

# Management Letter

## City of Henderson

Henderson, Minnesota

For the Year Ended  
December 31, 2016

Management, Honorable Mayor and City Council  
City of Henderson, Minnesota

We have audited the financial statements of the governmental activities, the business-type activities, each major fund and the aggregate remaining fund information of the City of Henderson, Minnesota (the City) for the year ended December 31, 2016, and have issued our report thereon dated March 6, 2017. Professional standards require that we provide you with the following 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 dated December 13, 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, *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 of the financial statements, we considered the City's internal control over financial reporting (internal control) to determine the audit procedures that are appropriate in the circumstances for the purpose of expressing our opinions on the financial statements, but not for the purpose of expressing an opinion on the effectiveness of the City's internal control. Accordingly, we do not express an opinion on the effectiveness of the City's internal control.

Our consideration of internal control was for the limited purpose described in the preceding paragraph and was not designed to identify all deficiencies in internal control that might be material weaknesses or significant deficiencies and therefore, material weaknesses or significant deficiencies may exist that were not identified. However, as described in the following pages, we identified certain deficiencies in internal control that we consider to be a material weakness and 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 a combination of deficiencies, in internal control such that there is a reasonable possibility that a material misstatement of the entity's financial statements will not be prevented, or detected and corrected on a timely basis. We consider the deficiency described in the following pages as item 2016-002 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 deficiency described in the following pages as item 2016-001 to be a significant deficiency.

**2016-001 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 Administrator/Clerk-Treasurer controls and maintains the check stock, approves time cards, runs payroll, prepares and signs checks, posts activity to the general ledger, reconciles bank accounts, prepares payroll tax returns, and maintains the payroll records.

*Recommendation:* Currently, the City Council and Mayor are involved in the payroll process through signing checks, approving general ledger postings, putting checks in envelopes, reconciliations, tax returns, payroll records, compensated absences, and accrued wages. We believe these procedures significantly mitigate the risk related to segregation of duties and should be continued.

*Updated progress from prior year:*

The Council is very involved in overseeing the financial reports and now reviews time cards. Since 2008 sign off sheets are being used to provide documentation of this oversight.

**Internal control over disbursements**

*Cause:* As a result of the small number of staff, the Administrative Assistant sets up vendors, posts activity to general ledger, prepares checks, mails checks to vendors, maintains the purchase journal and accounts payable records.

*Recommendation:* Currently, the City Council reviews and signs off on activity posted to general ledger, reviews checks before they are processed, and the mayor reviews disbursements before checks are signed. We believe these procedures significantly mitigate the risk related to segregation of duties and should be continued.

*Updated progress from prior year:*

The Council is very involved in overseeing the financial reports. Since 2008, sign off sheets are being used to provide documentation of this oversight.

**2016-001 Segregation of duties - Continued**

**Internal control over cash receipts**

*Cause:* As a result of the small number of staff, the Administrative Assistant sets up customers, posts activity to the general ledger, receives and endorses checks and currency, prepares the deposit, generates billing statements, and maintains the receipts journal and receivable records.

*Recommendation:* Currently, the City Council reviews and reconciles deposits and receivables monthly. We believe these procedures significantly mitigate the risk related to segregation of duties and should be continued.

*Updated progress from prior year:*

The Council is very involved in overseeing the financial reports. Since 2008, sign off sheets are being used to provide documentation of this oversight.

**Internal control over utility billing**

*Cause:* As a result of the small number of staff, the Administrator/Clerk-Treasurer opens mail, takes the deposit to the bank, reviews adjustments to accounts, and controls the accuracy completeness of and access to utility billing program and data files.

*Recommendation:* Currently, Council members review the accuracy and completeness of reports in fund accounting and utility billing, and approve adjustments to accounts. We believe these procedures significantly mitigate the risk related to segregation of duties and should be continued.

*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, approval of adjustments to accounts, and approval of the reconciliation of the utility subledger to the general ledger. The Administrative Assistant now prepares the bank deposits and reconciles the receivable subledger.

*Updated progress from prior year:*

The Council is very involved in overseeing the financial reports. Since 2008, sign off sheets are being used to provide documentation of this oversight.

## 2016-002 Material audit adjustments

*Condition:* During our audit, two adjustments were needed to correct coding and reclassify amounts to correct funds. The following are related to the reclassification and adjustment that was made during the audit:

- To adjust activity related to 2016 debt activity.
- To adjust activity related to 2016 loans activity.

*Criteria:* Such adjustments should be detected and made by the City's personnel.

*Cause:* City staff has not prepared a year-end trial balance reflecting all necessary accruals and year-end adjustments without auditor assistance.

*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 ensure that future corrections are not needed.

*Management response:*

The City will review all adjusting entries posted this year and make all such necessary adjustments in the future. The Administrator/Clerk-Treasurer will continue to monitor all financial activity and adjust account balances as needed throughout the year and at year end to prevent material misstatements from occurring.

*Updated progress from prior year:*

Improvement was made in this area during 2016 as the number of journal entries decreased by five. However, we believe that the adjusting entries made to adjust the 2016 debt and loans activity caused this finding to be a material weakness.

## Compliance and Other Matters

As part of obtaining reasonable assurance about whether the City's financial statements are free from material misstatement, we performed tests of its compliance with certain provisions of laws, regulations, contracts, and grant agreements, 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, and accordingly, we do not express such an opinion. The results of our tests disclosed no instances of noncompliance or other matters that are required to be reported under *Government Auditing Standards* and Minnesota statutes.

## Difficulties Encountered in Performing the Audit

We encountered no significant difficulties in dealing with management in performing and completing 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. The City changed accounting policies during 2016 related to fair market value and application (GASB 72), accounting and financial reporting for pension and related assets not within the scope of GASB 68, including amendments to certain provisions GASB Statement No. 67 and No. 68 (GASB 73), and certain external investment pools and pool participants (GASB 79). 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 depreciation on capital assets, allocation of payroll and the liability related to the City's pensions.

