

City of Hanover
Communications Letter
December 31, 2015



**City of Hanover
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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 Hanover
Hanover, Minnesota

In planning and performing our audit of the financial statements of the City of Hanover, Minnesota, as of and for the year ended December 31, 2015, 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 auditing procedures that are appropriate in the circumstances for the purpose of expressing our opinion on the financial statements, but not for the purpose of expressing an opinion on the effectiveness of the City's internal control. Accordingly, we do not express an opinion on the effectiveness of the City's internal control.

Our consideration of internal control was for the limited purpose described in the preceding paragraph and was not designed to identify all deficiencies in internal control that might be material weaknesses or significant deficiencies and, therefore, material weaknesses or significant deficiencies may exist that were not identified.

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

A significant deficiency is a deficiency, or combination of deficiencies, in internal control that is less severe than a material weakness, yet important enough to merit attention by those charged with governance. The significant deficiency identified is stated within this letter.

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 10, , on such statements.

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This communication is intended solely for the information and use of the City Council and management and others within the City and state oversight agencies and is not intended to be and should not be used by anyone other than these specified parties.

BerganKDV, Ltd.

St. Cloud, Minnesota
May 10,

City of Hanover
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. In order to have appropriate segregation of accounting duties, the performance of the following duties would need to be completed by a different employee: initiation and authorization of transactions, recording and processing of transactions, reconciliation and reporting of transactions, and financial information and custody of assets.

Management and the City Council are aware of this condition and have taken certain steps to compensate for the lack of segregation, but due to the number of staff needed to properly segregate all of the accounting duties, the costs 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.

City of Hanover
Required Communication

We have audited the financial statements of the City for the year ended December 31, 2015, and have issued our report dated May 10, 2016. Professional standards require that we provide you with the following information related to our audit.

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

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

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.

As part of obtaining reasonable assurance about whether the financial statements are free of material misstatement, we performed tests of the City's compliance with certain provisions of laws, regulations, contracts, and grants. However, the objective of our tests was not to provide an opinion on compliance with such provisions.

In planning and performing our audit, we considered the City's internal control over financial reporting in order to determine our auditing procedures for the purpose of expressing an opinion on the financial statements and not to provide assurance on the internal control over financial reporting.

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 grants, 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. While our audit provided a reasonable basis for our opinion, it did not provide a legal determination on the City's compliance with those requirements.

Our responsibility for the supplementary information accompanying the financial statements, as described by professional standards, is to evaluate the presentation of the supplementary information in relation to the financial statements as a whole and to report on whether the supplementary information is fairly stated, in all material respects, in relation to the financial statements taken as a whole.

City of Hanover Required Communication

PLANNED SCOPE AND TIMING OF THE AUDIT

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

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

QUALITATIVE ASPECTS OF ACCOUNTING PRACTICES

Management is responsible for the selection and use of appropriate accounting policies. The significant accounting policies used by the City are described in Note 1 to the financial statements. The City implemented GASB Statement No. 68, *Accounting and Financial Reporting for Pensions* and GASB Statement No. 71, *Pension Transition for Contributions Made Subsequent to the Measurement Date*. 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 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 – The City is currently allocating certain costs among the programs and supporting services benefited. The costs are allocated based on management's estimates.

Net Pension Liability, Deferred Outflows of Resources Related to Pensions and Deferred Inflows of Resources Related to Pensions – These balances are based on allocation by the pension plans using estimates based on contributions.

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

DIFFICULTIES ENCOUNTERED IN PERFORMING THE AUDIT

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

**City of Hanover
Required Communication**

CORRECTED AND UNCORRECTED MISSTATEMENTS

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

- Net pension asset of Hanover Fire Relief Association was not recorded

DISAGREEMENTS WITH MANAGEMENT

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

MANAGEMENT REPRESENTATIONS

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

MANAGEMENT CONSULTATIONS WITH OTHER 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 the consultant has all the relevant facts. To our knowledge, there were no such consultations with other accountants.

