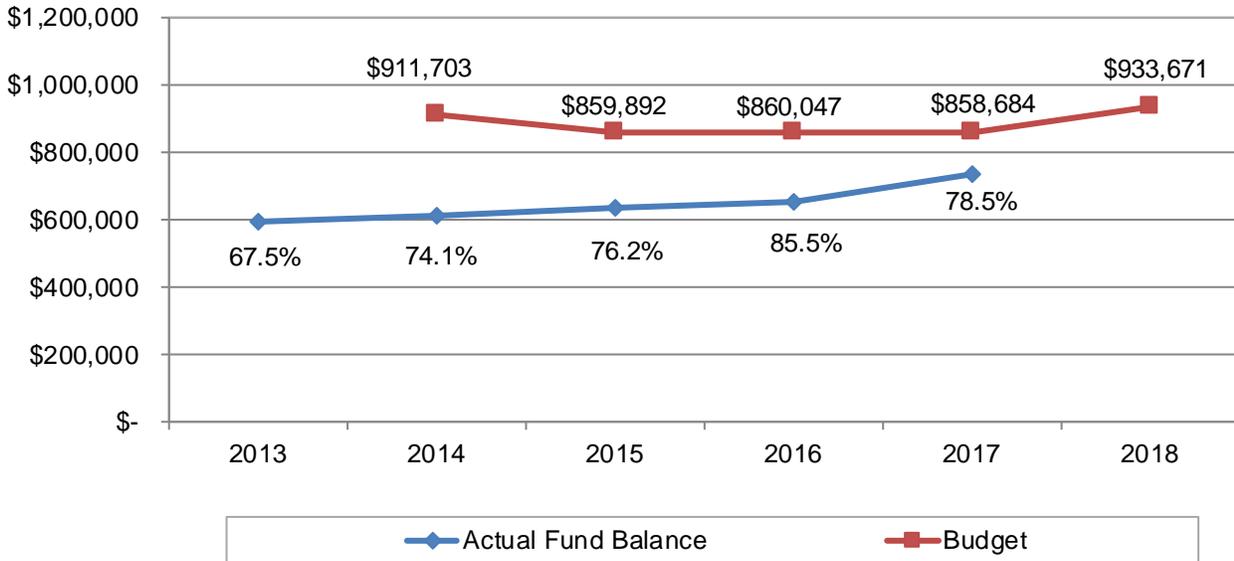
Minnesota municipalities must maintain substantial amounts of fund balance in order to meet their liquidity and working capital needs as an operating entity. That is because a substantial portion of your revenue sources (taxes and intergovernmental revenues) are received in the last two months of each six-month cycle.

As you can see from the following information, it is necessary to maintain fund balance in order to keep pace with the increasing operating budget. *This information is also presented in graphic form below.*

Year	Unassigned Fund Balance December 31	Budget Year	General Fund Budget	Percent of Fund Balance to Budget
2013	\$ 615,092	2014	\$ 911,703	67.5 %
2014	637,387	2015	859,892	74.1
2015	655,493	2016	860,047	76.2
2016	734,558	2017	858,684	85.5
2017	732,658	2018	933,671	78.5

The following is an analysis of the General fund’s unassigned fund balance for the past five years compared to the following year’s budget:

**Unassigned Fund Balance/Budget Comparison**



We have compiled a peer group average derived from information we have request from the Office of the State Auditor and then compiled data for Cities of the 4<sup>th</sup> class which have populations below 2,500. In 2015 and 2016, the average General fund balance as a percentage of expenditures was 104 and 111 percent, respectively. Based on comparison to the peer groups, the City’s general fund balance is below average. The peer group average is derived from information from the Office of the State Auditor.

The fund balance increased by \$15,951 in 2017. The total unassigned fund balance of \$732,658 represents 78.5 percent of the 2018 budgeted expenditures. Many other organizations, including the Office of the State Auditor (the OSA) and League of Minnesota Cities (LMC) recommend that a unassigned fund balance reserve be anywhere from 35 to 50 percent of planned expenditures. We concur with those recommendations.

Although there is no legislation regulating fund balance, it is a good policy to designate intended use of fund balance. This helps address citizen concerns as to the use of fund balance and tax levels. The City should consider assigning for intended use of fund balance at and above the fifty percent level. This documentation could be accomplished by an annual resolution to identify intended use of available fund balance. We recommend a minimum unassigned fund balance to be approximately 40 percent to 50 percent of planned disbursements. So at the current level, the fund balance is considered higher than what is recommended.

The purposes and benefits of a fund balance are as follows:

- Expenditures are incurred somewhat evenly throughout the year. However, property tax and state aid revenues are not received until the second half of the year. An adequate fund balance will provide the cash flow required to finance the governmental fund expenditures.
- The City is vulnerable to legislative actions at the State and Federal level. The State continually adjusts the local government aid and property tax credit formulas. We also have seen the State mandate levy limits for cities over 2,500 in population. An adequate fund balance will provide a temporary buffer against those aid adjustments or levy limits.
- Expenditures not anticipated at the time the annual budget was adopted may need immediate Council action. These would include capital outlay, replacement, lawsuits and other items. An adequate fund balance will provide the financing needed for such expenditures.
- A strong fund balance will assist the City in maintaining, improving or obtaining its bond rating. The result will be better interest rates in future bond sales.

The 2017 General fund operations are summarized as follows:

	Budgeted Amounts		Actual Amounts	Variance with Final Budget
	Original	Final		
Revenues	\$ 995,466	\$ 995,466	\$ 970,376	\$ (25,090)
Expenditures	858,684	858,684	963,328	(104,644)
Excess of Revenues Over Expenditures	136,782	136,782	7,048	(129,734)
Other Financing Sources (Uses)				
Proceeds from sale of capital assets	-	-	4,169	4,169
Transfers in	-	-	16,305	16,305
Transfers out	(300)	(300)	(11,571)	(11,271)
Total Other Financing Sources (Uses)	(300)	(300)	8,903	9,203
Net Change in Fund Balances	<u>\$ 136,482</u>	<u>\$ 136,482</u>	15,951	<u>\$ (120,531)</u>
Fund Balances, January 1			1,225,985	
Fund Balances, December 31			<u>\$ 1,241,936</u>	

