

City of Hanover
Communications Letter
December 31, 2017



**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 governmental activities, business-type activities, the aggregate discretely presented component unit(s), each major fund, and the aggregate remaining fund information of the City of Hanover, Minnesota, as of and for the year ended December 31, 2017, in accordance with auditing standards generally accepted in the United States of America, we considered the City's internal control over financial reporting (internal control) as a basis for designing audit procedures that are appropriate in the circumstances for the purpose of expressing our 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. 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 a certain deficiency in internal control that we consider to be a significant deficiency.

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 7, 2018, on such statements.

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 7, 2018

**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 governmental activities, business-type activities, the aggregate discretely presented component unit, each major fund, and the aggregate remaining fund information of the City as of and for the year ended December 31, 2017, and have issued our report dated May 7, 2018. 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 opinions about whether the financial statements prepared by management with your oversight are fairly presented, in all material respects, in conformity with accounting principles generally accepted in the United States of America. Our audit of the financial statements does not relieve you or management of your responsibilities.

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 our opinions 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.

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 supplement(s) 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.

**City of Hanover
Required Communication**

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

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.

PLANNED SCOPE AND TIMING OF THE AUDIT

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

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

QUALITATIVE ASPECTS OF ACCOUNTING PRACTICES

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

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.

**City of Hanover
Required Communication**

QUALITATIVE ASPECTS OF ACCOUNTING PRACTICES (CONTINUED)

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.

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

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

DIFFICULTIES ENCOUNTERED IN PERFORMING THE AUDIT

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

CORRECTED AND UNCORRECTED MISSTATEMENTS

Professional standards require us to accumulate all known and likely misstatements identified during the audit, other than those that are clearly trivial, and communicate them to the appropriate level of management. 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, 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.

**City of Hanover
Required Communication**

OTHER AUDIT FINDINGS OR ISSUES

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

OTHER MATTERS

We applied certain limited procedures to the RSI that supplements the basic financial statements. Our procedures consisted of inquiries of management regarding the methods of preparing the information and comparing the information for consistency with management's responses to our inquiries, the basic financial statements, and other knowledge we obtained during our audit of the basic financial statements. We did not audit the RSI and do not express an opinion or provide any assurance on the RSI.

With respect to the supplementary information accompanying the financial statements, we made certain inquiries of management and evaluated the form, content and methods of preparing the information to determine that the information complies with accounting principles generally accepted in the United States of America, the method of preparing it has not changed from the prior period, and the information is appropriate and complete in relation to our audit of the financial statements. We compared and reconciled the supplementary information to the underlying accounting records used to prepare the financial statements or to the financial statements themselves.