OTHER AUDIT FINDINGS OR ISSUES

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

OTHER MATTERS

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.

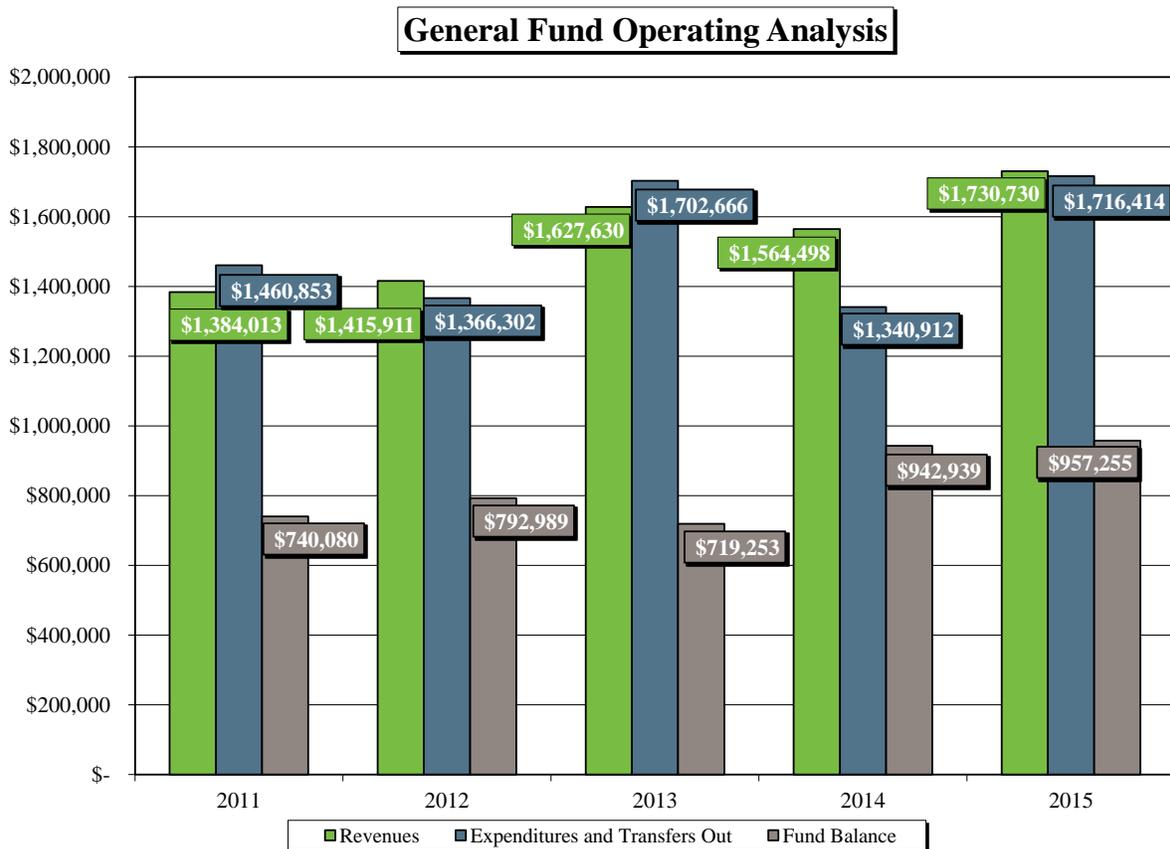
City of Hanover Financial Analysis

The following pages provide graphic representation of select data pertaining to the financial position and operations of the City for the past five years. Our analysis of each graph is presented to provide a basis for discussion of past performance and how implementing certain changes may enhance future performance. We suggest you view each graph and document if our analysis is consistent with yours. A subsequent discussion of this information should be useful for planning purposes.