- Management's estimate of depreciation is based on the estimated useful lives of capital assets. Depreciation is calculated using the straight-line method.
- Allocations of gross wages and payroll benefits are derived from each employee's estimated time to be spent servicing the respective functions of the City. These allocations are also used in allocating accrued wages and compensated absences payable.
- 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 they are 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 trivial, and communicate them to the appropriate level of management. Management has corrected all such misstatements. We proposed two journal entries that we consider to be material audit entry or correction of management decisions. They relate to the following situations:

- To adjust activity related to 2016 debt activity.
- To adjust activity related to 2016 loans activity.

### **Disagreements with Management**

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.

### **Management Representations**

We have requested certain representations from management that are included in the management representation letter dated March 6, 2017.

### **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 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 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 section which accompanies 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.

## **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 \$6,040 per month, the Sewer Utility fund is \$16,900 per month, and \$440 for the Environmental Services Utility fund per month.

## **Written Policies and Procedures**

Written policies and procedures are an important part of the City's internal control, and will be helpful if there is staff turnover. The City currently has written job descriptions and a capital asset policy. They are planning on drafting policies for out of state travel, investment, accounting, internal control, budget and other financial, personnel management, loss control, and similar policies.

## 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, 2016.

### General Fund

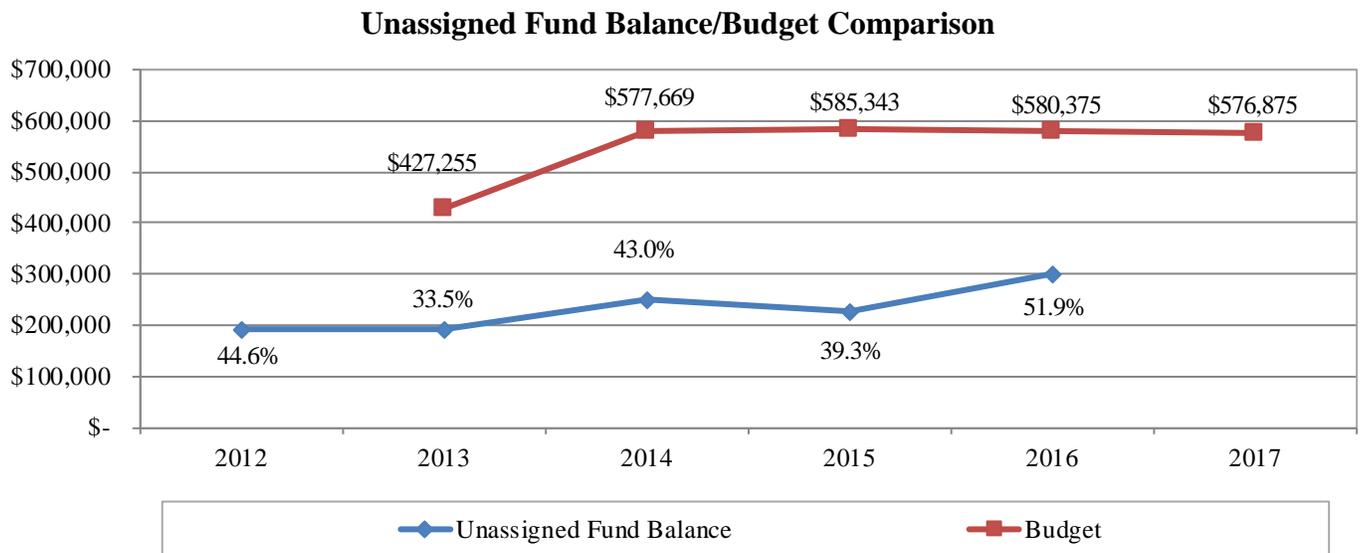
All general governmental functions of the City which are not accounted for in separate funds are included in the General fund.

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. We commend the City for progress made over the last five years in increasing General fund balance to a healthy level. *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
2012	\$ 190,344	2013	\$ 427,255	44.6 %
2013	193,282	2014	577,669	33.5
2014	251,885	2015	585,343	43.0
2015	228,131	2016	580,375	39.3
2016	299,199	2017	576,875	51.9

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:



We have compiled a peer group average derived from information we have requested from the Office of the State Auditor and then compiled the data for Cities of the 4th class which have populations below 2,500. In 2014 and 2015, the average General fund balance as a percentage of expenditures was 87 percent and 93 percent, respectively. Based on comparison to the peer groups, the City's General fund balance is below that average.

The City's unassigned fund balance increased by \$71,068 in 2016. The total unassigned fund balance of \$299,199 represents 51.9 percent of the 2017 budget. Organizations, including the Office of the State Auditor (the OSA) and League of Minnesota Cities (LMC), recommend that a 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 assign intended use of fund balance. This helps address citizen concerns as to the use of fund balance and tax levels. Currently, the City's policy is to maintain an unassigned fund balance of an amount not less than 20 percent of next year's budgeted expenditures of the General fund. We recommend a minimum fund balance for working capital be approximately 40 percent to 50 percent of planned disbursements. So at the current level, unassigned fund balance is slightly above than 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 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 2016 General fund operations are summarized as follows:

	Budgeted Amounts		Actual Amounts	Variance with Final Budget
	Original	Final		
Revenues	\$ 567,475	\$ 568,768	\$ 585,523	\$ 16,755
Expenditures	567,375	567,375	517,830	49,545
Excess (deficiency) of revenues over (under) expenditures	100	1,393	67,693	66,300
Other financing sources (uses)				
Transfers out	-	(13,000)	(13,000)	-
Net change in fund balances	<u>\$ 100</u>	<u>\$ (11,607)</u>	54,693	<u>\$ 66,300</u>
Fund balances, January 1			<u>251,246</u>	
Fund balances, December 31			<u>\$ 305,939</u>	