City of Hanover Financial Analysis

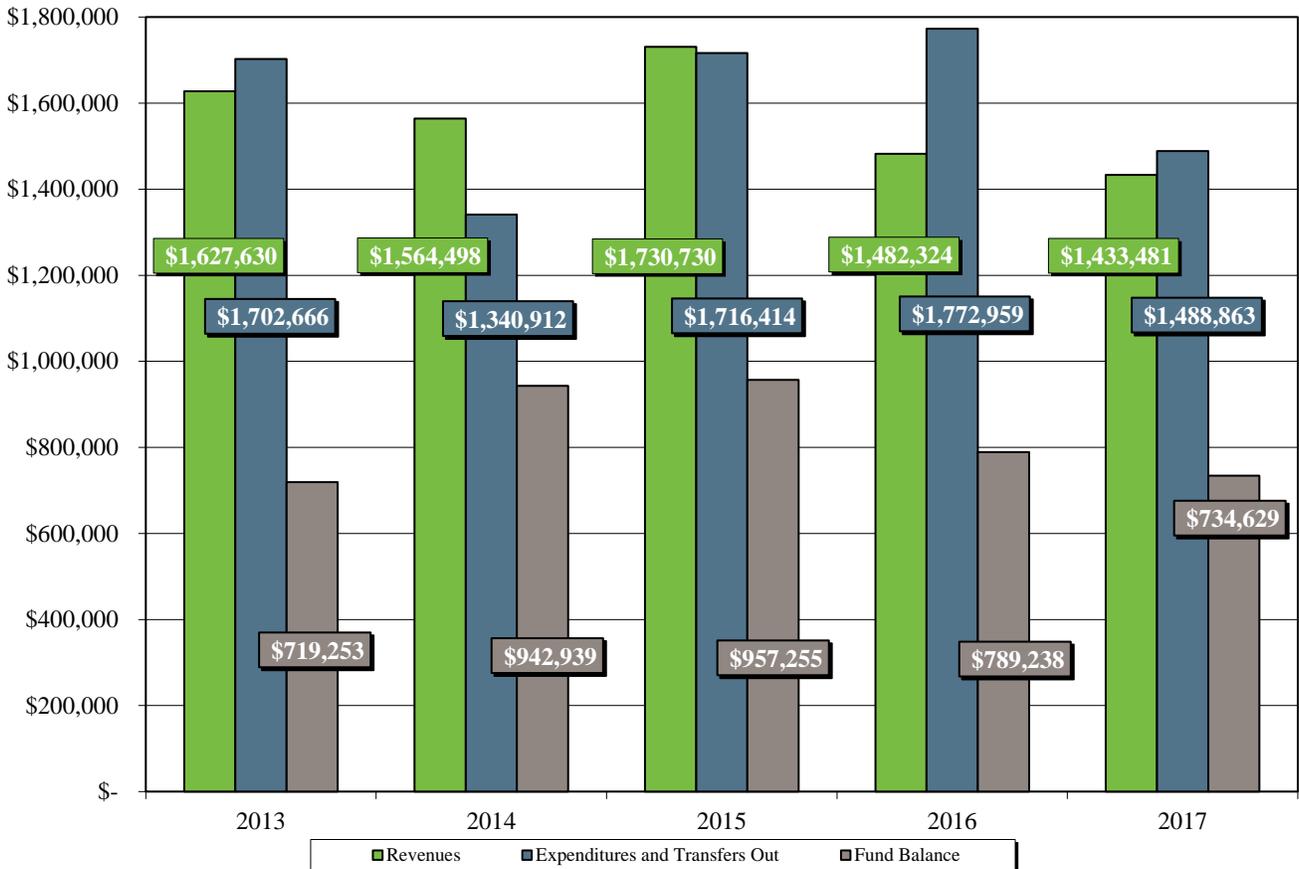
The following pages provide graphic representation of select data pertaining to the financial position and operations of the City for the past five years. Our analysis of each graph is presented to provide a basis for discussion of past performance and how implementing certain changes may enhance future 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 decreased by approximately \$55,000. Fund balance represented 58%, or approximately seven months' worth of expenditures at the 2017 levels, or 49% 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.