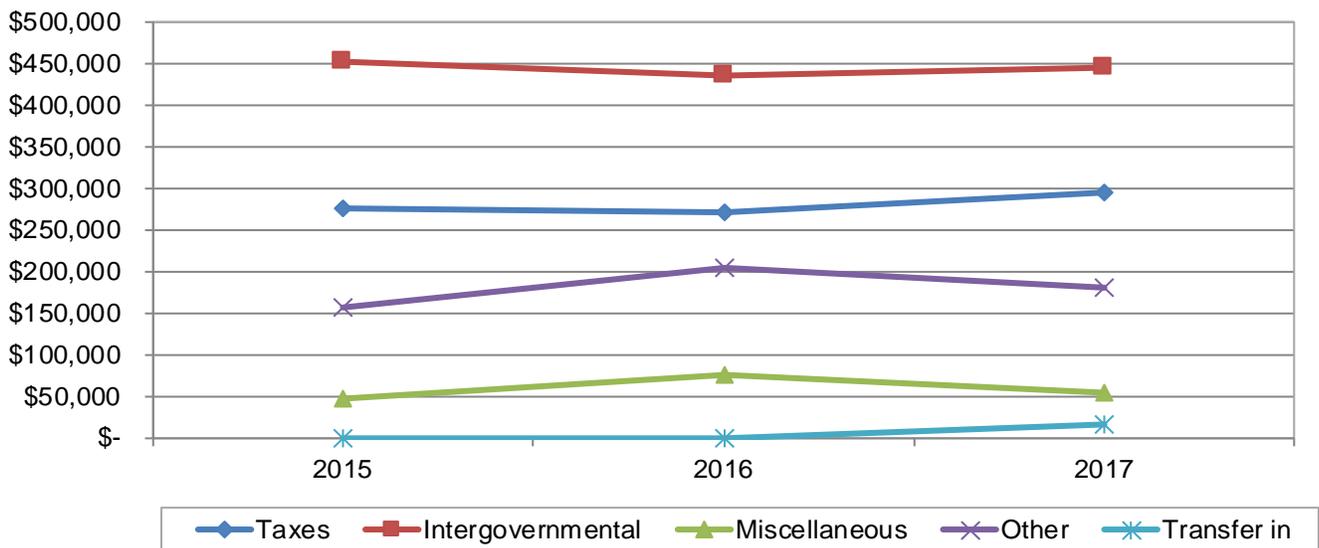
The overall change in fund balance is related to the following:

- Ambulance current expenditures were under budget by \$25,309.
- Tax revenues were under budget by \$122,613. It appears that the budget was based on total levy versus the General fund only. This should be reviewed going forward and do not include the debt service levy.
- Capital outlay expenditures which were over budget by \$96,370.

A comparison of General fund revenues for the last three years is presented below:

Source	2015	2016	2017	Percent of Total	Per Capita
Taxes	\$ 276,415	\$ 271,575	\$ 294,748	29.7 %	\$ 244
Special assessments	1,118	1,424	450	-	-
Licenses and permits	18,831	24,324	22,694	2.3	19
Intergovernmental	452,754	435,116	444,757	45.1	368
Charges for services	131,320	167,778	145,001	14.6	120
Fines and forfeits	2,286	2,684	1,291	0.1	1
Investment earnings	3,116	5,465	6,888	0.7	6
Miscellaneous	48,461	76,232	54,547	5.5	45
Proceeds from sale of capital assets	-	2,107	4,169	0.4	
Transfers in	-	-	16,305	1.6	13
<b>Total Revenues</b>	<b>\$ 934,301</b>	<b>\$ 986,705</b>	<b>\$ 990,850</b>	<b>100.0 %</b>	<b>\$ 816</b>

### General Fund Revenues by Source

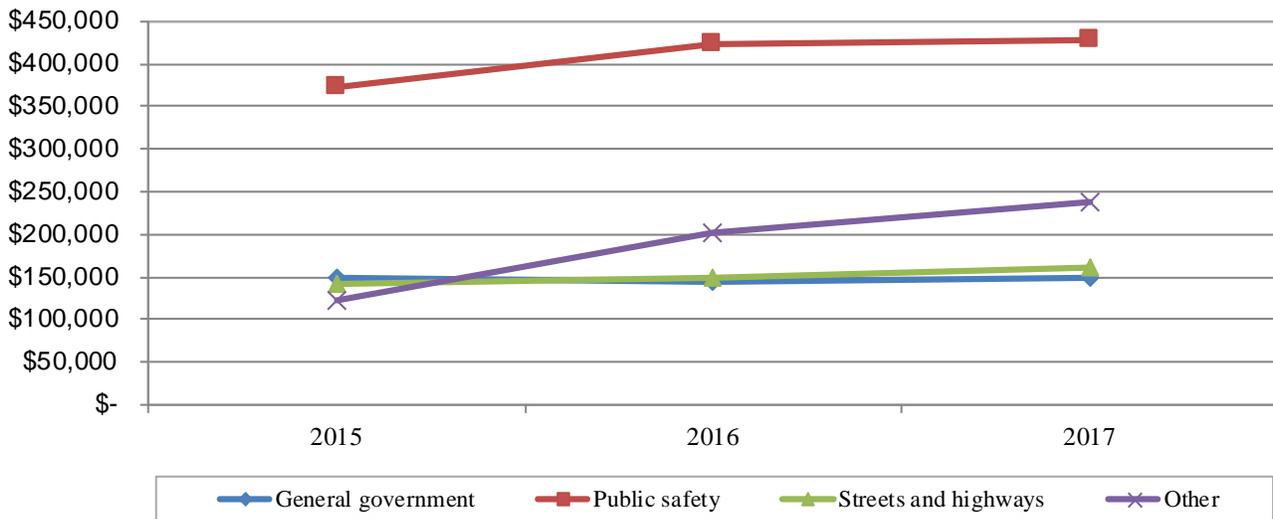


A comparison of General fund expenditures and transfers for the last three years is presented below:

Program	2015	2016	2017	Percent	Per Capita	Peer Group Per Capita
<b>Current</b>						
General government	\$ 148,803	\$ 144,294	\$ 149,115	15.3 %	\$ 123	\$ 198
Public safety	371,590	422,181	426,629	43.7	353	212
Streets and highways	141,020	149,873	160,690	16.5	133	162
Sanitation and waste removal	1,511	2,242	3,414	0.4	3	-
Culture and recreation	37,084	35,641	46,110	4.7	38	71
Economic development	4,800	4,800	4,800	0.5	4	6
<b>Total current</b>	<b>704,808</b>	<b>759,031</b>	<b>790,758</b>	<b>81.1</b>	<b>654</b>	<b>649</b>
Capital outlay	79,450	159,607	172,570	17.7	143	79
Transfers out	300	300	11,571	1.2	10	-
<b>Total Expenditures and Transfers</b>	<b><u>\$ 784,558</u></b>	<b><u>\$ 918,938</u></b>	<b><u>\$ 974,899</u></b>	<b><u>100.0 %</u></b>	<b><u>\$ 807</u></b>	<b><u>\$ 728</u></b>

The above chart compares the amount your City spends per capita, in comparison to a peer group. The peer group average is compiled from financial information requested from the Office of the State Auditor. Different peer group averages are used for cities of the 4<sup>th</sup> class (population less than 2,500) has been developed for comparison purposes).

### General Fund Expenditures and Transfers by Program



## Special Revenue Funds

Special revenue funds have revenue from specific sources to be used for specific purpose. Listed below are the special revenue funds of the City along with the fund balances for 2017 and 2016 and the net change:

Fund	Fund Balances December 31,		Increase (Decrease)
	2017	2016	
Nonmajor			
Rural Fire	\$ 170,959	\$ 153,817	\$ 17,142
2010 Flood	-	14,412	(14,412)
2016 Flood	-	520	(520)
TIF District 1-1 Homestake Subdivision	(267,197)	(219,264)	(47,933)
Total	<u>\$ (96,238)</u>	<u>\$ (50,515)</u>	<u>\$ (45,723)</u>

## Debt Service Funds

Debt Service funds are a type of governmental fund to account for the accumulation of resources for the payment of interest and principal on debt (other than enterprise fund debt).

