

**City of Silver Bay  
Lake County, Minnesota**

**Communications Letter**

**December 31, 2015**



**City of Silver Bay  
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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 Silver Bay  
Silver Bay, Minnesota

In planning and performing our audit of the financial statements of the City of Silver Bay, Minnesota, as of and for the year ended December 31, 2015, in accordance with auditing standards generally accepted in the United States of America, we considered the City's internal control over financial reporting (internal control) as a basis for designing auditing procedures that are appropriate in the circumstances for the purpose of expressing our opinion on the financial statements, but not for the purpose of expressing an opinion on the effectiveness of the City's internal control. Accordingly, we do not express an opinion on the effectiveness of the City's internal control.

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

A deficiency in internal control exists when the design or operation of a control does not allow management or employees, in the normal course of performing their assigned functions, to prevent, or detect and correct misstatements on a timely basis. A material weakness is a deficiency, or a 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 a combination of deficiencies, in internal control that is less severe than a material weakness, yet important enough to merit attention by those charged with governance. The significant deficiencies identified are 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 March 3, 2016, on such statements.

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

*Bergan KDV, Ltd.*

St. Cloud, Minnesota  
March 3, 2016

## **City of Silver Bay Significant Deficiencies**

### **LACK OF SEGREGATION OF ACCOUNTING DUTIES**

During the year ended December 31, 2015, the City had a lack of segregation of accounting duties due to a limited number of office employees. The lack of adequate segregation of accounting duties could adversely affect the City's ability to initiate, record, process, and report financial data consistent with the assertions of management in the financial statements.

Management and the City Council are aware of the lack of segregation of accounting duties and have taken certain steps to compensate for the condition, but due to the small staff needed to handle 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.

The lack of segregation of accounting duties can be demonstrated in the following areas, which is not intended to be an all-inclusive list:

- The Deputy Clerk has full general ledger access, including the ability to write and post journal entries and is also responsible for review of the financial activities of the City, including preparation of the bank reconciliation.
- Receipting Process
  - The Assistant Deputy Clerk creates and sends invoices, occasionally collects payments as they are received, prepares deposits, and enters the receipts into the accounting system.
  - The Assistant Deputy Clerk enters the utility billing into the utility billing register, bills commercial and residential customers, and mails the utility bills. The Assistant Deputy Clerk also occasionally receives payments, records the receipts, and is also able to make adjustments to the utility billing register.
- Disbursement Process
  - The Assistant Deputy Clerk creates a batch list for City Council approval, enters information for payment on all bills, prints checks, mails checks, and creates the paid claims list that is presented to the City Council.

### **PREPARATION OF FINANCIAL STATEMENTS AND RELATED NOTE DISCLOSURES**

As a function of the audit process, auditors are required to gain an understanding of the City's internal control, including the financial reporting process.

The City does not have an internal control system designed to provide for the preparation of the financial statements and related note disclosures in accordance with accounting principles generally accepted in the United States of America. As auditors, we were requested to draft the financial statements and accompanying notes to financial statements. This circumstance is not unusual in a city of your size.

**City of Silver Bay**  
**Significant Deficiencies**

**PREPARATION OF FINANCIAL STATEMENTS AND RELATED NOTE DISCLOSURES  
(CONTINUED)**

This condition increases the risk that errors could occur which would not be prevented, or detected and corrected in a timely manner. Even though all management decisions related to financial reporting are made by the City's management and approval of the financial statements and accompanying note disclosures lies with management, it is the responsibility of management and those charged with governance to make the decision whether to accept the degree of risk associated with this condition because of cost or other considerations.

**City of Silver Bay  
Required Communication**

We have audited the financial statements of the City for the year ended December 31, 2015, and have issued our report dated March 3, 2016. Professional standards require that we provide you with the following information related to our audit.

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

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

As part of our audit, we considered the internal control of the City. Such considerations were solely for the purpose of determining our audit procedures and not to provide any assurance concerning such internal control.

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

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

**PLANNED SCOPE AND TIMING OF THE AUDIT**

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

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

**City of Silver Bay  
Required Communication**

**QUALITATIVE ASPECTS OF ACCOUNTING PRACTICES**

Management is responsible for the selection and use of appropriate accounting policies. The significant accounting policies used by the City are described in Note 1 to the financial statements. No new accounting policies were adopted and the application of existing policies was not changed during the year ended December 31, 2015. 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.

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

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

**DIFFICULTIES ENCOUNTERED IN PERFORMING THE AUDIT**

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

**CORRECTED AND UNCORRECTED MISSTATEMENTS**

Professional standards require us to accumulate all misstatements identified during the audit, other than those that are clearly trivial, and communicate them to the appropriate level of management. Management did not identify and we did not notify them of any uncorrected financial statement misstatements.

**City of Silver Bay  
Required Communication**

**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 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**

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.

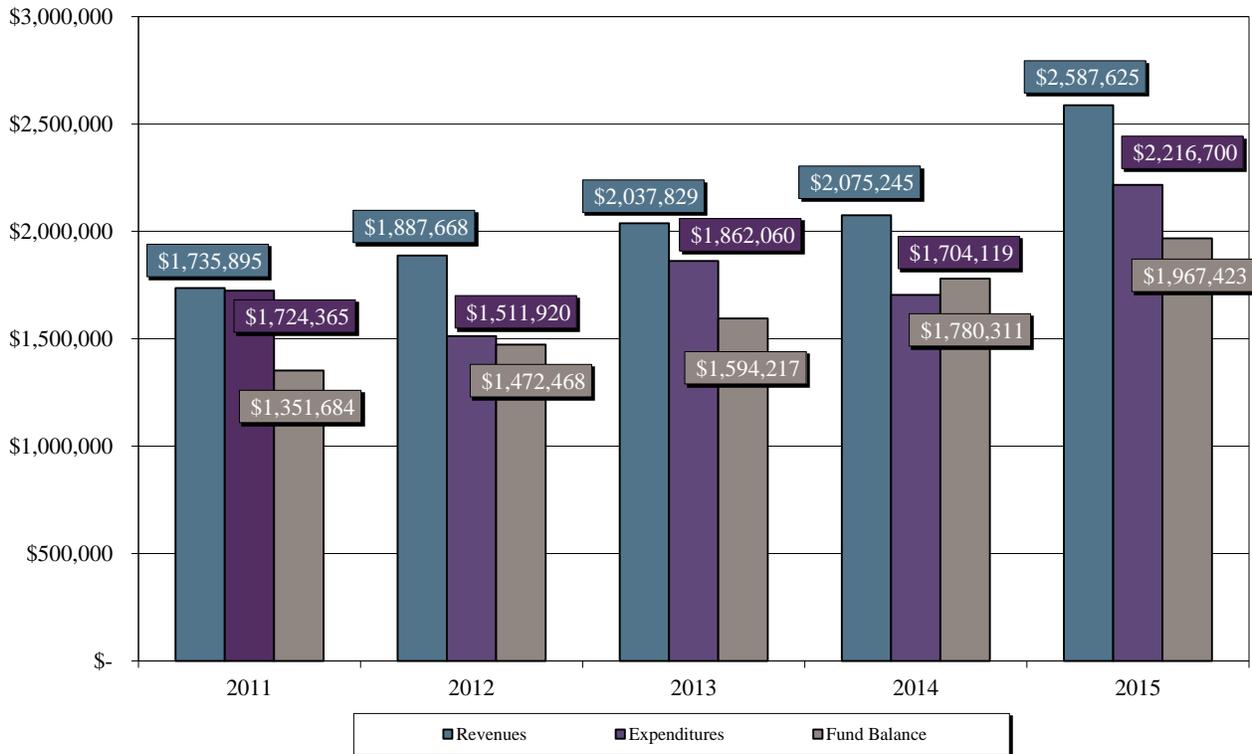
## City of Silver Bay Financial Analysis