General Fund Operating Analysis

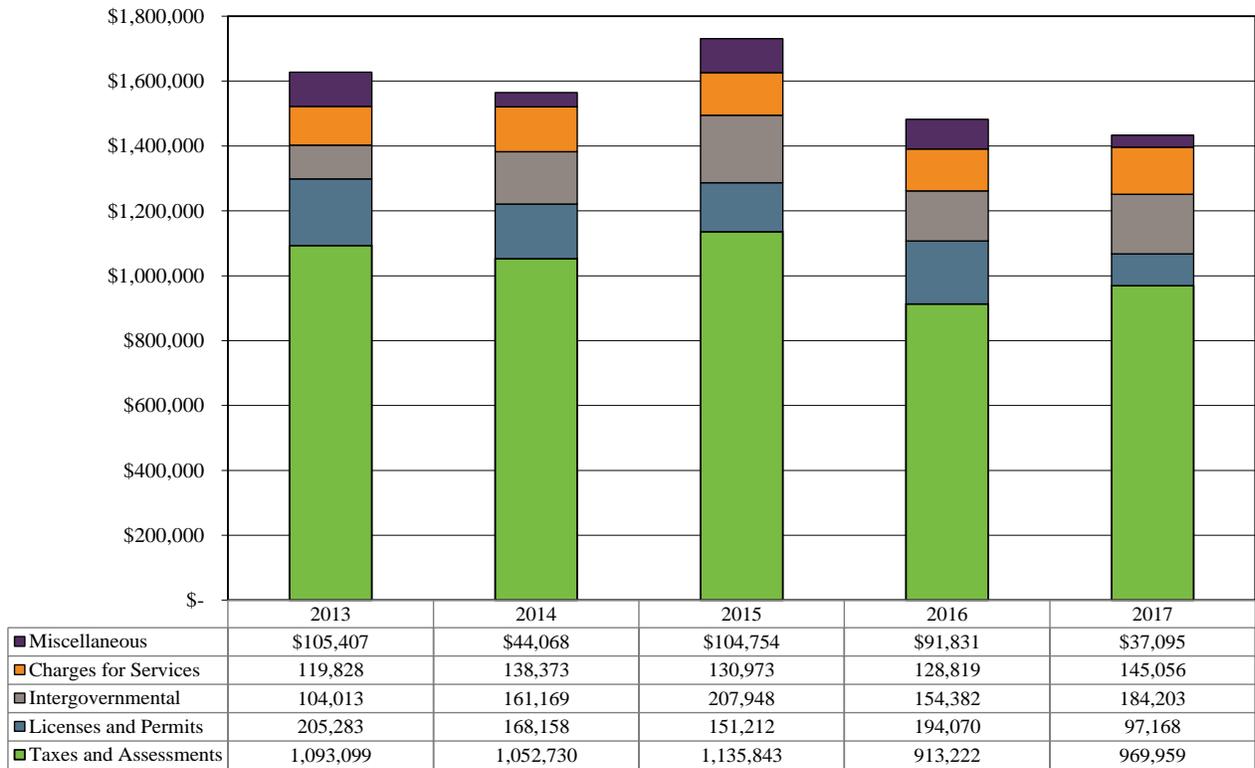


City of Hanover Financial Analysis

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 67% of total revenues for year 2013 and has stayed consistent at approximately 67% in 2017. In total, General Fund revenues decreased \$48,843, from \$1,482,324 in 2016, to \$1,433,481 in 2017. The largest variance occurred in licenses and permits revenue, which decreased \$96,902 due to a decrease in permits as there were fewer new homes constructed in 2017.