GENERAL FUND

At year-end, fund balance increased by approximately \$14,000. Fund balance represented 77%, or approximately nine months' worth of expenditures at the 2015 levels, or 56% of combined expenditures and transfers. The Office of the State Auditor recommends a level of between four and six months, or 35% to 50% of annual expenditures.

Details of operations are explained further on the following pages.

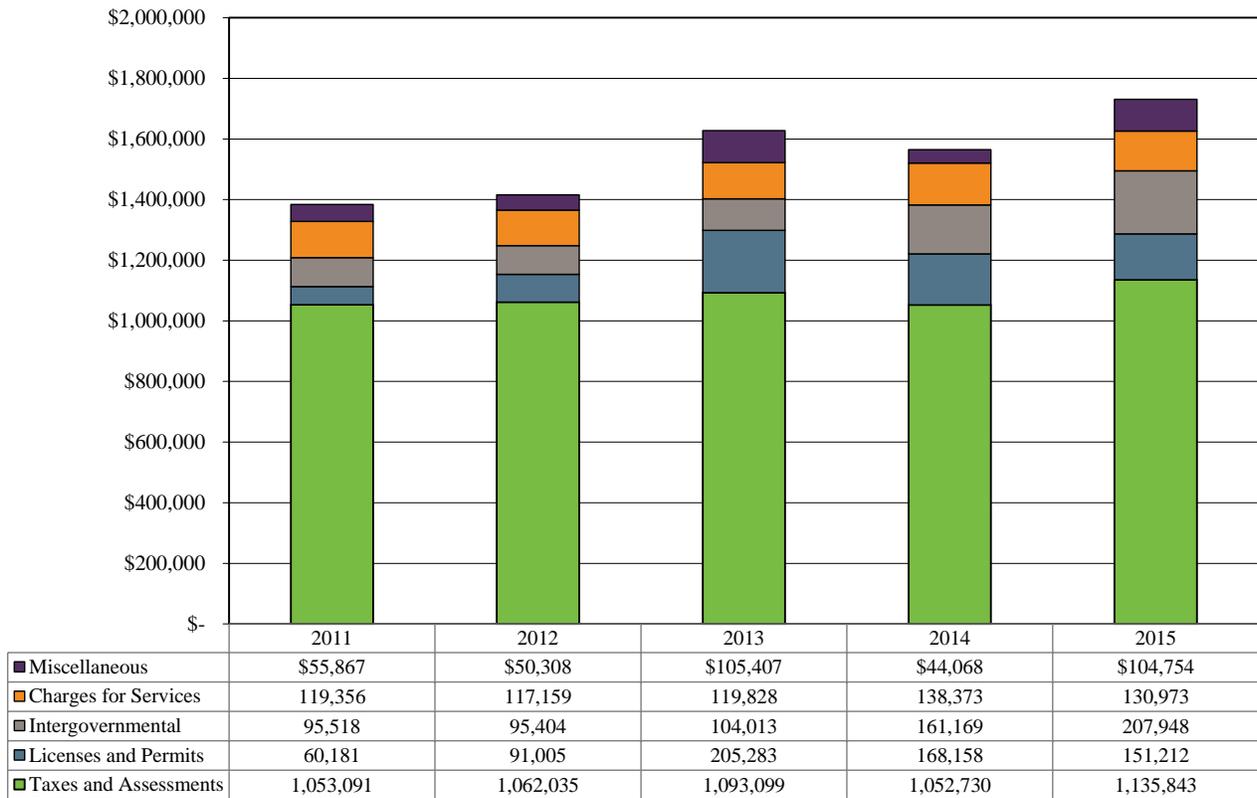


City of Hanover Financial Analysis

GENERAL FUND REVENUES

This graph presents the sources of revenue for the past five years. The main source of revenue has consistently remained property taxes, which was 76% of total revenues for year and has decreased to 66% in 2015. In total, General Fund revenues increased \$166,232, from \$1,564,498 in , to \$1,730,730 in 2015. The largest variance occurred in taxes and assessments revenues which increased \$83,113 due to an increase in property tax levy and delinquent collections in 2015.