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

Revenues over expenditures, before transfers and other financing sources, in the General Fund for 2015 totaled \$370,925. General Fund revenues funded \$302,718 in routine operating transfers to fund Library, Cemetery, Airport, Arena, Park and Recreation, Community Building, and Public Work's Reserve Funds' operations. Fund balance in the General Fund increased \$187,112, or 10.5%, from \$1,780,311 in 2014 to \$1,967,423 in 2015. This fund balance represents just over 10 months of total General Fund operating expenditures, based on 2015 operations. As the graph below indicates, revenues have increased each of the last 4 years. Fund balance has increased steadily over the last five years, to a high in 2015.

**General Fund Revenues, Expenditures and Fund Balance**

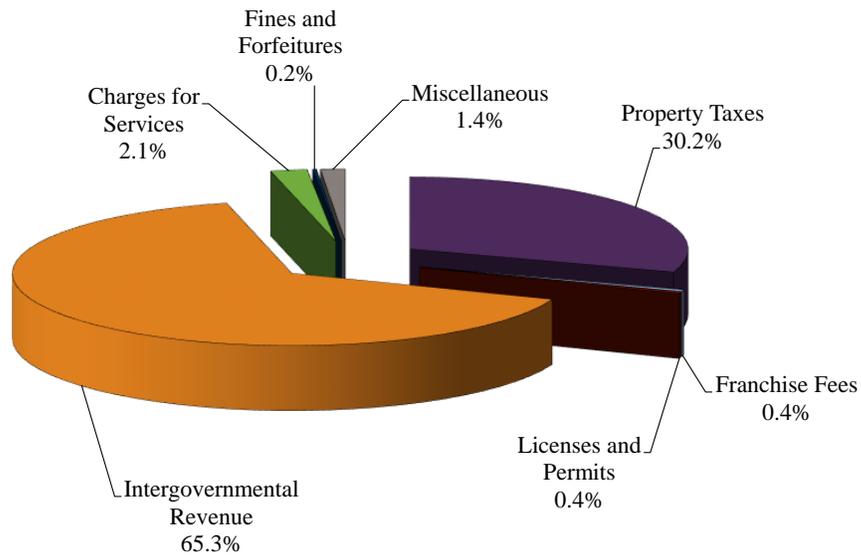


# City of Silver Bay Financial Analysis

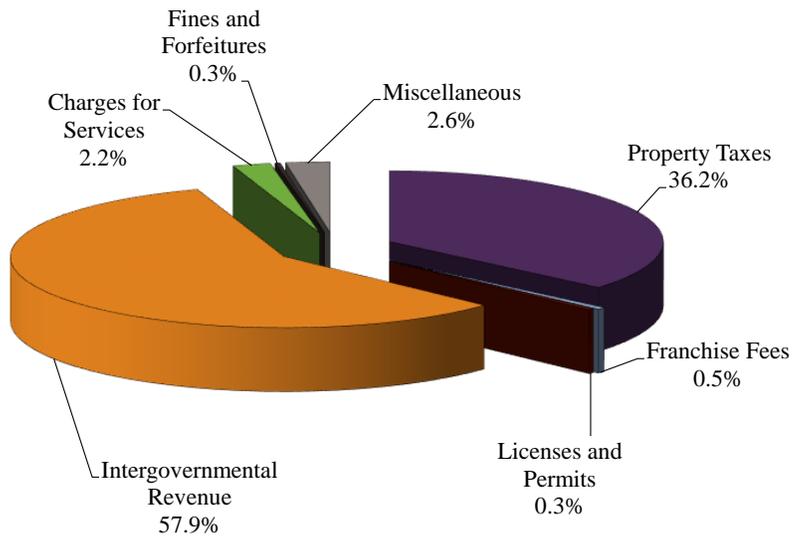
## GENERAL FUND

As the graphs below indicate, the City relies upon intergovernmental revenue and tax levies as the majority of its total General Fund revenues. These two revenue sources accounted for 95.5% and 94.1% of total revenue in 2015 and 2014, respectively. There were significant changes this year in the percentage of intergovernmental revenue and property taxes as a result of a FEMA grant for the fire truck purchase.