Debt Service funds may have one or a combination of the following revenue sources pledged to retire debt as follows:

- Property taxes - Primarily for general City benefit projects such as parks and municipal buildings. Property taxes may also be used to fund special assessment bonds which are not fully assessed.
- Tax increments - Pledged exclusively for tax increment/economic development districts.
- Capitalized interest portion of bond proceeds - After the sale of bonds, the project may not produce revenue (tax increments or special assessments) for a period of one to two years. Bonds are issued with this timing difference considered in the form of capitalized interest.
- Special assessments - Charges to benefited properties for various improvements.

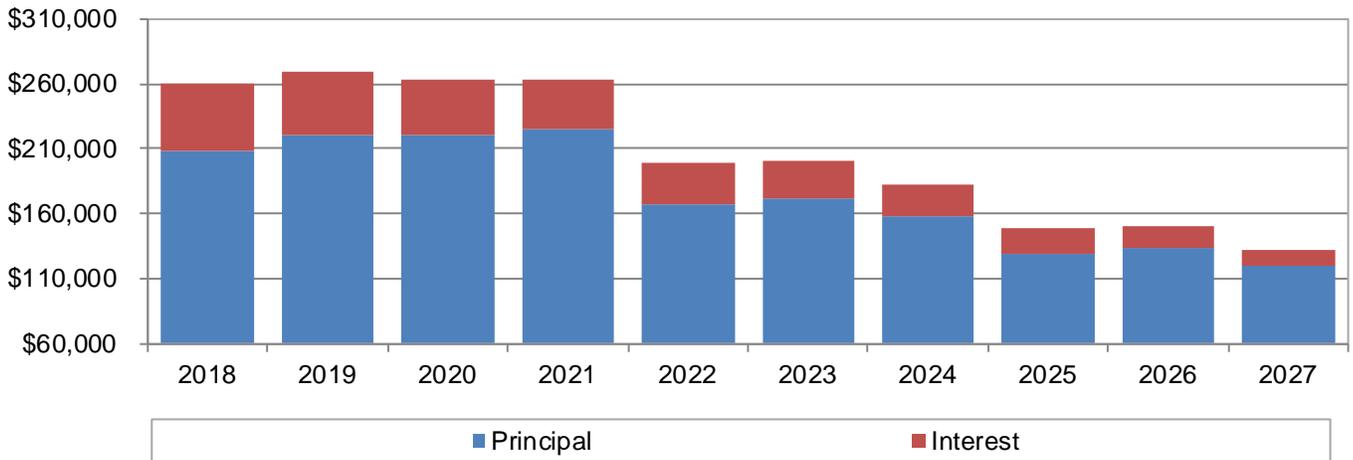
In addition to the above pledged assets, other funding sources may be received by Debt Service funds as follows:

- Residual project proceeds from the related capital project fund
- Investment earnings
- State or Federal grants
- Transfers from other funds

The following is a summary of Debt Service fund assets and outstanding debt as of December 31, 2017:

Debt Description	Total Cash and Temporary Investments	Total Assets	Outstanding Debt	Maturity Date
G.O. Special Assessment Bonds				
2009 G.O. Refunding/2010 G.O. Improvement	\$ -	\$ 61,124	\$ 369,000	02/01/26
2007 G.O. Improvement/2012 G.O. Refunding	164,230	224,719	275,500	02/01/24
2014A G.O. Improvement	<u>45,726</u>	<u>276,460</u>	<u>1,355,000</u>	12/01/29
 Total All Debt Service Funds	 <u>\$ 209,956</u>	 <u>\$ 562,303</u>	 <u>\$ 1,999,500</u>	
 Future Interest on Debt			 <u>\$ 326,632</u>	

The annual debt service requirements for the next 10 years for the debt detailed above are as follows:



**Capital Projects Funds**

Capital projects funds are used to account for the acquisition and construction of major capital facilities other than those financed by proprietary funds. The table below compares 2017 fund balances with 2016.

Fund	Fund Balances December 31		Increase (Decrease)
	2017	2016	
Nonmajor			
Capital Improvement	\$ 72,639	\$ 66,706	\$ 5,933
2014 Street Reconstruction	352,473	352,223	250
Oddfellows Building	<u>531</u>	<u>538</u>	<u>(7)</u>
 Total	 <u>\$ 425,643</u>	 <u>\$ 419,467</u>	 <u>\$ 6,176</u>

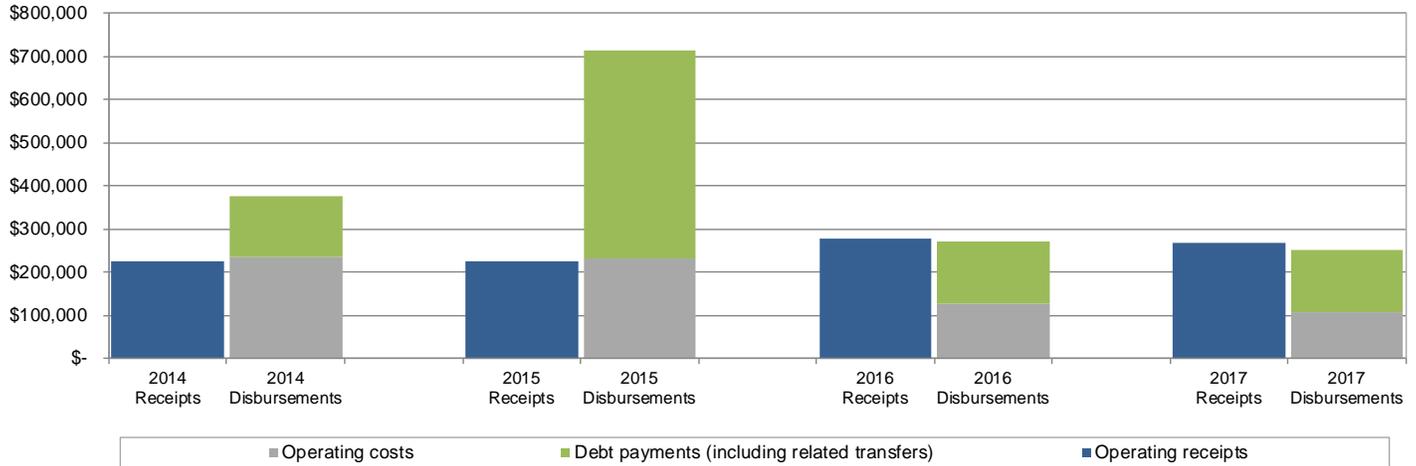
The City should analyze projects' status each year and close those that are completed.