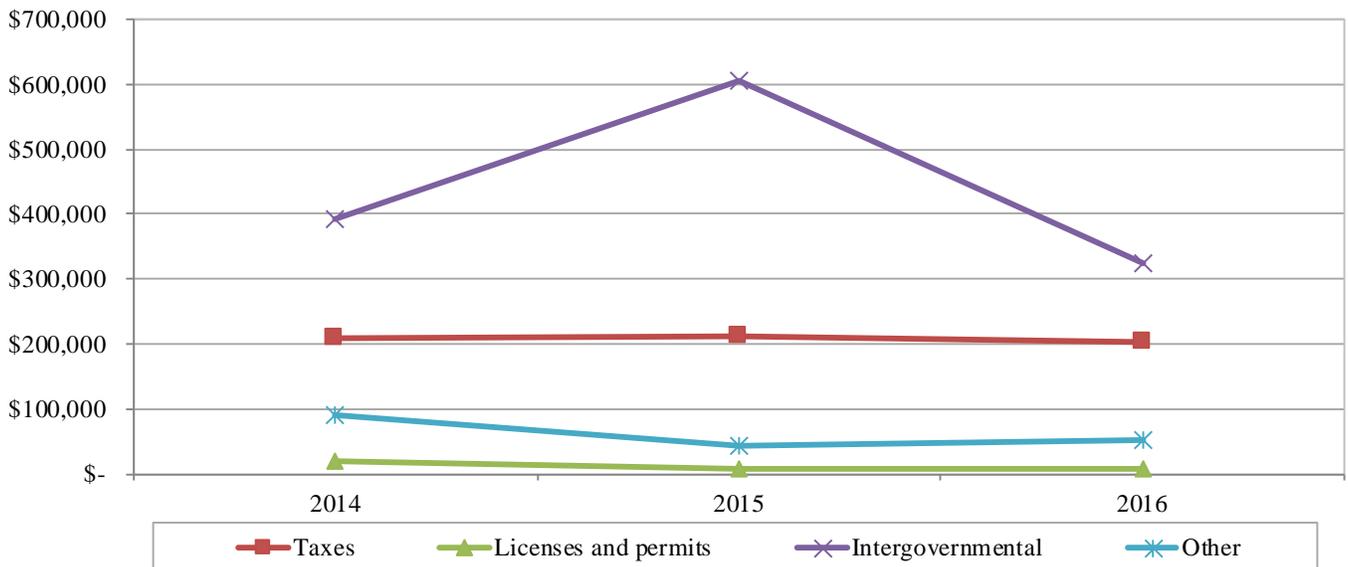
In 2016, larger budget variances were as follows:

- Rents and refunds revenue exceeded budgeted amounts by \$15,935 due to a higher volume of activity at the campground and a larger than expected insurance dividend.
- Streets and highways budgeted capital outlay costs of \$33,000 went unspent.

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

Source	2014	2015	2016	Percent of Total	Per Capita
Taxes	\$ 207,847	\$ 212,312	\$ 202,161	34.5 %	\$ 226
Special assessments	20	6	-	-	-
Licenses and permits	18,833	6,900	7,664	1.3	9
Intergovernmental	392,593	605,286	325,009	55.5	363
Charges for services	6,282	10,253	14,966	2.6	17
Fines and forfeits	8,130	3,646	4,245	0.7	5
Investment earnings	1,109	1,052	443	0.1	-
Miscellaneous	53,577	28,506	31,035	5.3	35
Transfers in	21,714	-	-	-	-
<b>Total revenues and transfers</b>	<b>\$ 710,105</b>	<b>\$ 867,961</b>	<b>\$ 585,523</b>	<b>100.0 %</b>	<b>\$ 654</b>

### General Fund Revenues by Source

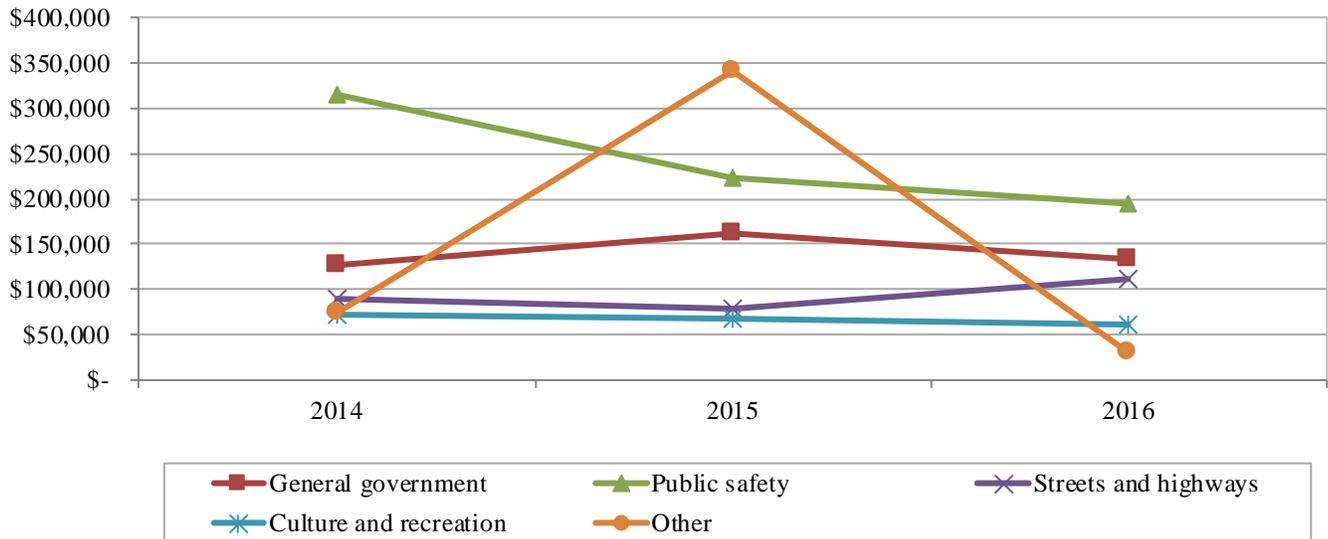


A comparison of General fund expenditures and transfers for the last three years is presented below:

Program	2014	2015	2016	Percent of Total	Per Capita	Peer Group Per Capita
<b>Current</b>						
General government	\$ 127,027	\$ 161,918	\$ 133,847	25.2 %	\$ 150	\$ 198
Public safety	314,461	223,332	193,778	36.6	217	212
Streets and highways	90,240	79,599	111,051	20.9	124	162
Culture and recreation	71,888	68,272	61,981	11.7	69	71
Unallocated	75	-	-	-	-	23
<b>Total current</b>	<b>603,691</b>	<b>533,121</b>	<b>500,657</b>	<b>94.4</b>	<b>560</b>	<b>666</b>
Capital outlay	44,437	327,685	10,730	2.0	12	79
Debt service	16,368	6,978	6,443	1.2	7	-
Transfers out	12,717	6,000	13,000	2.4	15	-
<b>Total expenditures and transfers</b>	<b>\$ 677,213</b>	<b>\$ 873,784</b>	<b>\$ 530,830</b>	<b>100.0 %</b>	<b>\$ 579</b>	<b>\$ 745</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 derived information we have derived from information we have requested from the Office of the State Auditor. Different peer group averages are used for Cities of the 4<sup>th</sup> class (a separate subgroup of those under 2,500 population has been developed for comparison purposes).