**General Fund 2015 Revenues by Source**



**General Fund 2014 Revenues by Source**



**City of Silver Bay  
Financial Analysis**

**GENERAL FUND**

	<u>2011</u>	<u>2012</u>	<u>2013</u>	<u>2014</u>	<u>2015</u>
<b>Revenues</b>					
Property taxes	\$ 489,640	\$ 663,145	\$ 708,293	\$ 750,973	\$ 780,909
Franchise fees	10,114	9,952	10,102	9,901	10,033
Licenses and permits	10,109	15,411	44,728	6,920	9,029
Intergovernmental revenue	1,117,779	1,083,161	1,166,623	1,200,661	1,690,460
Charges for services	52,399	66,173	50,771	46,528	54,597
Fines and forfeitures	8,057	6,060	7,607	6,265	5,748
Miscellaneous	47,797	43,766	49,705	53,997	36,849
<b>Total revenues</b>	<u>\$ 1,735,895</u>	<u>\$ 1,887,668</u>	<u>\$ 2,037,829</u>	<u>\$ 2,075,245</u>	<u>\$ 2,587,625</u>

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General Fund revenues increased \$512,380, or 24.7% from 2014. Property taxes increased \$29,936 from 2014 as a result of an increase in the General Fund portion of the levy of approximately \$23,000. Intergovernmental revenue increased \$489,799 due to a grant from FEMA for a fire truck, a new state aid for road maintenance, and an IRRRB grant for the completion of a comprehensive plan. In the five years presented, total revenues have increased significantly, increasing by \$851,730 or 49.1%. Revenues can change significantly year to year based on different grants received.

There were some significant changes between property tax revenue and intergovernmental revenue from 2011 to 2012. Prior to 2012, the state subsidized a portion of property taxes and paid that portion in the form of a market value credit. In an effort to balance the state's budget, the market value credit subsidization was discontinued beginning with the 2012 levy, resulting in the entire levy being the responsibility of local tax payers causing the property tax revenue to be significantly higher and intergovernmental revenue lower than previous years.

	<u>2011</u>	<u>2012</u>	<u>2013</u>	<u>2014</u>	<u>2015</u>
<b>Expenditures</b>					
General government	\$ 439,134	\$ 434,300	\$ 485,463	\$ 489,705	\$ 513,041
Public safety	587,363	529,727	533,772	562,821	557,153
Public works	358,725	470,546	506,284	514,993	502,256
Culture and recreation	19,216	27,086	17,799	41,454	19,359
Debt service	21,423	21,422	21,423	3,240	-
Capital outlay	298,504	28,839	297,319	91,906	624,891
<b>Total expenditures</b>	<u>\$ 1,724,365</u>	<u>\$ 1,511,920</u>	<u>\$ 1,862,060</u>	<u>\$ 1,704,119</u>	<u>\$ 2,216,700</u>

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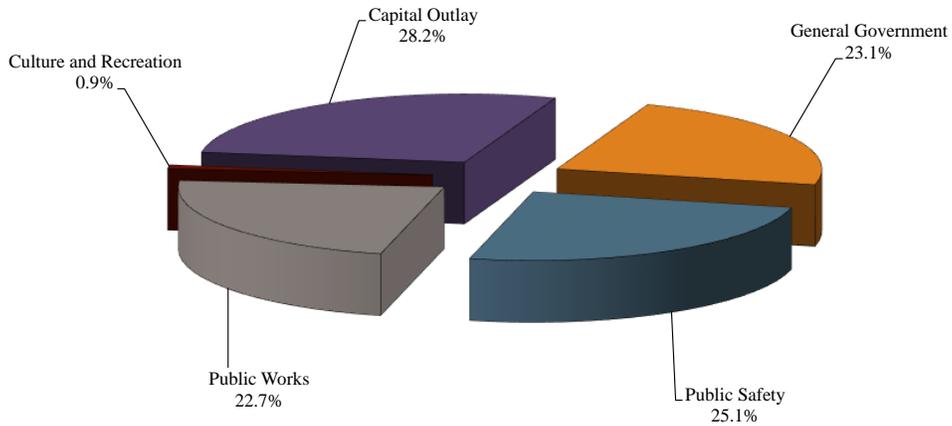
General Fund expenditures increased \$512,581, or 30.1% during 2015. Capital outlay changed significantly from 2014 to 2015, increasing by \$532,985. This increase is due to the purchase of a fire truck during the year. Culture and recreation expenditures decreased \$22,095 due to more salary and benefit expenditures related to time spent on culture and recreation projects, including the golf course bridge, in 2014, while there were less projects in 2015. General government expenditures increased due to the preparation of their comprehensive plan. All other functions were consistent with the prior year.

# City of Silver Bay Financial Analysis

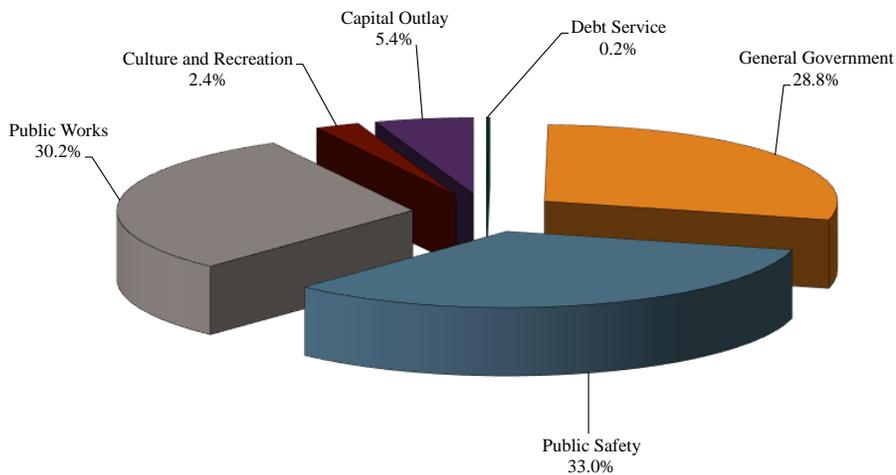
## GENERAL FUND

The graphs below illustrate the breakdown of expenditures by function for the last two years. As with other cities of similar size, public safety, public works, and general government expenditures make up the largest components of General Fund expenditures. Due to the capital purchases of the City in 2015, that function increased while expenditures in the other functions decreased proportionately in 2015.