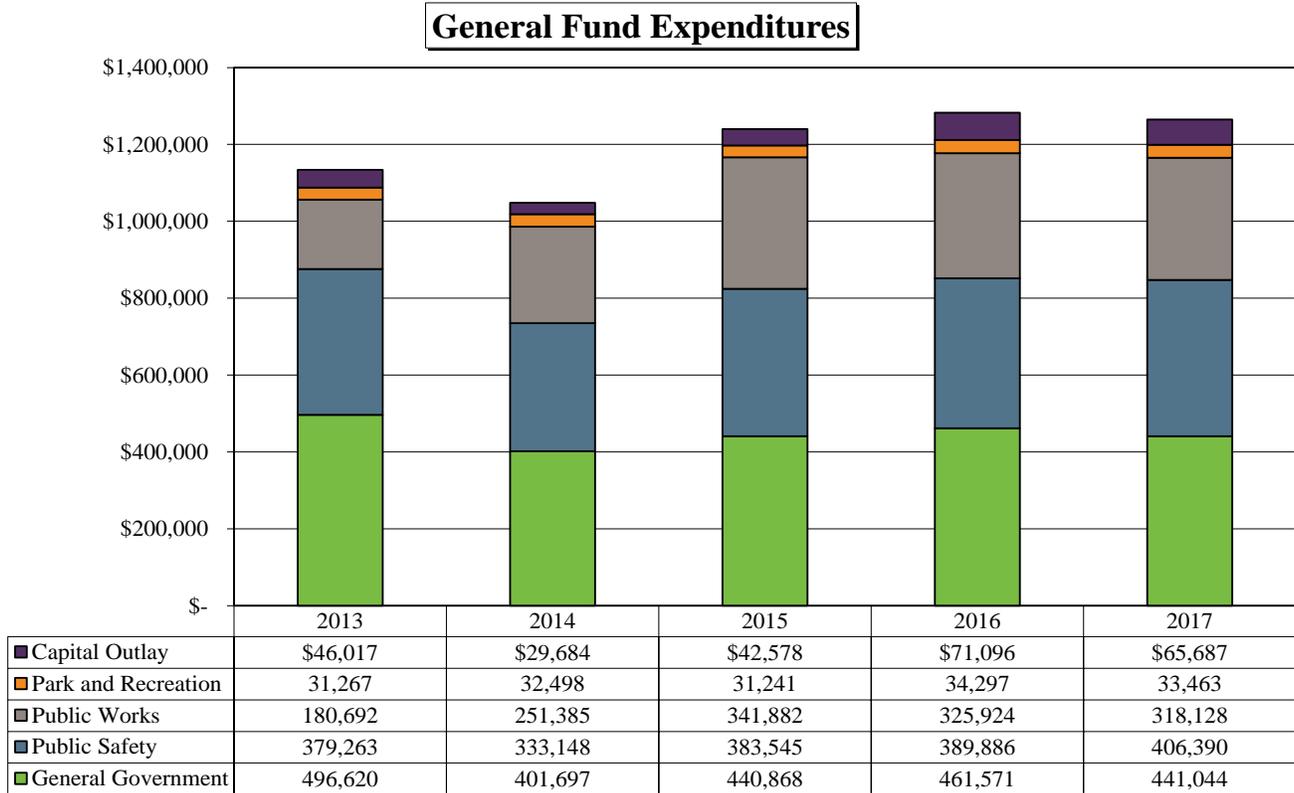
General Fund Revenues



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 decreased 3.4% in 2017, expenditures decreased 1.4%, or from \$1,282,774 to \$1,264,712. The majority of the decrease occurred in general government, which decreased \$20,527 from 2016 to 2017, due primarily to having higher planning and zoning costs in 2016 than in 2017.



The general government function accounted for the largest portion of the General Fund expenditures at 34.9%. 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 32.1%. This function consists of police, fire, and building inspection expenditures. Public works accounted for the third largest portion of the General Fund disbursements at 25.2% and consists primarily of street maintenance expenditures.

**City of Hanover
Financial Analysis**

GENERAL FUND BUDGET AND ACTUAL

The City budgeted for a decrease in fund balance in the General Fund with expenditures and transfers out anticipated to exceed revenues and transfers in by \$51,617. Revenues and expenditures were over the final budget.