## Enterprise Funds

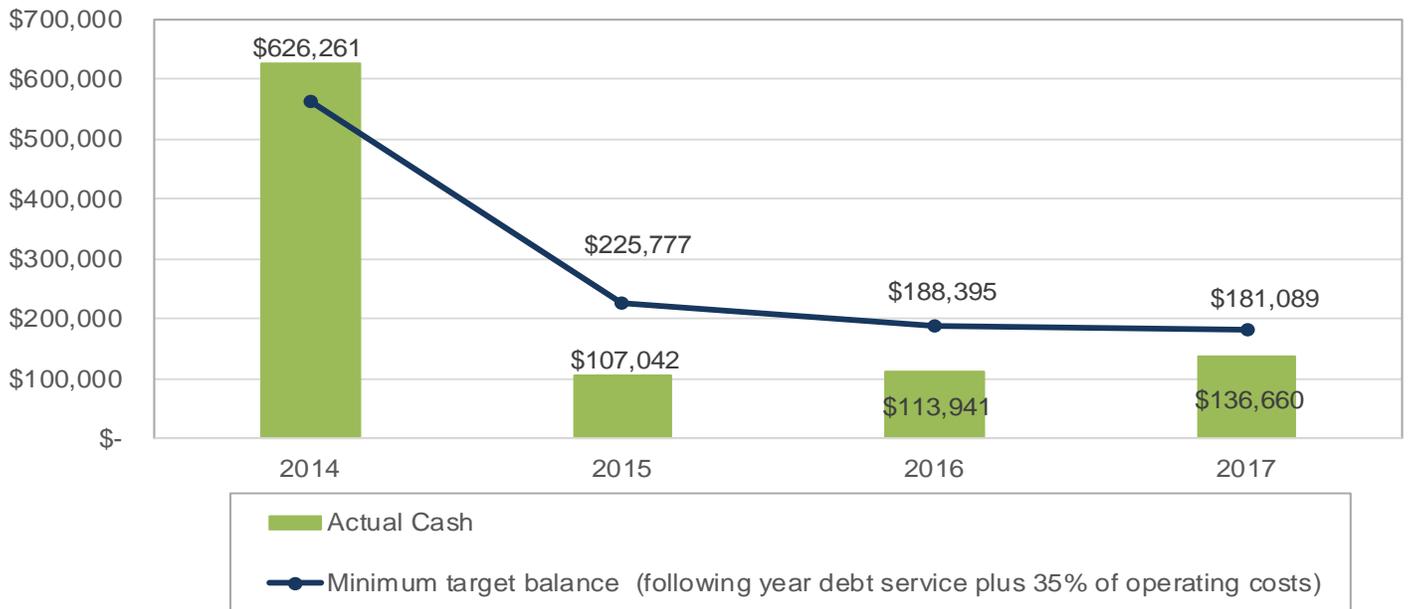
Enterprise funds are used to account for operations that are financed and operated in a manner similar to private business enterprises - where the intent is that the costs of providing goods or services to the general public on a continuing basis be financed or recovered primarily through user charges.

The results of the operations in terms of cash flow and the breakdown of the cash balance for the past four years are as follows:

### Water Utility Cash Flow



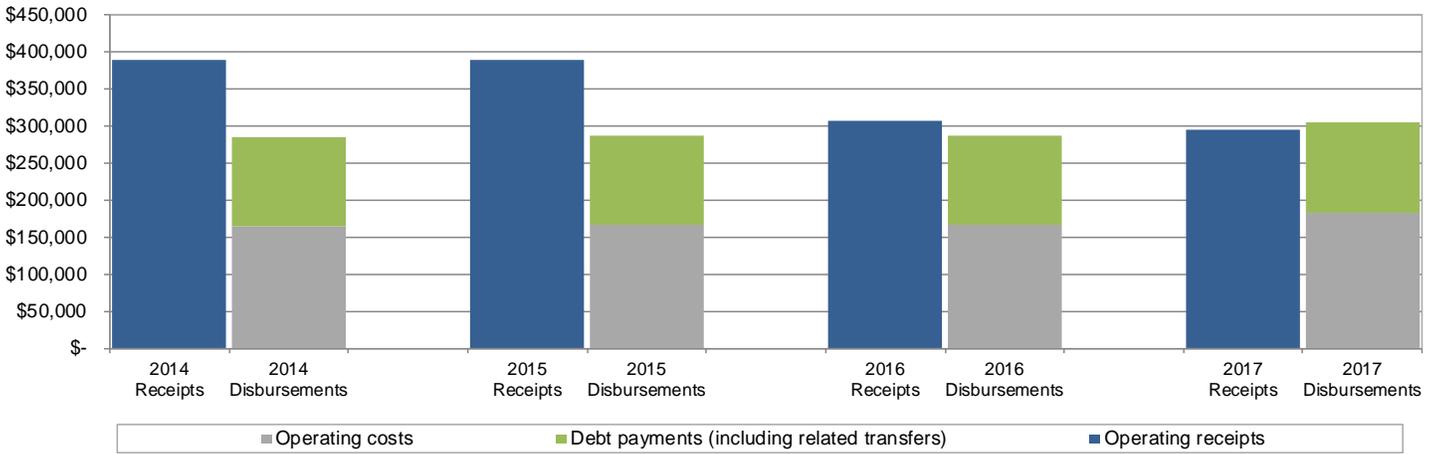
### Water Utility Cash Balance



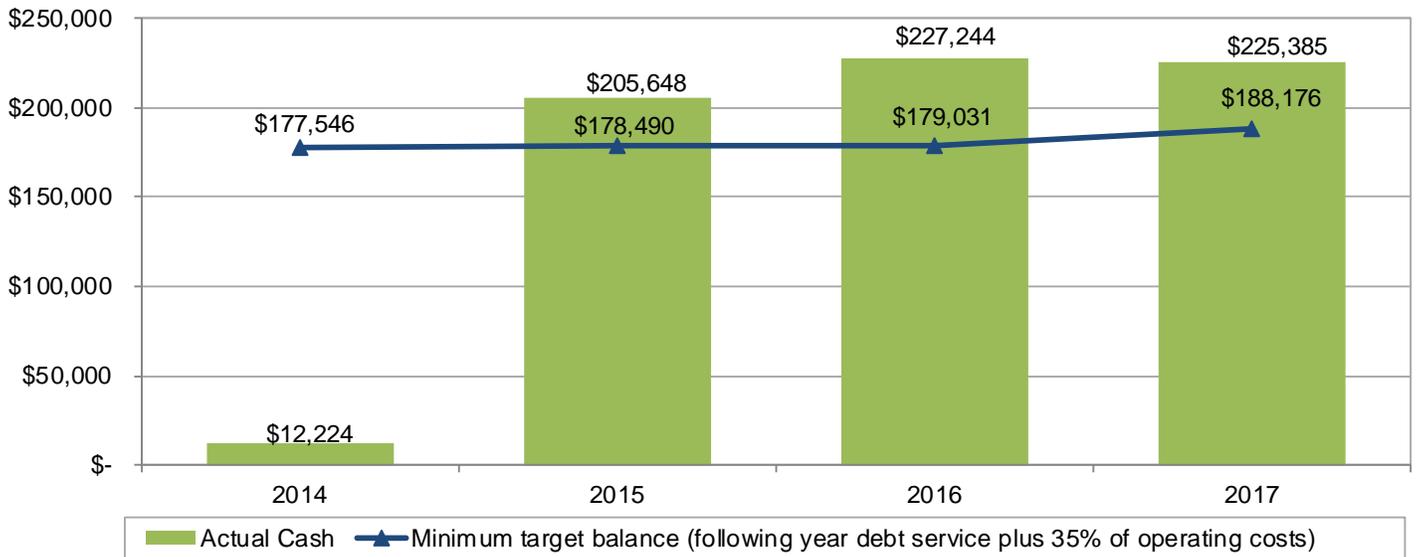
The minimum target cash balance is based on 35 percent of the operating costs.