**General Fund 2015 Expenditures by Function**



**General Fund 2014 Expenditures by Function**

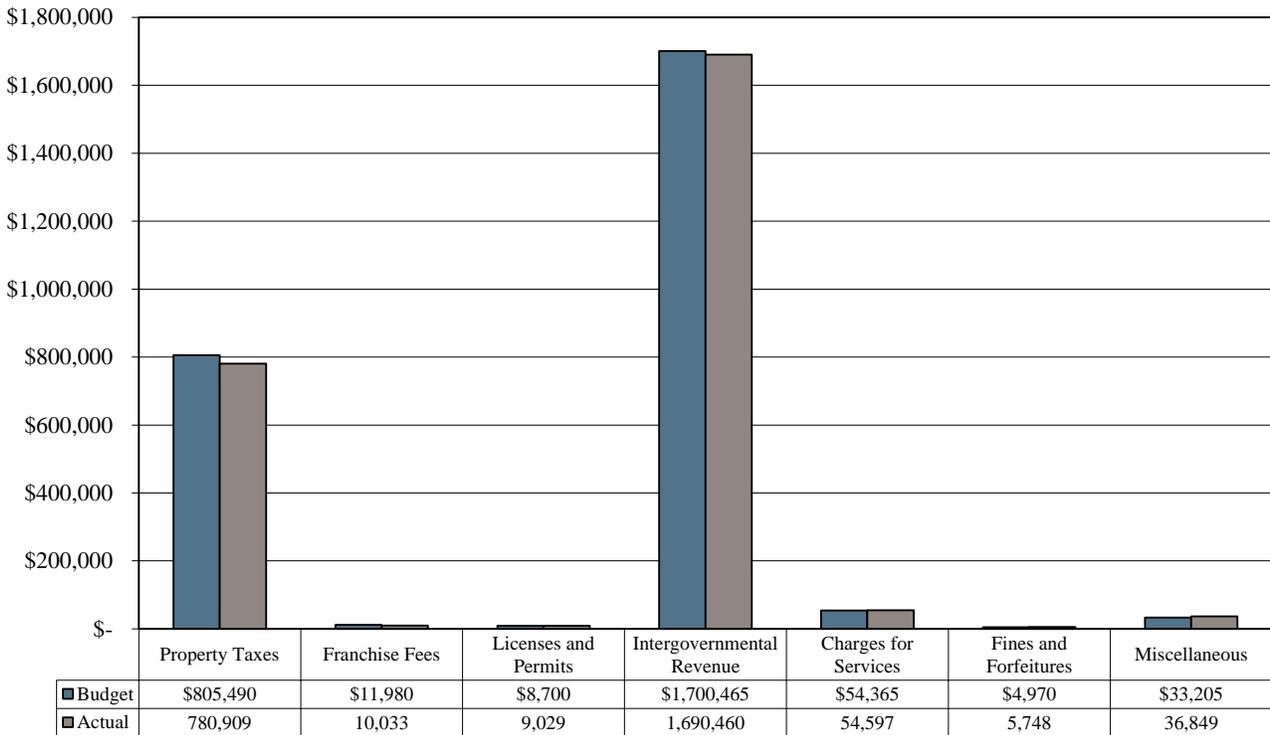


## City of Silver Bay Financial Analysis

### GENERAL FUND

The graphs below and on the following page outline the budget and actual comparison for General Fund revenues and expenditures. Overall, revenue was \$31,550 under budget. Property taxes were under budget \$24,581 as a result of delinquent tax receipts coming in under expected amounts. The rest of the revenue categories only had minimal budget variances.

**2015 General Fund Revenues  
Budget and Actual**

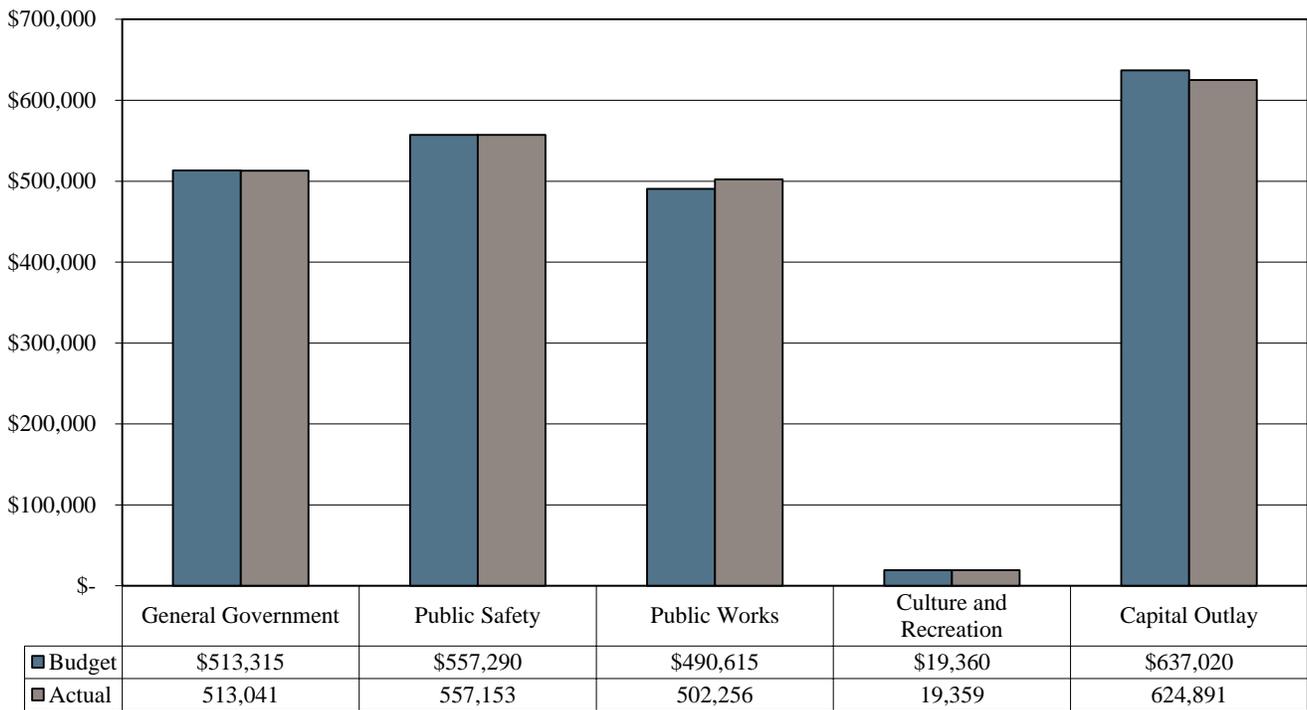


## City of Silver Bay Financial Analysis

### GENERAL FUND

Overall, expenditures were \$900 under budget in 2015. All functions had minor variances from the budget.