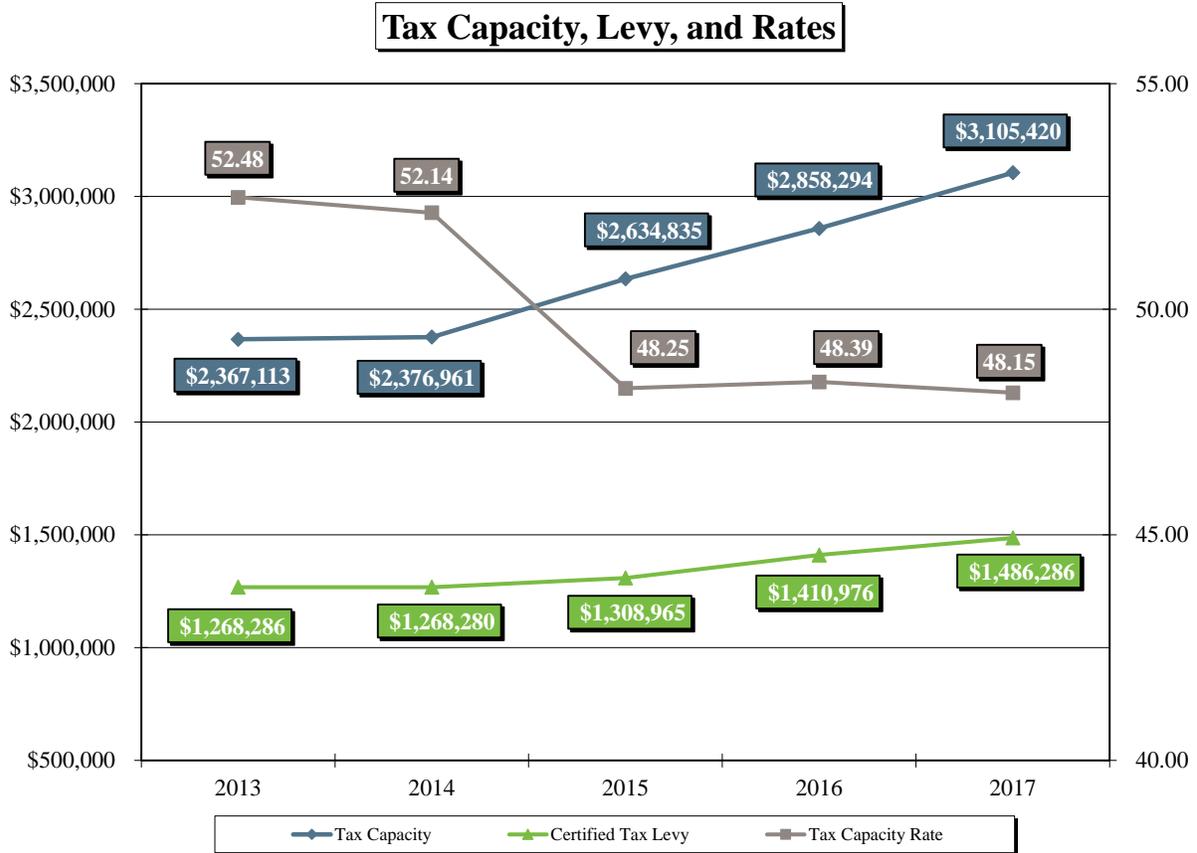
Revenues were over budget by \$31,531, or 2.2%, in total for the General Fund. The largest variance occurred in investment income due to being conservative on investment performance.

In total, the General Fund expenditures were 2.8%, or \$34,523, over budget. The largest variance was in public safety. This area was over budget by \$27,415 primarily due to not budgeting for the purchases of a vehicle, firefighter masks, and tank upgrades.

	Budgeted Amounts		Actual Amounts	Variance with Final Budget - Over (Under)
	Original	Final		
Revenues				
Taxes and assessments	\$ 954,464	\$ 959,728	\$ 969,959	\$ 10,231
Licenses and permits	62,120	97,168	97,168	-
Intergovernmental	150,007	184,203	184,203	-
Charges for services	136,450	143,865	145,056	1,191
Fines and forfeitures	2,000	5,167	5,167	-
Investment income	9,000	4,371	16,441	12,070
Other revenue	12,500	7,448	15,487	8,039
Total revenues	<u>1,326,541</u>	<u>1,401,950</u>	<u>1,433,481</u>	<u>31,531</u>
Expenditures				
General government	491,083	467,297	470,971	3,674
Public safety	408,357	404,165	431,580	27,415
Public works	372,101	314,694	318,128	3,434
Park and recreation	55,000	44,033	44,033	-
Total expenditures	<u>1,326,541</u>	<u>1,230,189</u>	<u>1,264,712</u>	<u>34,523</u>
Excess of revenues over expenditures	<u>-</u>	<u>171,761</u>	<u>168,769</u>	<u>(2,992)</u>
Other Financing Sources (Uses)				
Proceeds from sale of capital asset	-	773	773	-
Transfers in	-	-	-	-
Transfers out	-	(224,151)	(224,151)	-
Net change in fund balance	<u>\$ -</u>	<u>\$ (51,617)</u>	<u>\$ (54,609)</u>	<u>\$ (2,992)</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 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.

Comparing 2013 through 2017, the City's tax capacity increased \$738,307, or 31.2%. This increase is attributable to valuation increases due to the effects of a recovering economy. The City's certified levy over this same time frame increased \$218,000, or 17.2%.