	2014	2015	2016	2017
Bonds payable	<u>\$ 916,022</u>	<u>\$ 916,022</u>	<u>\$ 793,522</u>	<u>\$ 669,022</u>

### Sewer Utility Cash Flow



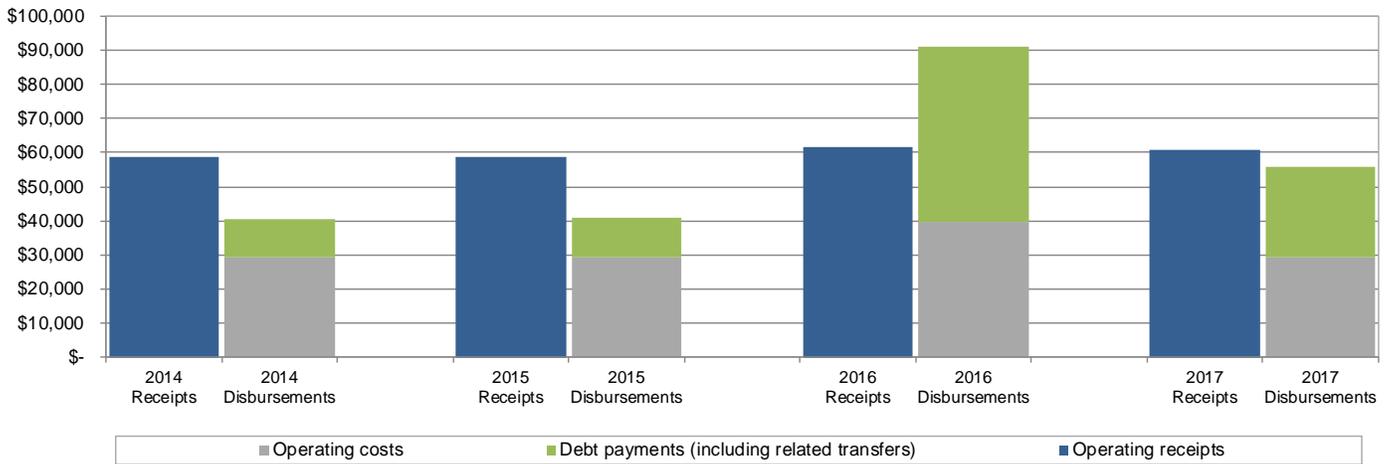
### Sewer Utility Cash Balance



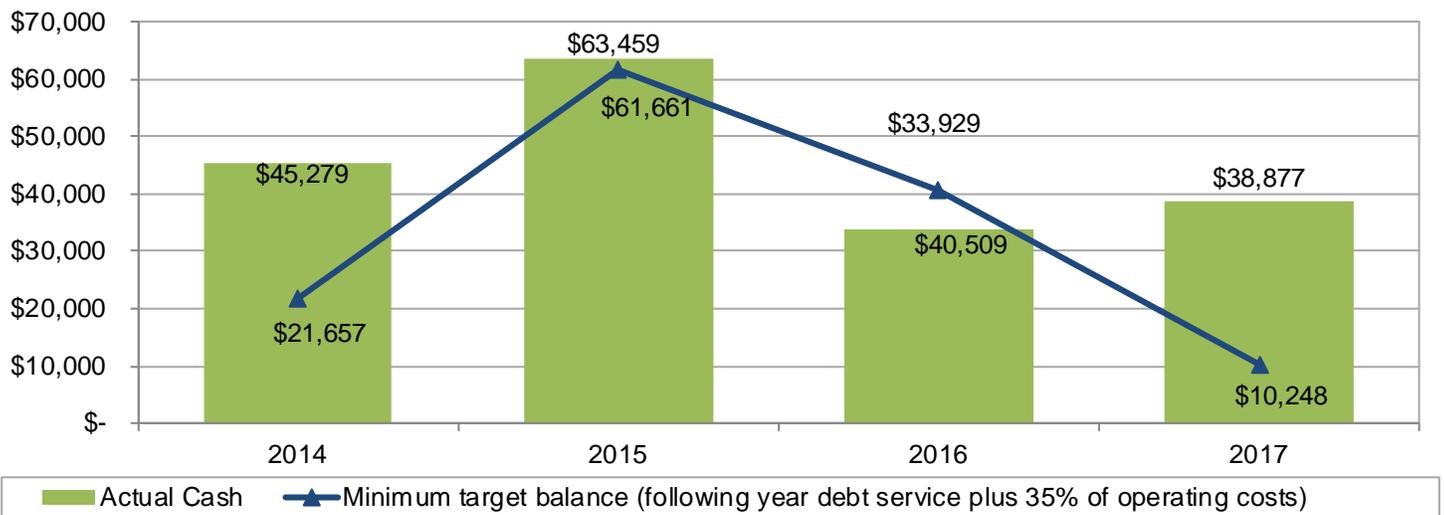
The minimum target cash balance is based on 35 percent of the operating costs. 2014 was the first time in the past four years operating receipts were sufficient to cover operating costs and debt payments. Increases in sewer rates over the last two years have helped with the deficit. However, we recommend ongoing cash flow projections to be created to determine if rate and tax levies are sufficient to cover operating costs, debt payments, repairs and future replacement/expansion.

	2014	2015	2016	2017
Bonds Payable	<u>\$ 1,765,999</u>	<u>\$ 1,765,999</u>	<u>\$ 1,663,999</u>	<u>\$ 1,560,999</u>