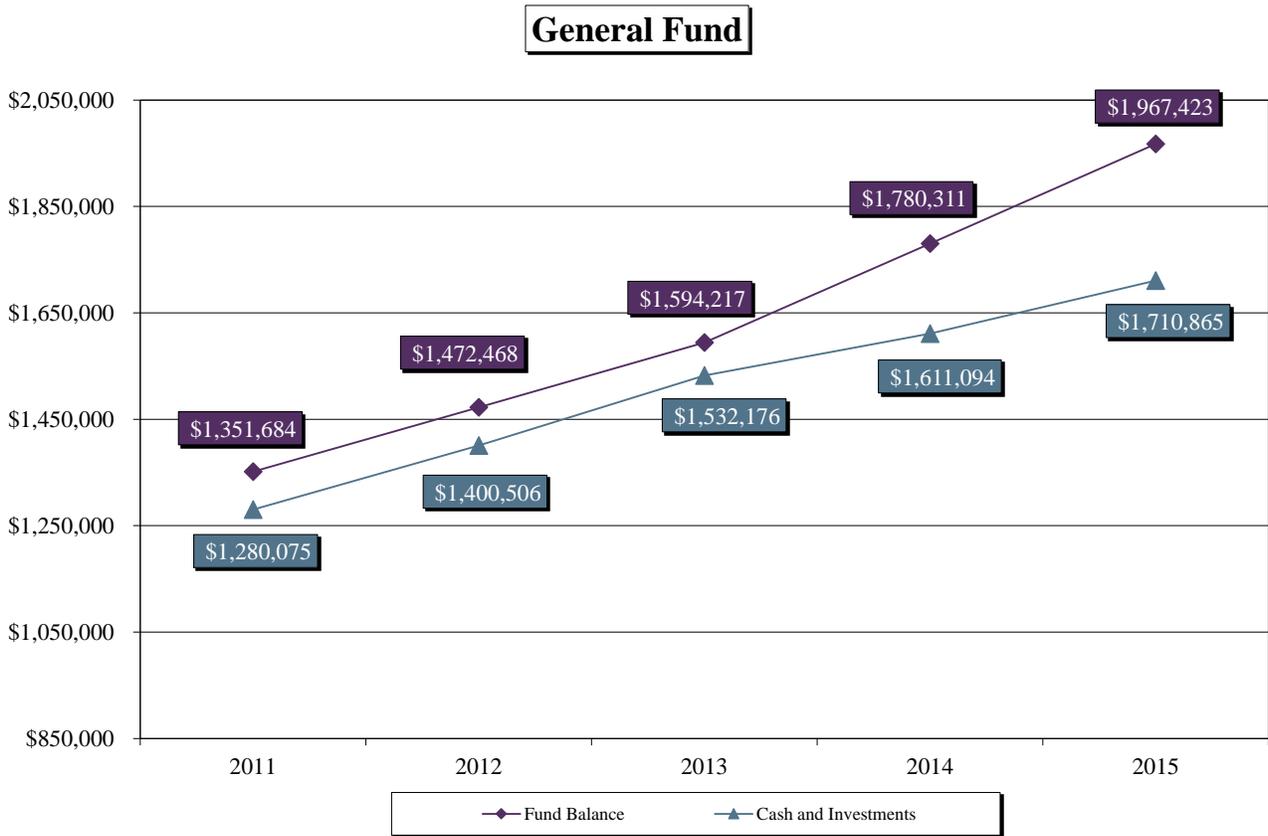
**2015 General Fund Expenditures  
Budget and Actual**



# City of Silver Bay Financial Analysis

## GENERAL FUND

As illustrated below, the fund balance and cash balance in the General Fund increased in 2015. Cash increased during 2015 by approximately 6.2%, while fund balance increased 10.5%. We commend the City and its administration for its focus and dedication in maintaining its General Fund balance at levels that can adequately fund operations and provide sufficient reserves to fund small projects without incurring bond issuance costs.

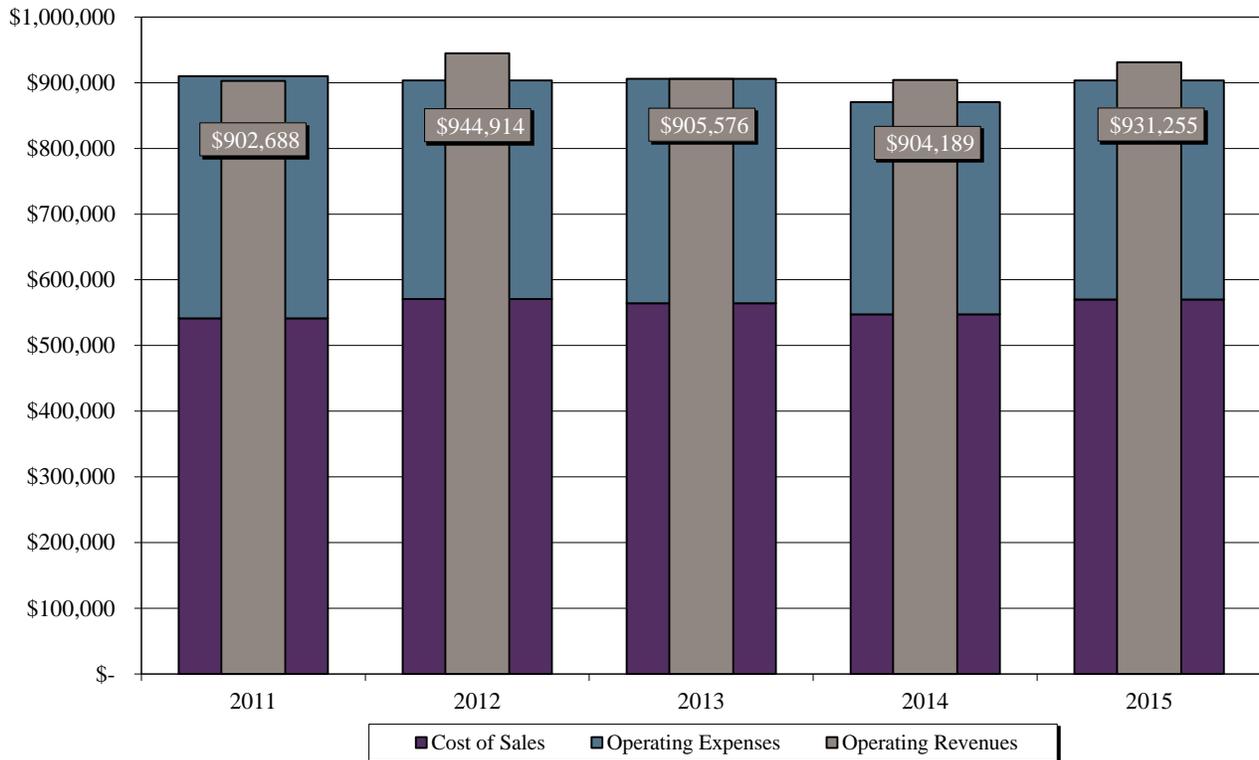


## City of Silver Bay Financial Analysis

### LIQUOR FUND

Liquor Fund operating trends are illustrated on the graphs below and on the following page. Sales increased by 3.2%, from \$889,061 in 2014 to \$917,159 in 2015. Sales increased due to larger functions in town, increased off-sales due to better economics and price adjustments during the year.