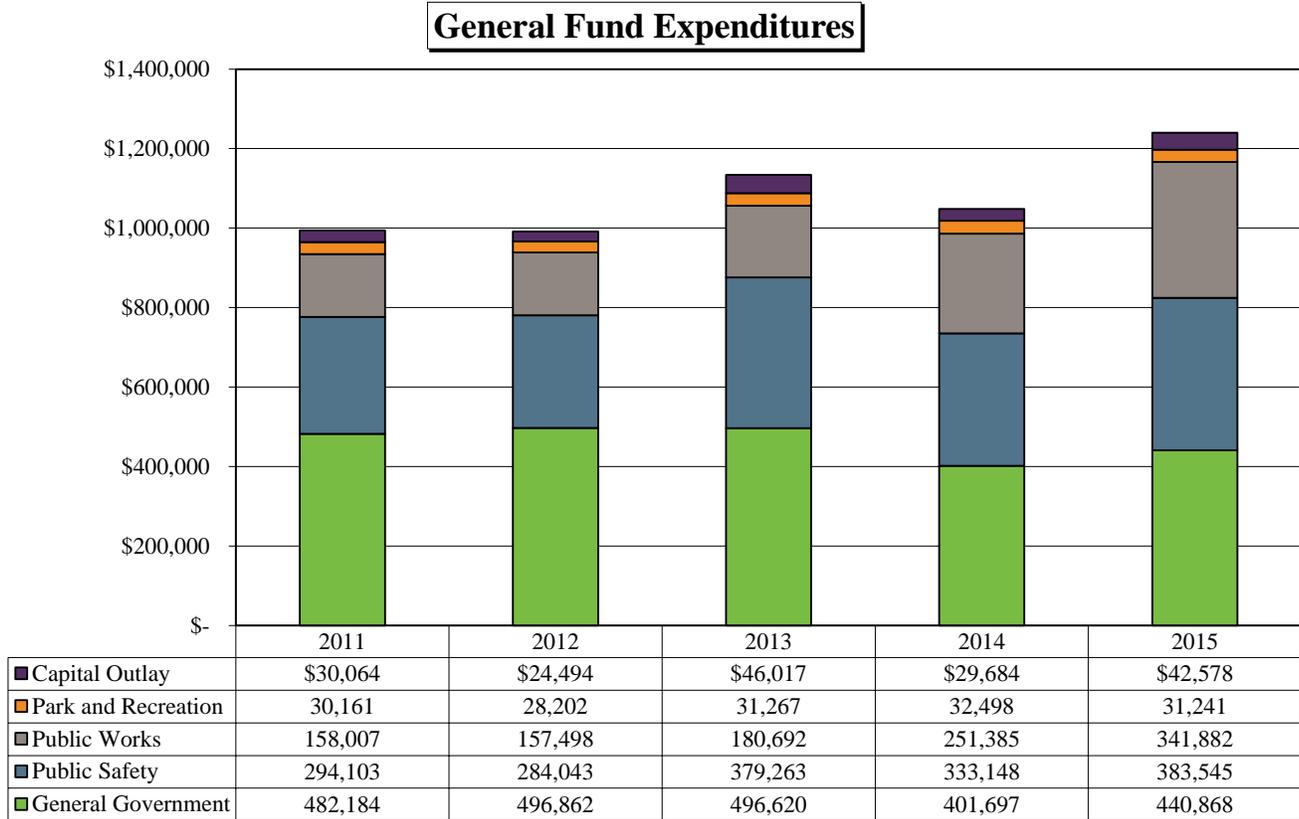
General Fund Revenues



**City of Hanover
Financial Analysis**

GENERAL FUND EXPENDITURES

The graph below shows General Fund expenditures by function for each of the last five years. As revenues increased 10.6% in 2015, expenditures increased 18.3%, or from \$1,048,412 to \$1,240,114. The majority of the increase occurred in public works which increased \$90,497 from 2014 to 2015, due to increased street maintenance repairs.