### General Fund Expenditures 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 2016 and 2015 and the net change:

Fund	Fund Balances December 31		Increase (Decrease)
	2016	2015	
Major Economic Development Authority	\$ (14,196)	\$ 1,138	\$ (15,334)

The decrease in the EDA fund balance was attributable to unbudgeted costs during the year related to flood mitigation planning.

## 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 2016 fund balances with 2015:

Fund	Fund Balances December 31		Increase (Decrease)
	2016	2015	
Major Minnesota and 6th Street Project	\$ (12,640)	\$ -	\$ (12,640)

The City should analyze projects' status each year and close those that are completed. Any deficits should be evaluated to ensure they are consistent with financing expectations. The *Minnesota and 6th Street Project fund* is a capital projects fund created in 2016 that accounts for project costs related to the upcoming street reconstruction.

## 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.

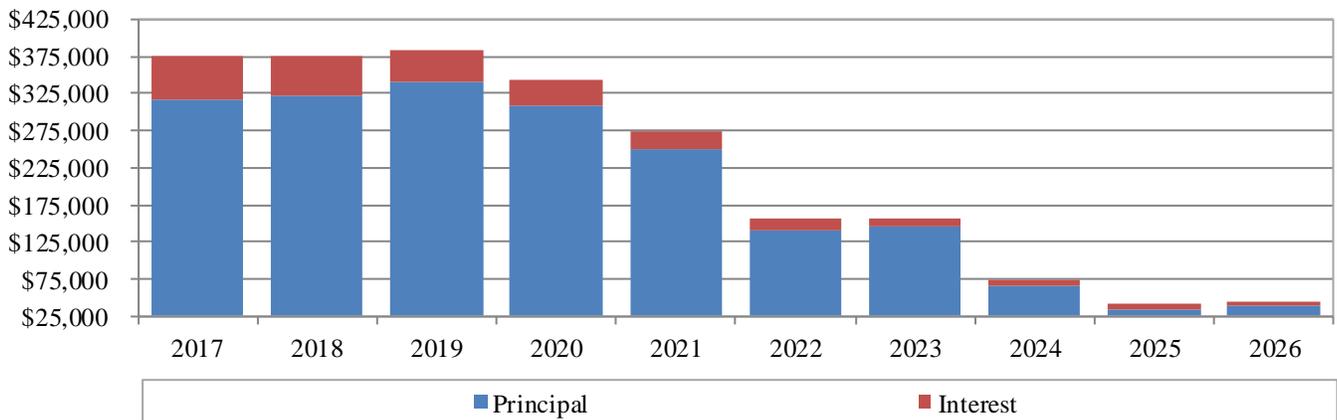
In addition to the above pledged assets, other funding sources may be received by Debt Service funds as follows:

- Residual project proceeds from the related capital projects 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, 2016:

Debt Description	Total Cash and Investments	Total Assets	Outstanding Debt	Maturity Date
<b>General Obligation Bonds</b>				
2011C G.O. Tax Abatement Bonds	\$ 31,439	\$ 31,439	\$ 415,000	02/01/28
2013A G.O. Equipment Certificates	11,382	11,382	70,000	01/01/23
2014A G.O. Bonds	2,768	2,768	220,000	02/01/24
Total G.O. Bonds	<u>45,589</u>	<u>45,589</u>	<u>705,000</u>	
<b>G.O. Tax Increment Bonds</b>				
G.O. Tax Increment Bonds of 2007	<u>10,124</u>	<u>10,555</u>	<u>100,000</u>	02/01/19
<b>G.O. Special Assessment Bonds</b>				
Permanent Improvement Revolving	(216,593)	(21,188)	-	
G.O. Refunding Bonds of 2011B (2002A)	969	969	350,000	02/01/23
G.O. Refunding Bonds of 2011B (2006A)	420	420	410,000	02/01/20
G.O. Refunding Bonds of 2011B (2003A)	98,072	98,072	105,000	02/01/23
G.O. Refunding Bonds of 2011B (2005A)	<u>274</u>	<u>274</u>	<u>380,000</u>	02/01/21
Total G.O. Special Assessment Bonds	<u>(116,858)</u>	<u>78,547</u>	<u>1,245,000</u>	
Total All Debt Service Funds	<u>\$ (61,145)</u>	<u>\$ 134,691</u>	<u>\$ 2,050,000</u>	
Future Interest on Debt			<u>\$ 113,622</u>	