**Liquor Fund**



## City of Silver Bay Financial Analysis

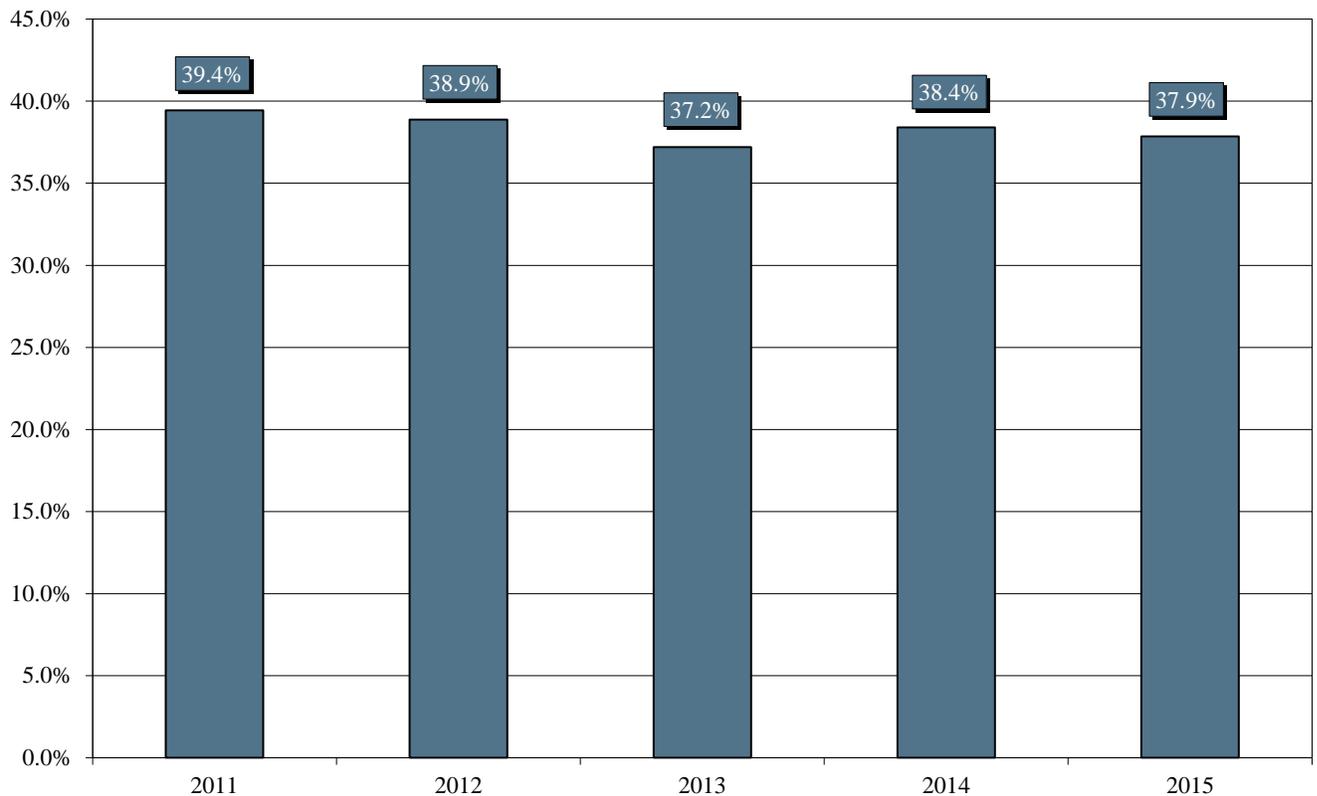
### LIQUOR FUND

Gross profit percentage decreased from 38.4% in 2014 to 37.9% in 2015. The Liquor Fund had operating income of \$27,663 in 2015, a decrease from the operating income in 2014 of \$33,686. This was primarily due to the cost of sales increasing at a faster rate than sale prices.

The City Council has chosen to suspend transfers from the Liquor Fund to other City operations until the Municipal Liquor Store Revenue Bonds have been paid in full.

We recommend the City continue to review markups on all products to maintain a gross profit percentage at approximately 40% to 42%. The liquor operations should consider increased strategic marketing through new products and promotion and display of higher margin products in order to increase sales and improve operating results. With this policy, the City should return to having the necessary funds to provide for park and recreation and public works reserve projects as they have in the past.