The general government function accounted for the largest portion of the General Fund expenditures at 35.6%. General government expenditures consist of disbursements related to the general operations of the City, including office employees' salaries and supplies, planning and zoning, accounting and auditing, and legal and engineering fees. Public safety accounted for the second largest portion of the General Fund disbursements at 30.9%. This function consists of police, fire, and building inspection expenditures. Public works accounted for the third largest portion of the General Fund disbursements at 27.6% and consists primarily of street maintenance expenditures.

**City of Hanover
Financial Analysis**

GENERAL FUND BUDGET AND ACTUAL

The City budgeted for a small increase in fund balance in the General Fund with revenues anticipated to exceed expenditures and transfers out by \$18,536. Revenues were over budget and expenditures were under budget. This surplus allowed the City to transfer additional funds to the various Capital Project Funds for future capital needs.

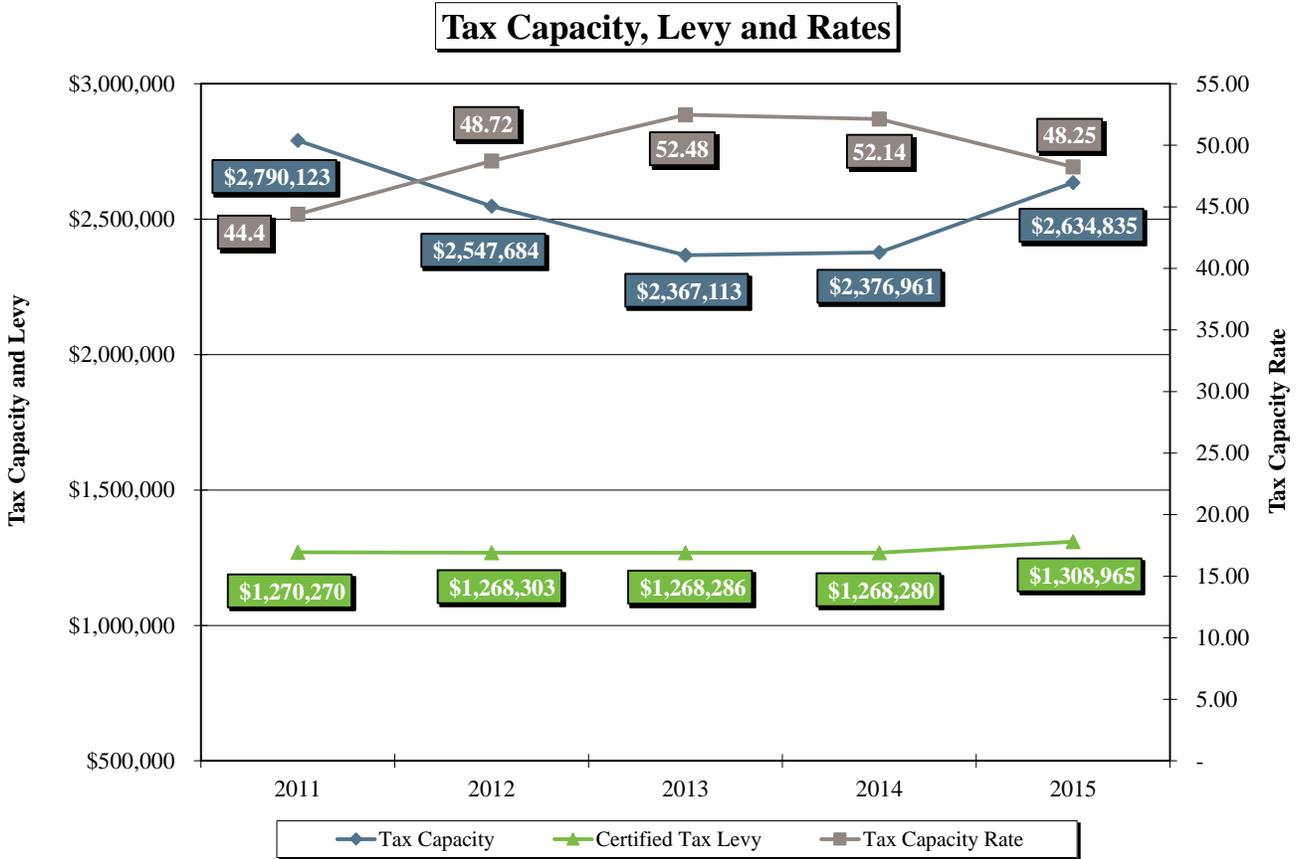
The majority of the variance in revenues was in other revenue due to a conservative budget. Other revenue is comprised of contributions and donations, refunds and reimbursements, and other revenues.