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

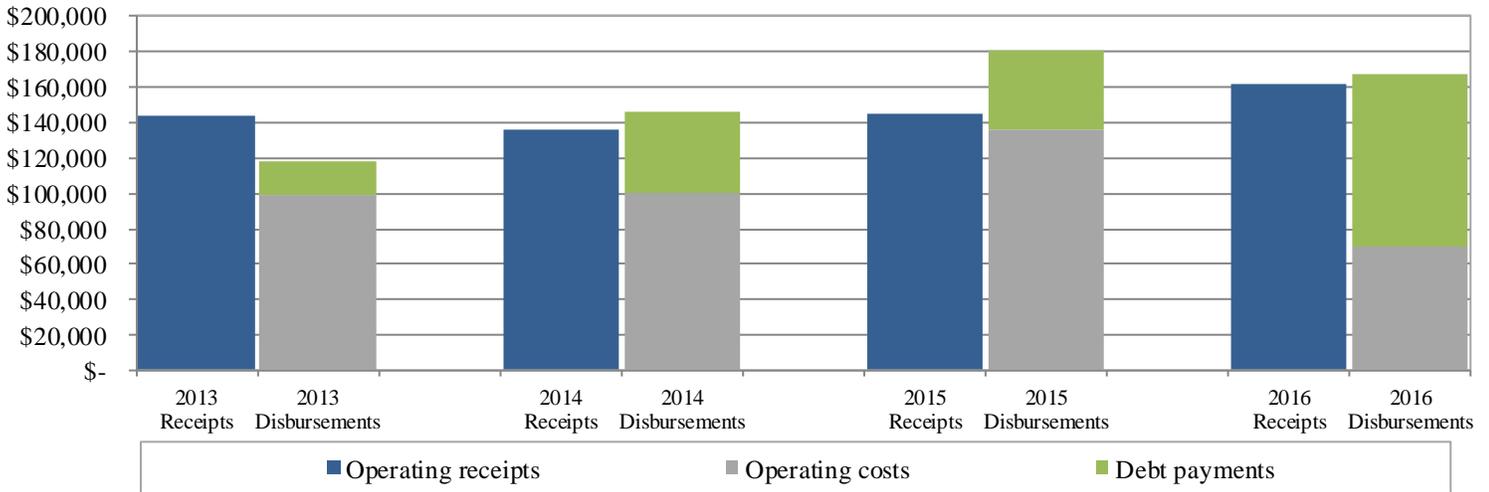


The City's outstanding debt is required to be funded by various resources such as special assessments, tax increments, property taxes, transfers from enterprise funds, etc. Special assessments and tax increments are usually certified once to the County for collection, but tax levies need to be certified annually. We recommend management pay particular attention to annual tax levies and transfers listed in each bond issue book to ensure proper funding of debt service.

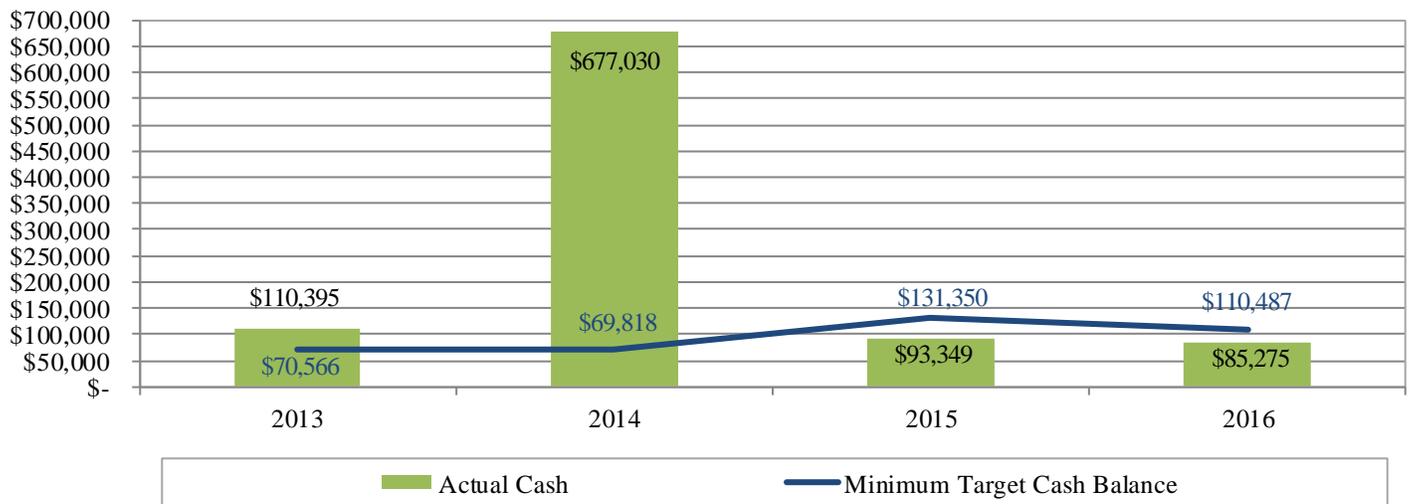
**Enterprise Funds**

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 balances for the past four years are as follows:

**Water Utility Cash Flows**



**Water Utility Cash Balances**

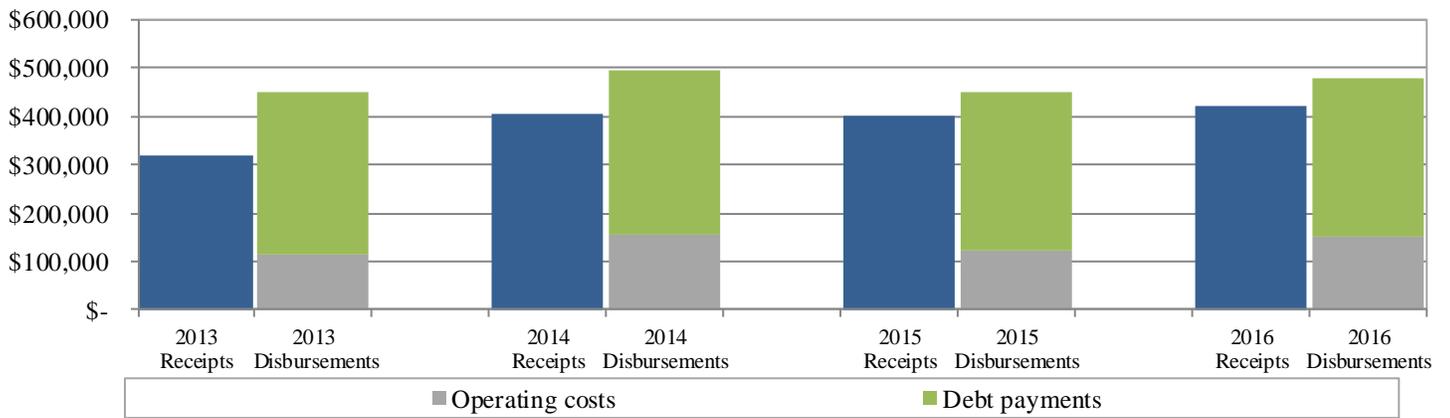


The minimum target cash balance is based on 25 percent of the operating costs plus one year of debt services payments.