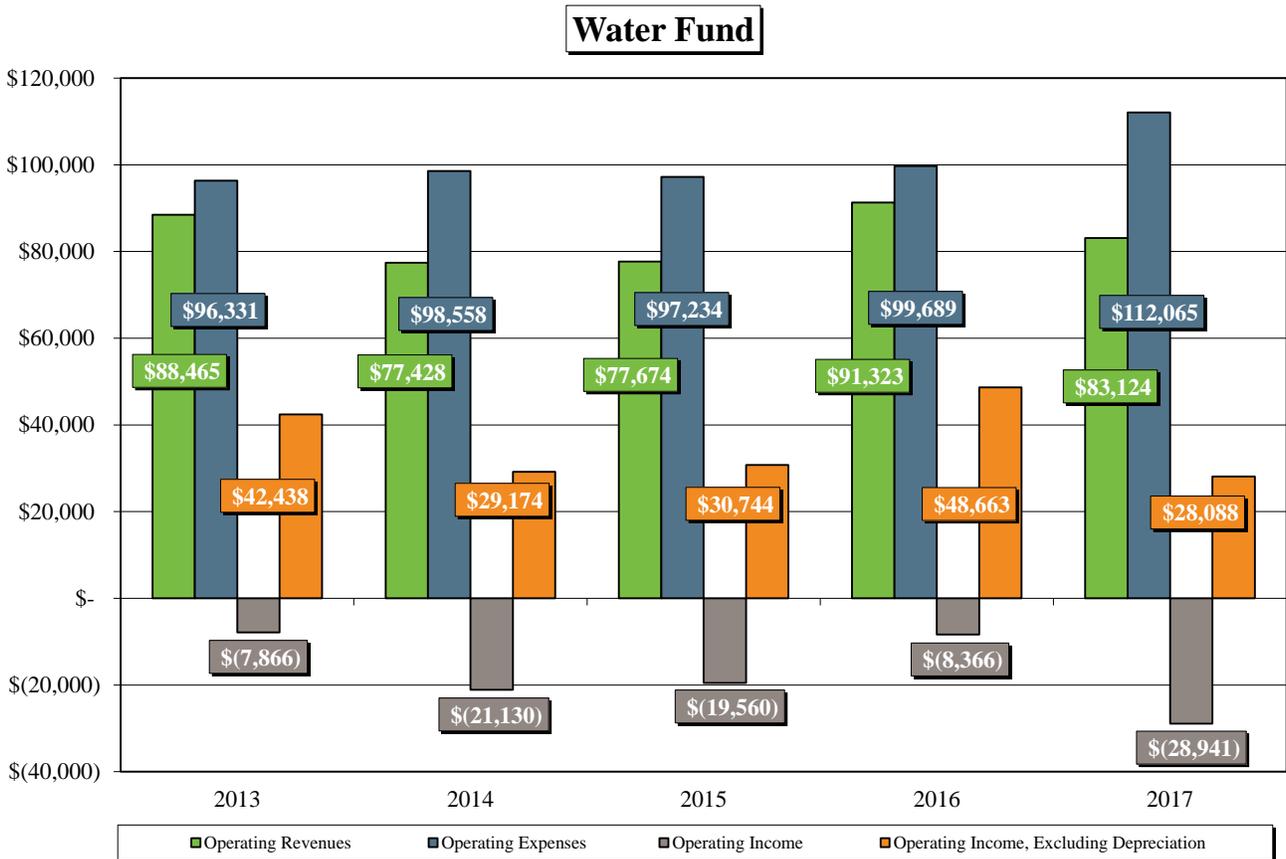
This graph provides a simplified viewpoint of the amounts. More information can be obtained from the League of Minnesota Cities *Property Tax Data Tables for 2012-2017* (www.lmnc.org).

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.