In total, the General Fund expenditures were 2.2%, or \$27,949, under budget. The largest variance was in general government coming in under budget by \$25,230 primarily due to budgeting conservatively for professional services, utilities, supplies, and maintenance.

	Budgeted Amounts		Actual Amounts	Variance with Final Budget - Over (Under)
	Original	Final		
Revenues				
Taxes and assessments	\$ 1,101,352	\$ 1,101,352	\$ 1,135,843	\$ 34,491
Licenses and permits	132,350	132,350	151,212	18,862
Intergovernmental	175,053	175,053	207,948	32,895
Charges for services	124,344	124,344	130,973	6,629
Fines and forfeitures	1,500	1,500	2,643	1,143
Investment income	8,000	8,000	36,521	28,521
Other revenue	13,000	13,000	65,590	52,590
Total revenues	<u>1,555,599</u>	<u>1,555,599</u>	<u>1,730,730</u>	<u>175,131</u>
Expenditures				
General government	498,371	498,371	473,141	(25,230)
Public safety	375,329	375,329	386,660	11,331
Public works	347,713	347,713	341,882	(5,831)
Park and recreation	46,650	46,650	38,431	(8,219)
Total expenditures	<u>1,268,063</u>	<u>1,268,063</u>	<u>1,240,114</u>	<u>(27,949)</u>
Excess of revenues Over expenditures	<u>287,536</u>	<u>287,536</u>	<u>490,616</u>	<u>203,080</u>
Other Financing Sources (Uses)				
Transfers out	<u>(269,000)</u>	<u>(269,000)</u>	<u>(476,300)</u>	<u>(207,300)</u>
Net change in fund balance	<u>\$ 18,536</u>	<u>\$ 18,536</u>	<u>\$ 14,316</u>	<u>\$ (4,220)</u>

City of Hanover Financial Analysis

Tax Capacity, Levy and Rates



The chart above graphs the tax capacity, certified tax levy, and City tax rate for through 2015. 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.

Over the past five years, the City's tax capacity decreased \$155,288, or 5.6%. This decrease is attributable to valuation declines due to the effects of a struggling economy. The City's certified levy over this same time frame increased \$38,695.

The City's tax capacity rate has decreased from to 2015 as a result of the tax capacity increasing at a more significant rate than the levy. In basic terms, the City's tax capacity rate is the percentage, which when multiplied by the City's tax capacity, results in the gross property tax levy.