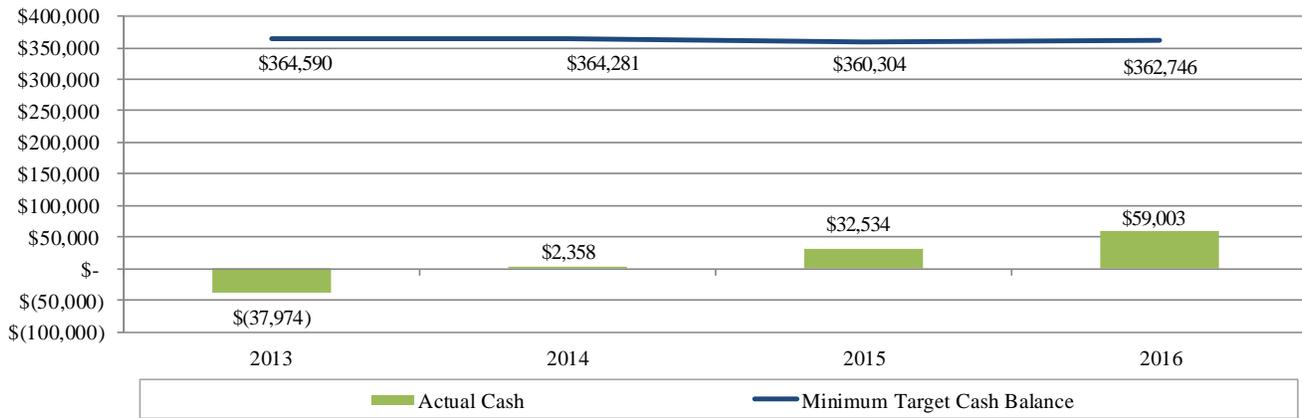
	2013	2014	2015	2016
Bonds payable	<u>\$ 349,000</u>	<u>\$ 1,089,100</u>	<u>\$ 1,071,300</u>	<u>\$ 1,008,100</u>

The increase in cash and investment balances in 2013 was attributable to a bond issuance of \$135,000. Cash and investment balances in 2014 include unspent bond proceeds of \$606,273. These bond proceeds were spent in 2015 on the water system improvement project. We recommend a cash flow projection be created to determine if rates and tax levies are sufficient to cover operating costs, debt payments, repairs, and future replacement/expansion.

### Sewer Utility Cash Flows



### Sewer Utility Cash Balances

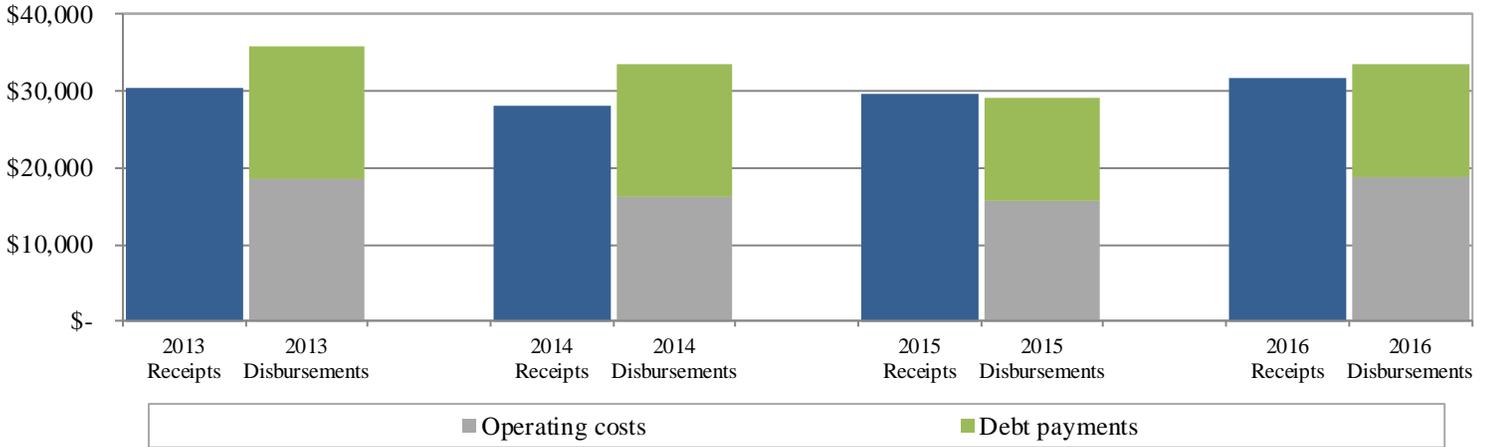


The minimum target cash balance is based on 25 percent of the operating costs plus one year of debt services payments.

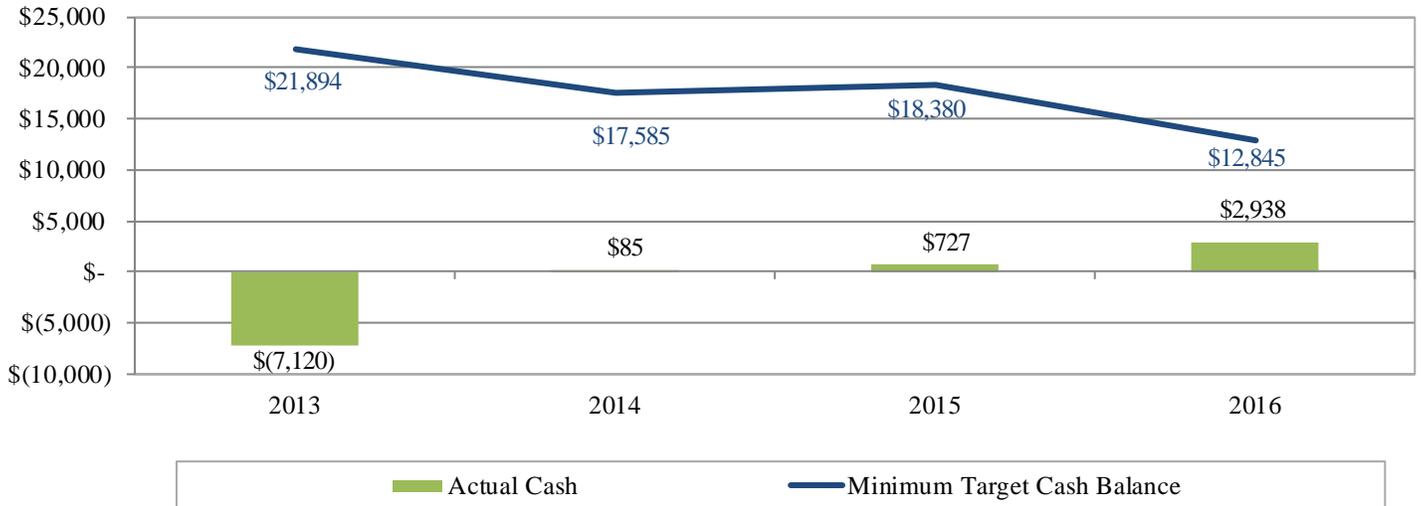
	2013	2014	2015	2016
Bonds payable	<u>\$ 3,684,700</u>	<u>\$ 3,415,600</u>	<u>\$ 3,153,000</u>	<u>\$ 2,885,100</u>