**Liquor Fund Gross Profit Percentage**



## City of Silver Bay Financial Analysis

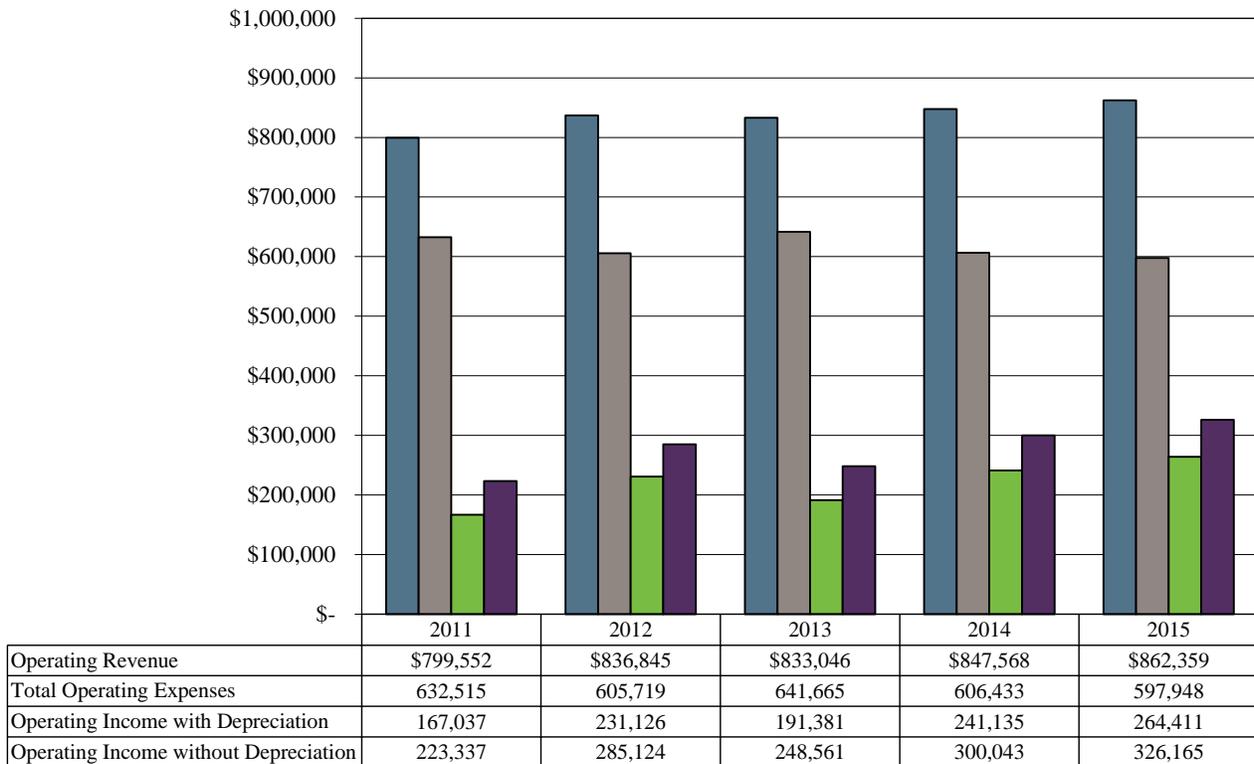
### WATER AND SEWER FUNDS

Water and sewer rates increased in late 1995, 1999, 2005, and annually from 2007 to 2015, to fund the repayment of the water and wastewater treatment facilities and water system improvements financed through the PFA loan program. For all five years presented, sufficient revenues were generated in the Water Fund to cover the costs associated with the facilities. For all years presented, the Sewer Fund also had an operating profit, generating \$198,530 in 2015.

The operating trends of the Water and Sewer Funds are illustrated below and on the following page. Operating expenses of the Water Fund decreased 1.4% in 2015, while operating revenues increased slightly from 2014 revenues, increasing \$14,791 or 1.7% as a result of an increase of 2% in the water rate.

We recommend the City continue to monitor operating costs and user fees in this Fund to ensure rates are sufficient to provide revenues to cover operating costs and fund future capital improvements of the water system. The City has been able to realize an operating gain with the inclusion of depreciation expense charged to the Fund in all 5 years presented. The City should look to continue this trend in future years.

**Water Fund**



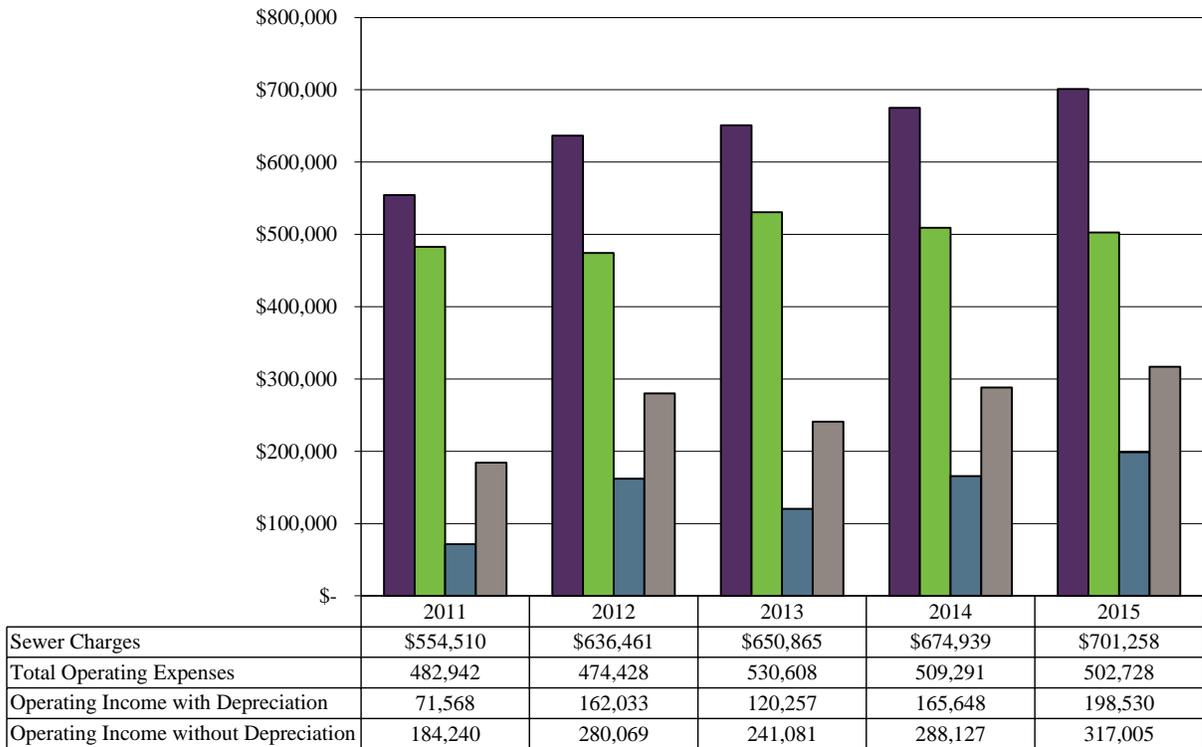
## City of Silver Bay Financial Analysis

### WATER AND SEWER FUNDS

As a result of an increase in the rates in 2015, Sewer Fund operating revenues increased 3.9% in 2015. Operating expenses remained consistent, decreasing \$6,563, or 1.3%.