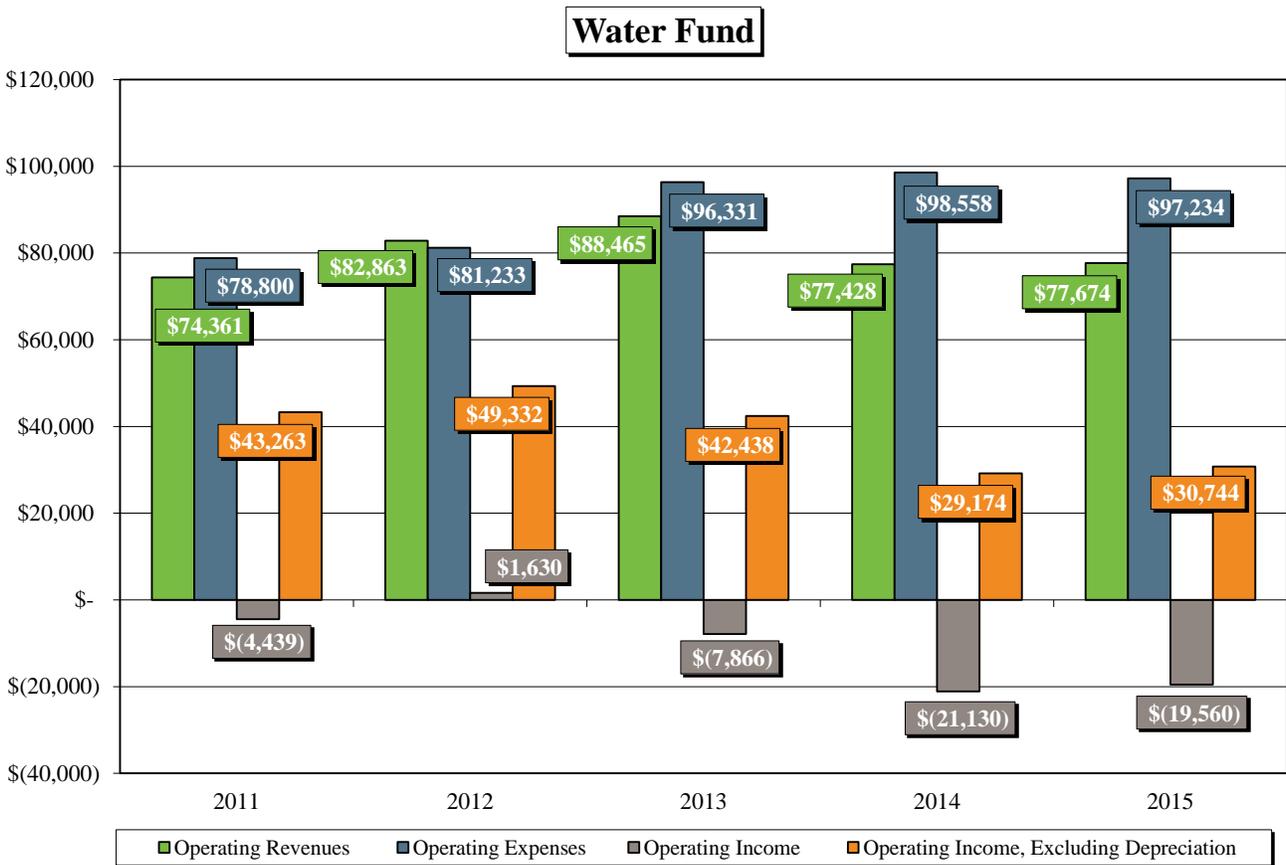
This graph provides a simplified viewpoint of the amounts. More information can be obtained from the League of Minnesota Cities *Property Tax Data Tables for 2011-2015* (www.lmnc.org).

City of Hanover Financial Analysis

ENTERPRISE FUNDS

Since 1999, the City has been responsible for the distribution of water and the Joint Powers Board is responsible for the supply of water. The graphs below and on the next page show the results of the Water and Sewer Funds for the past five years.