Over the past four years, operating receipts were insufficient to cover operating costs and debt payments. Additionally, cash balances annually fell short of targeted balances. We recommend a cash flow projection be created to determine if rates and tax levies are sufficient to cover operating costs, debt payments, repairs, and future replacement/expansion.

### Environmental Services Cash Flows



### Environmental Services Cash Balances



The minimum target cash balance is based on 25 percent of the operating costs plus one year of debt services payments.

	2013	2014	2015	2016
Bonds payable	<u>\$ 99,300</u>	<u>\$ 85,300</u>	<u>\$ 74,700</u>	<u>\$ 62,800</u>

The Environmental Services fund operations are generating just enough cash to cover its operating expenses. Additionally, while performance is much improved over prior years, the fund is still not generating enough cash to make debt service transfers or provide for any capital reserves for future replacements. We recommend a cash flow projection be created to determine if rates and tax levies are sufficient to cover operating costs, debt payments, repairs, and future replacement/expansion.

## 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. The peer group average is derived from information we have requested from the Office of the State Auditor. The peer group averages used is for cities of the 4<sup>th</sup> class (a separate subgroup of those under 2,500 population has been developed for comparison purposes). 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) ratios are shown below.

Ratio	Calculation	Source	Year			
			2013	2014	2015	2016
Debt to assets	Total liabilities/total assets	Government-wide	54% 36%	55% 37%	54% 41%	54% N/A
Debt service coverage	Net cash provided by operations/ enterprise fund debt payments	Enterprise funds	61% 99%	74% 98%	85% 100%	82% N/A
Debt per capita	Bonded debt/population	Government-wide	\$ 7,719 \$ 3,309	\$ 8,125 \$ 3,433	\$ 7,473 \$ 3,307	\$ 6,739 N/A
Taxes per capita	Tax revenues/population	Government-wide	\$ 764 \$ 466	\$ 588 \$ 464	\$ 589 \$ 469	\$ 588 N/A
Current expenditures per capita	Governmental fund expenditures/ population	Governmental funds	\$ 629 \$ 805	\$ 718 \$ 819	\$ 659 \$ 810	\$ 625 N/A
Capital expenditures per capita	Governmental fund expenditures/ population	Governmental funds	\$ 379 \$ 293	\$ 649 \$ 342	\$ 366 \$ 385	\$ 26 N/A
Capital assets % left to depreciate - Governmental	Net capital assets/ gross capital assets	Government-wide	61% 57%	59% 56%	57% 55%	55% N/A
Capital assets % left to depreciate - Business-type	Net capital assets/ gross capital assets	Government-wide	67% 59%	65% 60%	64% 59%	61% N/A

**Represents City of Henderson**

*Represents Peer Group Average*

### **Debt-to-Assets Leverage Ratio (Solvency Ratio)**

The debt-to-assets leverage ratio is a comparison of a city's total liabilities to its total assets or the percentage of total assets that are provided by creditors. It indicates the degree to which the City's assets are financed through borrowings and other long-term obligations (i.e. a ratio of 50 percent would indicate half of the assets are financed with outstanding debt).

### **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.

### **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. 74 - *Financial Reporting for Postemployment Benefit Plans Other than Pension Plans***

#### **Summary**

The objective of this Statement is to improve the usefulness of information about postemployment benefits other than pensions (other postemployment benefits or OPEB) included in the general purpose external financial reports of state and local governmental OPEB plans for making decisions and assessing accountability. 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 Statements No. 43, Financial Reporting for Postemployment Benefit Plans Other Than Pension Plans, as amended, and No. 57, OPEB Measurements by Agent Employers and Agent Multiple-Employer Plans. It also includes requirements for defined contribution OPEB plans that replace the requirements for those OPEB plans in Statement No. 25, Financial Reporting for Defined Benefit Pension Plans and Note Disclosures for Defined Contribution Plans, as amended, Statement 43, and Statement No. 50, Pension Disclosures.

Statement No. 75, Accounting and Financial Reporting for Postemployment Benefits Other than Pensions, establishes new accounting and financial reporting requirements for governments whose employees are provided with OPEB, as well as for certain nonemployer governments that have a legal obligation to provide financial support for OPEB provided to the employees of other entities.

The scope of this Statement includes OPEB plans-defined benefit and defined contribution-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, and the OPEB plan administrator. If the plan is a defined benefit OPEB plan, plan assets also are legally protected from creditors of the plan members.

This Statement also includes requirements to address financial reporting for assets accumulated for purposes of providing defined benefit OPEB through OPEB plans that are not administered through trusts that meet the specified criteria.

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

This Statement is effective for financial statements for fiscal years beginning after June 15, 2016. 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 financial reporting primarily through enhanced note disclosures and schedules of required supplementary information that will be presented by OPEB plans that are administered through trusts that meet the specified criteria. The new information will enhance the decision-usefulness of the financial reports of those OPEB plans, their value for assessing accountability, and their transparency by providing information about measures of net OPEB liabilities and explanations of how and why those liabilities changed from year to year. The net OPEB liability information, including ratios, will offer an up-to-date indication of the extent to which the total OPEB liability is covered by the fiduciary net position of the OPEB plan. The comparability of the reported information for similar types of OPEB plans will be improved by the changes related to the attribution method used to determine the total OPEB liability. The contribution schedule will provide measures to evaluate decisions related to the assessment of contribution rates in comparison with actuarially determined rates, if such rates are determined. In addition, new information about rates of return on OPEB plan investments will inform financial report users about the effects of market conditions on the OPEB plan's assets over time and provide information for users to assess the relative success of the OPEB plan's investment strategy and the relative contribution that investment earnings provide to the OPEB plan's ability to pay benefits to plan members when they come due.