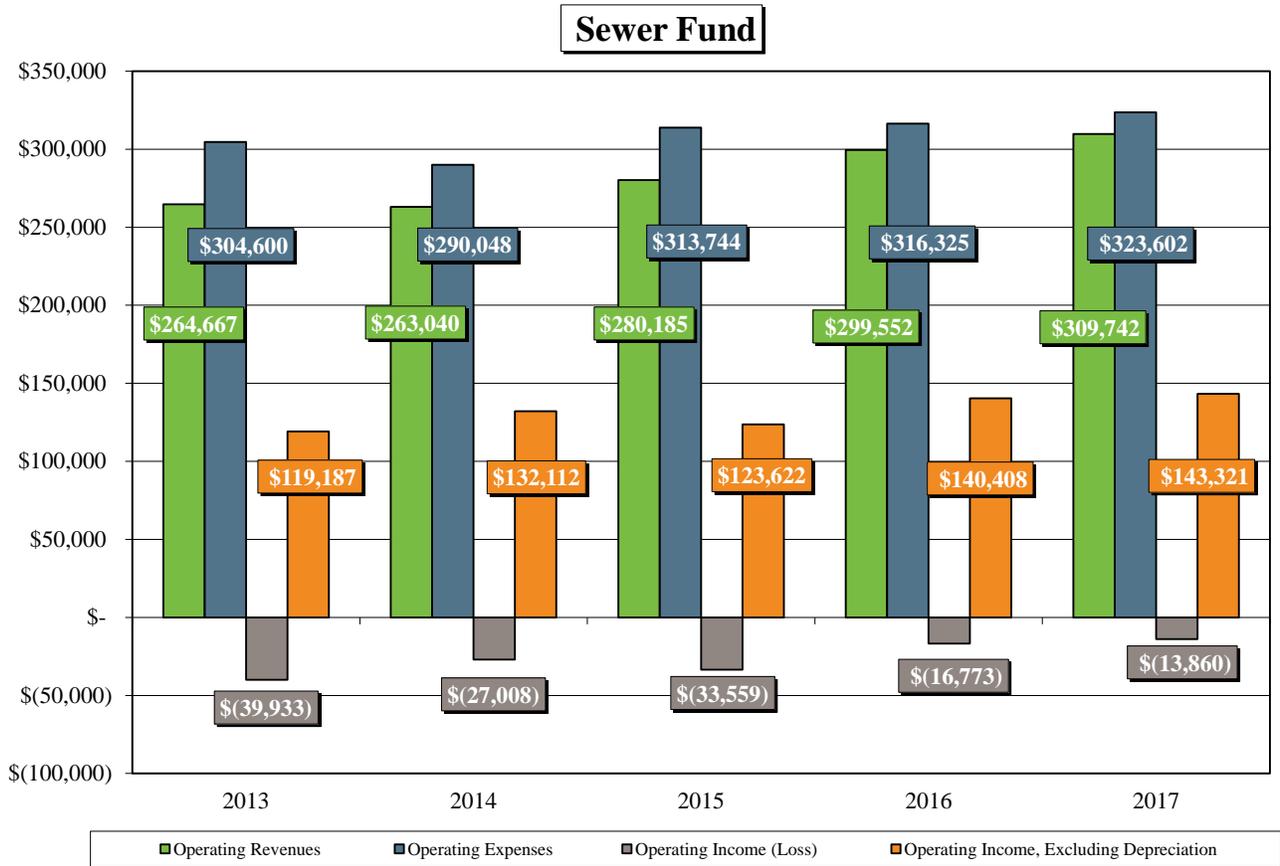
Operating income decreased \$20,575 in 2017, as operating revenue decreased \$8,199 while operating expenses increased \$12,376.