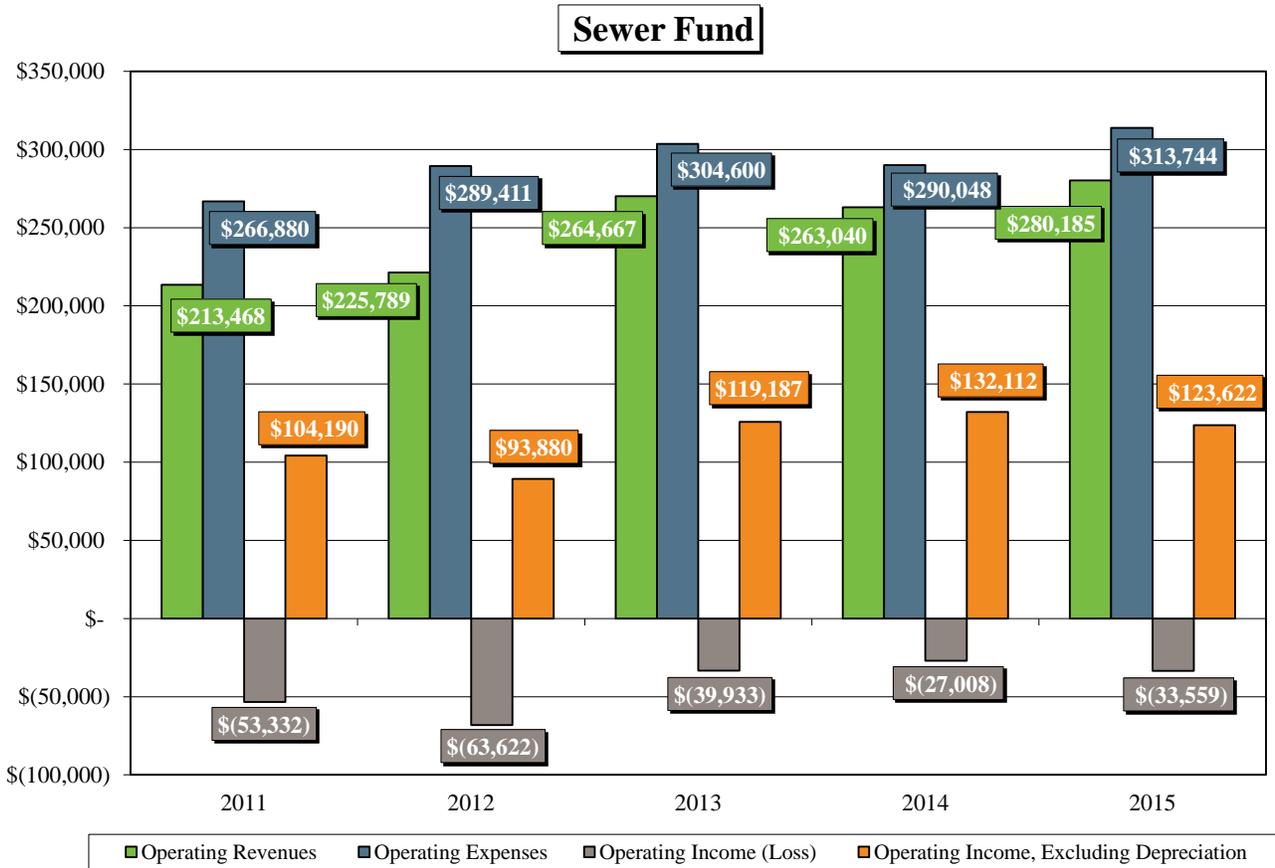
Operating revenues decreased \$ 2,172 in 2015, due to fewer hook-up fees than the prior year.



City of Hanover Financial Analysis

ENTERPRISE FUNDS

For all of the years shown, the City's Sewer Fund had operating losses; however, excluding depreciation, the Fund was able to cover all of its operating costs and cash flow positively from operations. The Sewer Fund saw an overall increase in operating revenue as a result of an increase in rates.



City of Hanover Financial Analysis

ENTERPRISE FUNDS

The Storm Water Enterprise Fund was established in 2009. In 2010, the City initiated a charge for storm water services for residents. With depreciation factored in, the fund has consistently posted operating losses, but has cash flowed positively from operations and built a \$134,173 unrestricted net position over its brief time in operation.