### **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.

## Future Accounting Standard Changes - Continued

### Effective Date

This Statement is effective for fiscal years 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 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.

### **GASB Statement No. 80** - *Blending Requirements for Certain Component Units - an Amendment of GASB Statement No. 14*

#### Summary

The objective of the Statement is to improve financial reporting by clarifying the financial statement presentation requirements for certain component units. This Statement amends the blending requirements established in paragraph 53 of Statement No. 14, *The Financial Reporting Entity, as amended*.

This Statement amends the blending requirements for the financial statement presentation of component units of all state and local governments. The additional criterion requires blending of a component unit incorporated as a not-for-profit corporation in which the primary government is the sole corporate member. The additional criterion does not apply to component units included in the financial reporting entity pursuant to the provisions of Statement No. 39, *Determining Whether Certain Organizations Are Component Units*.

## **Future Accounting Standard Changes - Continued**

### **Effective Date**

The requirements of this Statement are effective for reporting periods beginning after June 15, 2016. Earlier application is encouraged.

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

The requirements of this Statement enhance the comparability of financial statements among governments. Greater comparability improves the decision-usefulness of information reported in financial statements and enhances its value for assessing government accountability.

### **GASB Statement No. 81 - Irrevocable Split-Interest Agreements**

#### **Summary**

The objective of this Statement is to improve accounting and financial reporting for irrevocable split-interest agreements by providing recognition and measurement guidance for situations in which a government is a beneficiary of the agreement.

Split-interest agreements are a type of giving agreement used by donors to provide resources to two or more beneficiaries, including governments. Split-interest agreements can be created through trusts—or other legally enforceable agreements with characteristics that are equivalent to split-interest agreements—in which a donor transfers resources to an intermediary to hold and administer for the benefit of a government and at least one other beneficiary. Examples of these types of agreements include charitable lead trusts, charitable remainder trusts, and life-interests in real estate.

This Statement requires that a government that receives resources pursuant to an irrevocable split-interest agreement recognize assets, liabilities, and deferred inflows of resources at the inception of the agreement. Furthermore, this Statement requires that a government recognize assets representing its beneficial interests in irrevocable split-interest agreements that are administered by a third party, if the government controls the present service capacity of the beneficial interests. This Statement requires that a government recognize revenue when the resources become applicable to the reporting period.

#### **Effective Date**

The requirements of this Statement are effective for financial statements for periods beginning after December 15, 2016, and should be applied retroactively. Earlier application is encouraged.

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

This Statement enhances the comparability of financial statements by providing accounting and financial reporting guidance for irrevocable split-interest agreements in which a government is a beneficiary. This Statement also enhances the decision-usefulness of general purpose external financial reports, and their value for assessing accountability, by more clearly identifying the resources that are available for the government to carry out its mission.

### **GASB Statement No. 82 - Pension Issues an Amendment of GASB Statements No. 67, No. 68, and No. 73**

#### **Summary**

The objective of this Statement is to address certain issues that have been raised with respect to Statements No. 67, Financial Reporting for Pension Plans, No. 68, Accounting and Financial Reporting for Pensions, and No. 73, Accounting and Financial Reporting for Pensions and Related Assets That Are Not within the Scope of GASB Statement 68, and Amendments to Certain Provisions of GASB Statements 67 and 68. Specifically, this Statement addresses issues regarding (1) the presentation of payroll-related measures in required supplementary information, (2) the selection of assumptions and the treatment of deviations from the guidance in an Actuarial Standard of Practice for financial reporting purposes, and (3) the classification of payments made by employers to satisfy employee (plan member) contribution requirements.

## **Future Accounting Standard Changes - Continued**

### **Presentation of Payroll-Related Measures in Required Supplementary Information**

Prior to the issuance of this Statement, Statements 67 and 68 required presentation of covered-employee payroll, which is the payroll of employees that are provided with pensions through the pension plan, and ratios that use that measure, in schedules of required supplementary information. This Statement amends Statements 67 and 68 to instead require the presentation of covered payroll, defined as the payroll on which contributions to a pension plan are based, and ratios that use that measure.

### **Selection of Assumptions**

This Statement clarifies that a deviation, as the term is used in Actuarial Standards of Practice issued by the Actuarial Standards Board, from the guidance in an Actuarial Standard of Practice is not considered to be in conformity with the requirements of Statement 67, Statement 68, or Statement 73 for the selection of assumptions used in determining the total pension liability and related measures.

### **Classification of Employer-Paid Member Contributions**

This Statement clarifies that payments that are made by an employer to satisfy contribution requirements that are identified by the pension plan terms as plan member contribution requirements should be classified as plan member contributions for purposes of Statement 67 and as employee contributions for purposes of Statement 68. It also requires that an employer's expense and expenditures for those amounts be recognized in the period for which the contribution is assessed and classified in the same manner as the employer classifies similar compensation other than pensions (for example, as salaries and wages or as fringe benefits).

### **Effective Date**

The requirements of this Statement are effective for reporting periods beginning after June 15, 2016, except for the requirements of this Statement for the selection of assumptions in a circumstance in which an employer's pension liability is measured as of a date other than the employer's most recent fiscal year-end. In that circumstance, the requirements for the selection of assumptions are effective for that employer in the first reporting period in which the measurement date of the pension liability is on or after June 15, 2017. Earlier application is encouraged.

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

The requirements of this Statement will improve financial reporting by enhancing consistency in the application of financial reporting requirements to certain pension issues.

## 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.

#### **Effective Date**

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

## Future Accounting Standard Changes - Continued

### 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.

<sup>(1)</sup> *Note.* From GASB Pronouncements Summaries. Copyright 2016 by the Financial Accounting Foundation, 401 Merritt 7, Norwalk, CT 06856, USA, and is reproduced with permission.

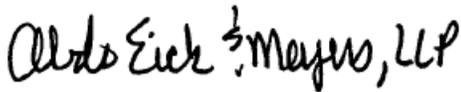
\* \* \* \* \*

### Restriction on Use

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

The comments and recommendation in this report are purely constructive in nature, and should be read in this context. 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.

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  
March 6, 2017