### Cedar Pointe Housing Cash Flow



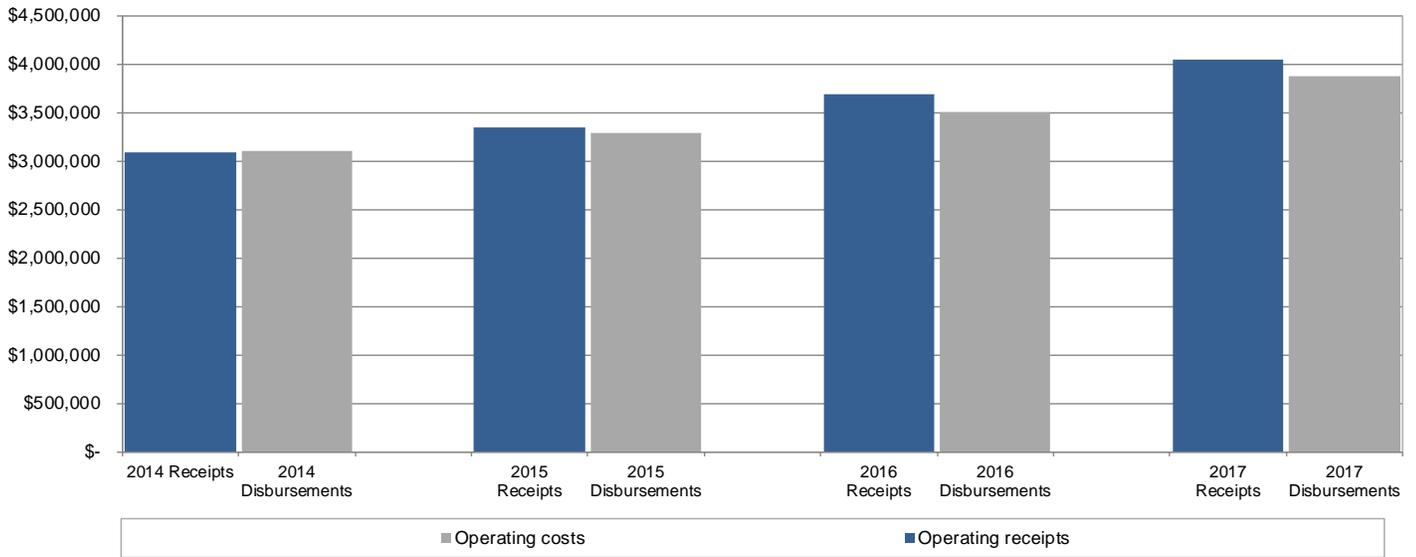
### Cedar Pointe Housing Cash Balance



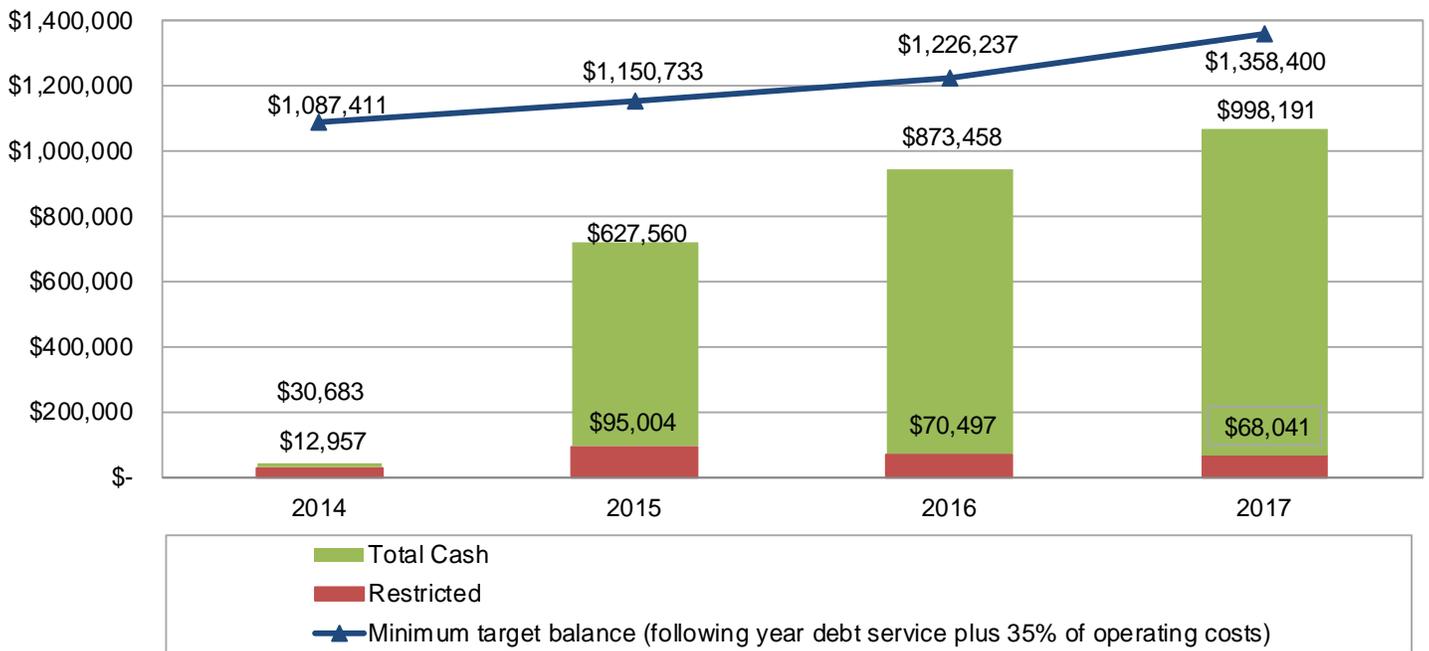
The Cedar Pointe Housing for 2017 had a positive cash flow from operations of which \$25,275 was used to pay down their current debt.

	2014	2015	2016	2017
Notes Payable	<u>\$ 340,723</u>	<u>\$ 340,723</u>	<u>\$ 291,893</u>	<u>\$ 266,618</u>

### New Richland Care Center Cash Flow



### New Richland Care Center Cash Balance



## Ratio Analysis

The following captures a few ratios from the City's financial statements that give some additional information for trend and peer group analysis. We have compiled peer group from information that we have required from the Office of the State Auditor and then compiled data for Cities of the 4<sup>th</sup> class with populations below 2,500.

The majority of these ratios facilitate the use of economic resources focus and accrual basis of accounting at the government-wide level. A combination of liquidity (ability to pay its most immediate obligations), solvency (ability to pay its long-term obligations), funding (comparison of financial amounts and economic indicators to measure changes in financial capacity over time) and common-size (comparison of financial data with other cities regardless of size) ratios are shown below.

Ratio	Calculation	Source	Year			
			2014	2015	2016	2017
Debt service coverage	Net cash provided by operations/ enterprise fund debt payments	Enterprise funds	117% 98%	53% 100%	100% 93%	104% N/A
Debt per capita	Bonded debt/population	Government-wide	\$ 4,936 \$ 3,433	\$ 4,195 \$ 3,307	\$ 3,839 \$ 2,997	\$ 3,475 N/A
Taxes per capita	Tax revenues/population	Government-wide	\$ 315 \$ 464	\$ 349 \$ 469	\$ 349 \$ 483	\$ 371 N/A
Current expenditures per capita	Governmental fund expenditures/ population	Governmental funds	\$ 605 \$ 819	\$ 650 \$ 810	\$ 692 \$ 833	\$ 674 N/A
Capital expenditures per capita	Governmental fund expenditures/ population	Governmental funds	\$ 1,034 \$ 342	\$ 132 \$ 385	\$ 132 \$ 443	\$ 146 N/A
Capital assets % left to depreciate - Governmental	Net capital assets/ gross capital assets	Government-wide	70% 56%	64% 55%	64% 55%	61% N/A
Capital assets % left to depreciate - Business-type	Net capital assets/ gross capital assets	Government-wide	54% 60%	50% 59%	49% 58%	47% N/A

**Represents City of New Richland**

**Represents Peer Group**

### **Debt Service Coverage Ratio (Solvency Ratio)**

The debt coverage ratio is a comparison of cash generated by operations to total debt service payments (principal and interest) of enterprise funds. This ratio indicates if there are sufficient cash flows from operations to meet debt service obligations. Except in cases where other nonoperating revenues (i.e. taxes, assessments, transfers from other funds, etc.) are used to fund debt service payments, an acceptable ratio would be above 1.

### **Bonded Debt per Capita (Funding Ratio)**

This dollar amount is arrived at by dividing the total bonded debt by the population of the city and represents the amount of bonded debt obligation for each citizen of the city at the end of the year. The higher the amount, the more resources are needed in the future to retire these obligations through taxes, assessments or user fees.