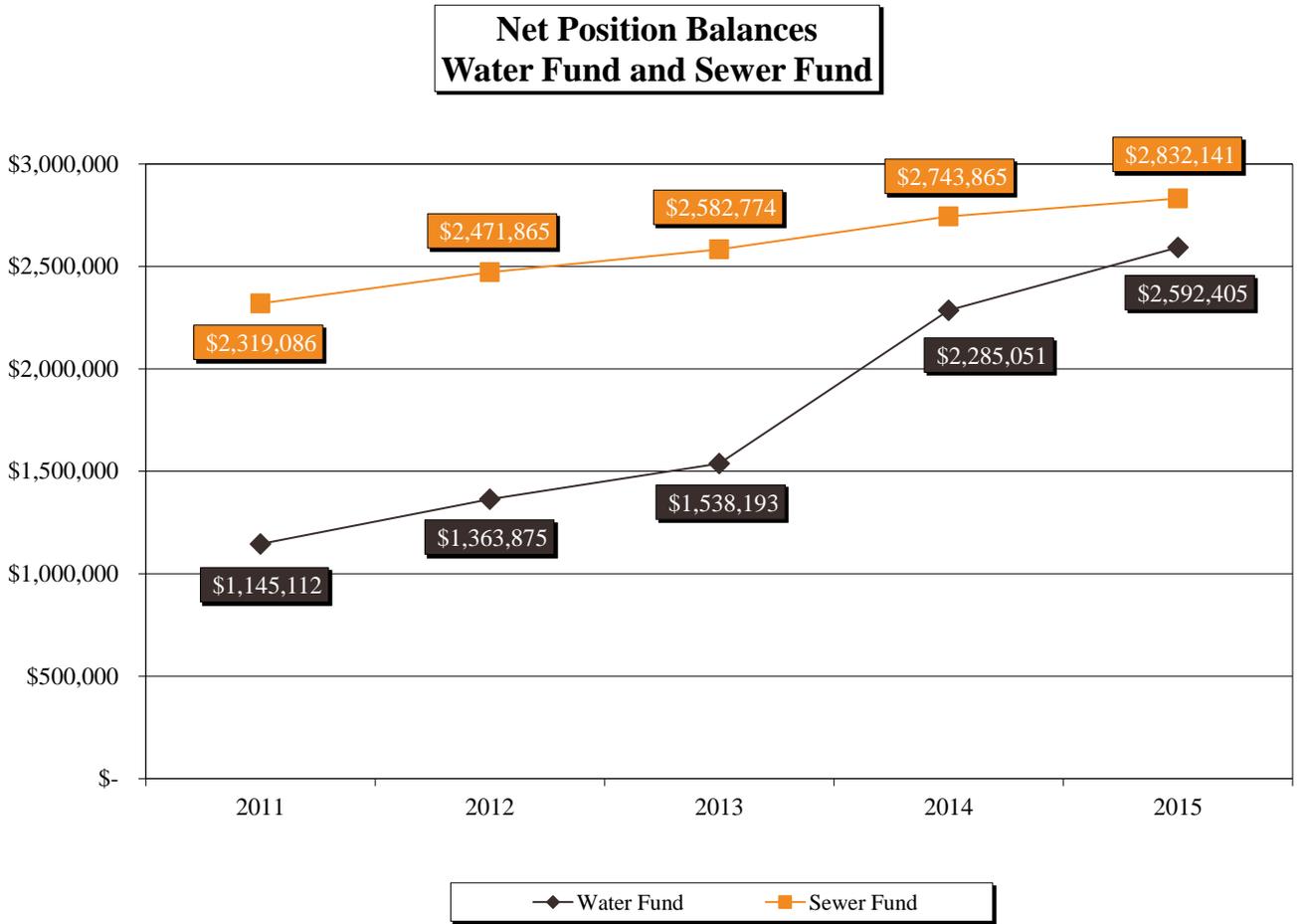
We recommend the City continue to monitor operating costs and user fees in this Fund to ensure rates are sufficient to provide revenues to cover operating costs including depreciation and fund future improvements.

**Sewer Fund**



**City of Silver Bay  
Financial Analysis**

**WATER AND SEWER FUNDS**



## City of Silver Bay Emerging Issue

### 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 – Accounting and Financial Reporting for Postemployment Benefits Other Than Pensions** – Governmental Accounting Standards Board (GASB) has issued GASB statement No. 75 relating to accounting and financial reporting for postemployment benefits other than pensions. The new statement requires governments in all types of OPEB plans to present more extensive note disclosures and required supplementary information (RSI) about their OPEB liabilities.

The following are extensive summaries of each 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. 75 – ACCOUNTING AND FINANCIAL REPORTING FOR POSTEMPLOYMENT BENEFITS OTHER THAN PENSIONS**

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.

GASB Statement No. 75 requires governments to report a liability on the face of the financial statements for the OPEB that they provide:

- Governments that are responsible only for OPEB liabilities related to their own employees and that provide OPEB through a defined benefit OPEB plan administered through a trust that meets specified criteria will report a *net OPEB liability*—the difference between the total OPEB liability and assets accumulated in the trust and restricted to making benefit payments.

**City of Silver Bay  
Emerging Issue**

**ACCOUNTING STANDARD UPDATE – GASB STATEMENT NO. 75 – ACCOUNTING AND FINANCIAL REPORTING FOR POSTEMPLOYMENT BENEFITS OTHER THAN PENSIONS (CONTINUED)**

- Governments that participate in a cost-sharing OPEB plan that is administered through a trust that meets the specified criteria will report a liability equal to their *proportionate share of the collective OPEB liability* for all entities participating in the cost-sharing plan.
- Governments that do not provide OPEB through a trust that meets specified criteria will report the *total OPEB liability* related to their employees.

GASB Statement No. 75 carries forward from Statement No. 45 the option to use a specified alternative measurement method in place of an actuarial valuation for purposes of determining the total OPEB liability for benefits provided through OPEB plans in which there are fewer than 100 plan members (active and inactive). This option was retained in order to reduce costs for smaller governments.

GASB Statement No. 75 requires governments in all types of OPEB plans to present more extensive note disclosures and required supplementary information (RSI) about their OPEB liabilities. Among the new note disclosures is a description of the effect on the reported OPEB liability of using a discount rate and a healthcare cost trend rate that are one percentage point higher and one percentage point lower than assumed by the government. The new RSI includes a schedule showing the causes of increases and decreases in the OPEB liability and a schedule comparing a government's actual OPEB contributions to its contribution requirements.

Information provided above was obtained from [www.gasb.org](http://www.gasb.org).