City of Hanover Financial Analysis

ENTERPRISE FUNDS (CONTINUED)

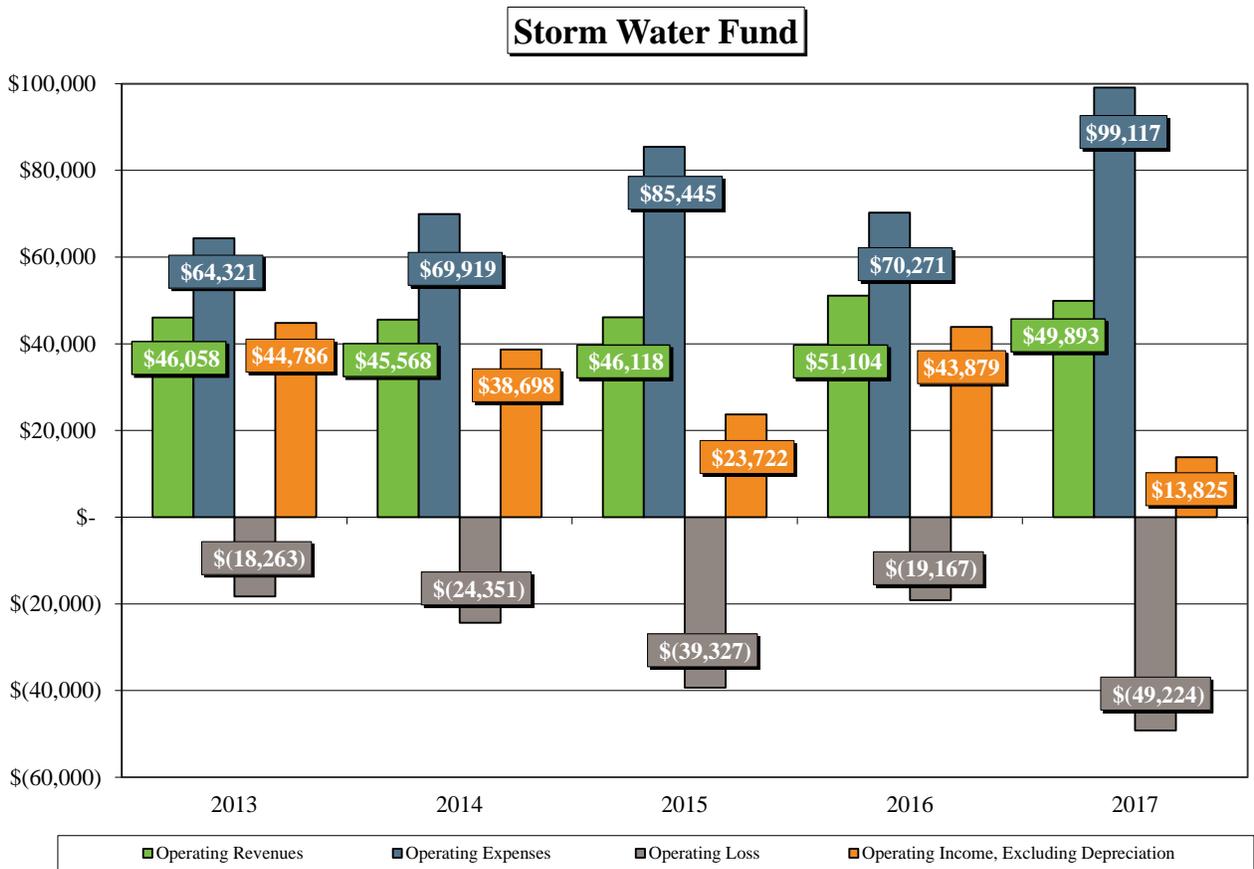
For all of the years shown, the City's Sewer Fund had operating losses; however, excluding depreciation, the Fund was able to cover all of its operating costs and cash flow positively from operations. The Sewer Fund saw an overall increase in operating revenue as a result of an increase in customers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



City of Hanover Financial Analysis

ENTERPRISE FUNDS (CONTINUED)

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 \$201,239 unrestricted net position over its brief time in operation. Operating expenses increased \$28,846 due to an increase in repairs and maintenance costs and an increase in professional service costs for a new swamp program.



City of Hanover 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 are extensive summaries of the current updates. As your continued business partner, we are committed to keeping you informed of new and emerging issues. We are happy to discuss these issues with you further and their applicability to your City.

ACCOUNTING STANDARD UPDATE – GASB STATEMENT NO. 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 Hanover
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 Hanover
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.