### **Taxes per Capita (Funding Ratio)**

This dollar amount is arrived at by dividing the total tax revenues by the population of the city and represents the amount of taxes for each citizen of the city for the year. The higher this amount is, the more reliant the city is on taxes to fund its operations.

### **Current Expenditures per Capita (Funding Ratio)**

This dollar amount is arrived at by dividing the total current governmental expenditures by the population of the City and represents the amount of governmental expenditure for each citizen of the City during the year. Since this is generally based on ongoing expenditures, we would expect consistent annual per capita results.

### **Capital Expenditures per Capita (Funding Ratio)**

This dollar amount is arrived at by dividing the total governmental capital outlay expenditures by the population of the City and represents the amount of capital expenditure for each citizen of the City during the year. Since projects are not always recurring, the per capita amount will fluctuate from year to year.

### **Capital Assets Percentage (Common-size Ratio)**

This percentage represents the percent of governmental or business-type capital assets that are left to be depreciated. The lower this percentage, the older the city's capital assets are and may need major repairs or replacements in the near future. A higher percentage may indicate newer assets being constructed or purchased and may coincide with higher debt ratios or bonded debt per capita.

## Future Accounting Standard Changes

The following Governmental Accounting Standards Board (GASB) Statements have been issued and may have an impact on future City financial statements: <sup>(1)</sup>

### **GASB Statement No. 75** - *Accounting and Financial Reporting for Postemployment Benefit Plans Other than Pension*

#### **Summary**

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.

The scope of this Statement addresses accounting and financial reporting for OPEB that is provided to the employees of state and local governmental employers. This Statement establishes standards for recognizing and measuring liabilities, deferred outflows of resources, deferred inflows of resources, and expense/expenditures. For defined benefit OPEB, this Statement identifies the methods and assumptions that are required to be used to project benefit payments, discount projected benefit payments to their actuarial present value, and attribute that present value to periods of employee service. Note disclosure and required supplementary information requirements about defined benefit OPEB also are addressed.

In addition, this Statement details the recognition and disclosure requirements for employers with payables to defined benefit OPEB plans that are administered through trusts that meet the specified criteria and for employers whose employees are provided with defined contribution OPEB. This Statement also addresses certain circumstances in which a nonemployer entity provides financial support for OPEB of employees of another entity.

In this Statement, distinctions are made regarding the particular requirements depending upon whether the OPEB plans through which the benefits are provided are administered through trusts that meet the following criteria:

- Contributions from employers and nonemployer contributing entities to the OPEB plan and earnings on those contributions are irrevocable.
- OPEB plan assets are dedicated to providing OPEB to plan members in accordance with the benefit terms.
- OPEB plan assets are legally protected from the creditors of employers, nonemployer contributing entities, the OPEB plan administrator, and the plan members.

#### **Effective Date**

This Statement is effective for fiscal years beginning after June 15, 2017. Earlier application is encouraged.

## Future Accounting Standard Changes (Continued)

### How the Changes in This Statement Will Improve Financial Reporting

The requirements of this Statement will improve the decision-usefulness of information in employer and governmental nonemployer contributing entity financial reports and will enhance its value for assessing accountability and interperiod equity by requiring recognition of the entire OPEB liability and a more comprehensive measure of OPEB expense. Decision-usefulness and accountability also will be enhanced through new note disclosures and required supplementary information, as follows:

- More robust disclosures of assumptions will allow for better informed assessments of the reasonableness of OPEB measurements.
- Explanations of how and why the OPEB liability changed from year to year will improve transparency.
- The summary OPEB liability information, including ratios, will offer an indication of the extent to which the total OPEB liability is covered by resources held by the OPEB plan, if any.
- For employers that provide benefits through OPEB plans that are administered through trusts that meet the specified criteria, the contribution schedules will provide measures to evaluate decisions related to contributions.

The consistency, comparability, and transparency of the information reported by employers and governmental nonemployer contributing entities about OPEB transactions will be improved by requiring:

- The use of a discount rate that considers the availability of the OPEB plan's fiduciary net position associated with the OPEB of current active and inactive employees and the investment horizon of those resources, rather than utilizing only the long-term expected rate of return regardless of whether the OPEB plan's fiduciary net position is projected to be sufficient to make projected benefit payments and is expected to be invested using a strategy to achieve that return.
- A single method of attributing the actuarial present value of projected benefit payments to periods of employee service, rather than allowing a choice among six methods with additional variations.
- Immediate recognition in OPEB expense, rather than a choice of recognition periods, of the effects of changes of benefit terms.
- Recognition of OPEB expense that incorporates deferred outflows of resources and deferred inflows of resources related to OPEB over a defined, closed period, rather than a choice between an open or closed period.

## Future Accounting Standard Changes (Continued)

### GASB Statement No. 83 - *Certain Asset Retirement Obligations*

#### Summary

This Statement addresses accounting and financial reporting for certain asset retirement obligations (AROs). An ARO is a legally enforceable liability associated with the retirement of a tangible capital asset. A government that has legal obligations to perform future asset retirement activities related to its tangible capital assets should recognize a liability based on the guidance in this Statement.

This Statement establishes criteria for determining the timing and pattern of recognition of a liability and a corresponding deferred outflow of resources for AROs. This Statement requires that recognition occur when the liability is both incurred and reasonably estimable. The determination of when the liability is incurred should be based on the occurrence of external laws, regulations, contracts, or court judgments, together with the occurrence of an internal event that obligates a government to perform asset retirement activities. Laws and regulations may require governments to take specific actions to retire certain tangible capital assets at the end of the useful lives of those capital assets, such as decommissioning nuclear reactors and dismantling and removing sewage treatment plants. Other obligations to retire tangible capital assets may arise from contracts or court judgments. Internal obligating events include the occurrence of contamination, placing into operation a tangible capital asset that is required to be retired, abandoning a tangible capital asset before it is placed into operation, or acquiring a tangible capital asset that has an existing ARO.

This Statement requires the measurement of an ARO to be based on the best estimate of the current value of outlays expected to be incurred. The best estimate should include probability weighting of all potential outcomes, when such information is available or can be obtained at reasonable cost. If probability weighting is not feasible at reasonable cost, the most likely amount should be used. This Statement requires that a deferred outflow of resources associated with an ARO be measured at the amount of the corresponding liability upon initial measurement.

This Statement requires the current value of a government's AROs to be adjusted for the effects of general inflation or deflation at least annually. In addition, it requires a government to evaluate all relevant factors at least annually to determine whether the effects of one or more of the factors are expected to significantly change the estimated asset retirement outlays. A government should remeasure an ARO only when the result of the evaluation indicates there is a significant change in the estimated outlays. The deferred outflows of resources should be reduced and recognized as outflows of resources (for example, as an expense) in a systematic and rational manner over the estimated useful life of the tangible capital asset.

A government may have a minority share (less than 50 percent) of ownership interest in a jointly owned tangible capital asset in which a nongovernmental entity is the majority owner and reports its ARO in accordance with the guidance of another recognized accounting standards setter. Additionally, a government may have a minority share of ownership interest in a jointly owned tangible capital asset in which no joint owner has a majority ownership, and a nongovernmental joint owner that has operational responsibility for the jointly owned tangible capital asset reports the associated ARO in accordance with the guidance of another recognized accounting standards setter. In both situations, the government's minority share of an ARO should be reported using the measurement produced by the nongovernmental majority owner or the nongovernmental minority owner that has operational responsibility, without adjustment to conform to the liability measurement and recognition requirements of this Statement.

In some cases, governments are legally required to provide funding or other financial assurance for their performance of asset retirement activities. This Statement requires disclosure of how those funding and assurance requirements are being met by a government, as well as the amount of any assets restricted for payment of the government's AROs, if not separately displayed in the financial statements.

This Statement also requires disclosure of information about the nature of a government's AROs, the methods and assumptions used for the estimates of the liabilities, and the estimated remaining useful life of the associated tangible capital assets. If an ARO (or portions thereof) has been incurred by a government but is not yet recognized because it is not reasonably estimable, the government is required to disclose that fact and the reasons therefor. This Statement requires similar disclosures for a government's minority shares of AROs.

## **Future Accounting Standard Changes (Continued)**

### **Effective Date**

The requirements of this Statement are effective for reporting periods beginning after June 15, 2018. Earlier application is encouraged.

### **How the Changes in This Statement Will Improve Financial Reporting**

This Statement will enhance comparability of financial statements among governments by establishing uniform criteria for governments to recognize and measure certain AROs, including obligations that may not have been previously reported. This Statement also will enhance the decision-usefulness of the information provided to financial statement users by requiring disclosures related to those AROs.

## **GASB Statement No. 84 – *Fiduciary Activities***

### **Summary**

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.

This Statement 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.

A fiduciary component unit, when reported in the fiduciary fund financial statements of a primary government, should combine its information with its component units that are fiduciary component units and aggregate that combined information with the primary government's fiduciary funds.

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.

### **Effective Date**

The requirements of this Statement are effective for reporting periods beginning after December 15, 2018. Earlier application is encouraged.

### **How the Changes in This Statement Will Improve Financial Reporting**

The requirements of this Statement will enhance consistency and comparability by (1) establishing specific criteria for identifying activities that should be reported as fiduciary activities and (2) clarifying whether and how business-type activities should report their fiduciary activities. Greater consistency and comparability enhances the value provided by the information reported in financial statements for assessing government accountability and stewardship.

## Future Accounting Standard Changes (Continued)

### GASB Statement No. 85 – Omnibus 2017

#### Summary

The objective of this Statement is to address practice issues that have been identified during implementation and application of certain GASB Statements. This Statement addresses a variety of topics including issues related to blending component units, goodwill, fair value measurement and application, and postemployment benefits (pensions and other postemployment benefits [OPEB]). Specifically, this Statement addresses the following topics:

- Blending a component unit in circumstances in which the primary government is a business-type activity that reports in a single column for financial statement presentation
- Reporting amounts previously reported as goodwill and “negative” goodwill
- Classifying real estate held by insurance entities
- Measuring certain money market investments and participating interest-earning investment contracts at amortized cost
- Timing of the measurement of pension or OPEB liabilities and expenditures recognized in financial statements prepared using the current financial resources measurement focus
- Recognizing on-behalf payments for pensions or OPEB in employer financial statements
- Presenting payroll-related measures in required supplementary information for purposes of reporting by OPEB plans and employers that provide OPEB
- Classifying employer-paid member contributions for OPEB
- Simplifying certain aspects of the alternative measurement method for OPEB
- Accounting and financial reporting for OPEB provided through certain multiple-employer defined benefit OPEB plans.

#### Effective Date

The requirements of this Statement are effective for reporting periods beginning after June 15, 2017. Earlier application is encouraged.

#### How the Changes in This Statement Will Improve Financial Reporting

The requirements of this Statement will enhance consistency in the application of accounting and financial reporting requirements. Consistent reporting will improve the usefulness of information for users of state and local government financial statements.

## **Future Accounting Standard Changes (Continued)**

### **GASB Statement No. 86 – *Certain Debt Extinguishment Issues***

#### **Summary**

The primary objective of this Statement is to improve consistency in accounting and financial reporting for in-substance defeasance of debt by providing guidance for transactions in which cash and other monetary assets acquired with only existing resources—resources other than the proceeds of refunding debt—are placed in an irrevocable trust for the sole purpose of extinguishing debt. This Statement also improves accounting and financial reporting for prepaid insurance on debt that is extinguished and notes to financial statements for debt that is defeased in substance.

#### **Effective Date**

The requirements of this Statement are effective for reporting periods beginning after June 15, 2017. Earlier application is encouraged.

#### **How the Changes in This Statement Will Improve Accounting and Financial Reporting**

The requirements of this Statement will increase consistency in accounting and financial reporting for debt extinguishments by establishing uniform guidance for derecognizing debt that is defeased in substance, regardless of how cash and other monetary assets placed in an irrevocable trust for the purpose of extinguishing that debt were acquired. The requirements of this Statement also will enhance consistency in financial reporting of prepaid insurance related to debt that has been extinguished. In addition, this Statement will enhance the decision-usefulness of information in notes to financial statements regarding debt that has been defeased in substance.

### **GASB Statement No. 87 – *Leases***

#### **Summary**

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.

#### **Effective Date and Transition**

The requirements of this Statement are effective for reporting periods beginning after December 15, 2019. Earlier application is encouraged.

Leases should be recognized and measured using the facts and circumstances that exist at the beginning of the period of implementation (or, if applied to earlier periods, the beginning of the earliest period restated). However, lessors should not restate the assets underlying their existing sales-type or direct financing leases. Any residual assets for those leases become the carrying values of the underlying assets.

## Future Accounting Standard Changes (Continued)

### How the Changes in This Statement Will Improve Accounting and Financial Reporting

This Statement will increase the usefulness of governments' financial statements by requiring reporting of certain lease liabilities that currently are not reported. It will enhance comparability of financial statements among governments by requiring lessees and lessors to report leases under a single model. This Statement also will enhance the decision-usefulness of the information provided to financial statement users by requiring notes to financial statements related to the timing, significance, and purpose of a government's leasing arrangements.

<sup>(1)</sup> *Note.* From GASB Pronouncements Summaries. Copyright 2017 by the Financial Accounting Foundation, 401 Merritt 7, Norwalk, CT 06856, USA, and is reproduced with permission.

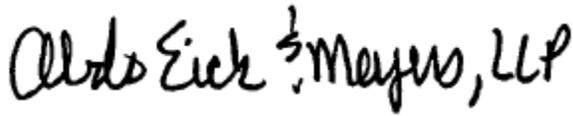
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### Restriction on Use

This communication is intended solely for the information and use of the City Council, management and the Minnesota Office of the State Auditor and is not intended and should not be used by anyone other than those specified parties.

Our audit would not necessarily disclose all weaknesses in the system because it was based on selected tests of the accounting records and related data. The comments and recommendations in the report are purely constructive in nature, and should be read in this context.

If you have any questions or wish to discuss any of the items contained in this letter, please feel free to contact us at your convenience. We wish to thank you for the continued opportunity to be of service and for the courtesy and cooperation extended to us by your staff.



ABDO, EICK & MEYERS, LLP  
Mankato, Minnesota  
June 6, 2018