

**City of Rockville
Stearns County, Minnesota**

Communications Letter

December 31, 2015



**City of Rockville
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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 Rockville
Rockville, Minnesota

In planning and performing our audit of the financial statements of the City of Rockville, 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. The material weaknesses identified are stated within this letter.

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

The accompanying memorandum also includes financial analysis provided as a basis for discussion. The matters discussed herein were considered by us during our audit and they do not modify the opinion expressed in our Independent Auditor's Report dated May 9, 2016, on such statements.

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

BergankDV, Ltd.

St. Cloud, Minnesota
May 9, 2016

City of Rockville Material Weaknesses

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. 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.

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.

MATERIAL AUDIT ADJUSTMENTS

During the course of our engagement, we proposed a material audit adjustment that would not have been identified as a result of the City's existing internal controls and, therefore, could have resulted in a material misstatement of the City's financial statements.

In order to ensure financial statements were free from material misstatement, an audit adjustment was required in the following area:

- Special Assessments

City of Rockville
Significant Deficiency

LACK OF SEGREGATION OF ACCOUNTING DUTIES

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

Although employees may at times have overlapping duties, the City works to segregate duties and has review processes in place for work performed. 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. This lack of segregation of accounting duties may, at times, be demonstrated in the following areas, which is not intended to be an all-inclusive list:

- The Finance/Utility Billing/Administrative Assistant collects receipts, brings deposits to the bank, and makes the entries into the system.
- The Finance/Utility Billing/Administrative Assistant prepares the utility bills, records utility payments, and can record adjustments into the utility billing system.
- The Finance/Utility Billing/Administrative Assistant records deposits into the accounting system, can make adjustments in the system, and completes the monthly bank reconciliation.
- Journal entries can be completed and entered into the general ledger without approval or proper documentation by all employees.
- The City Administrator/Clerk has full access to all areas of the finance system.

We recommend management, along with the City Council, evaluate the risks related to significant deficiencies noted above, and respond with improvements to processes to mitigate these risks. In doing this, management and the City Council must weigh the costs associated with adding more staff or procedures to its operations.

City of Rockville
Required Communication

We have audited the financial statements of the City for the year ended December 31, 2015, and have issued our report thereon dated May 9, 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 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 Rockville
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 one 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. The City implemented GASB 68 and 71 relating to pension accounting 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

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. We identified the following uncorrected misstatement of the financial statements. Management has determined its effect is immaterial, both individually and in the aggregate, to the financial statements taken as a whole.

- Fire Contract Revenue
- Prepaid Expenses

The following material misstatement detected as a result of audit procedures were corrected by management.

- Special Assessments

**City of Rockville
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 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 Rockville 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.

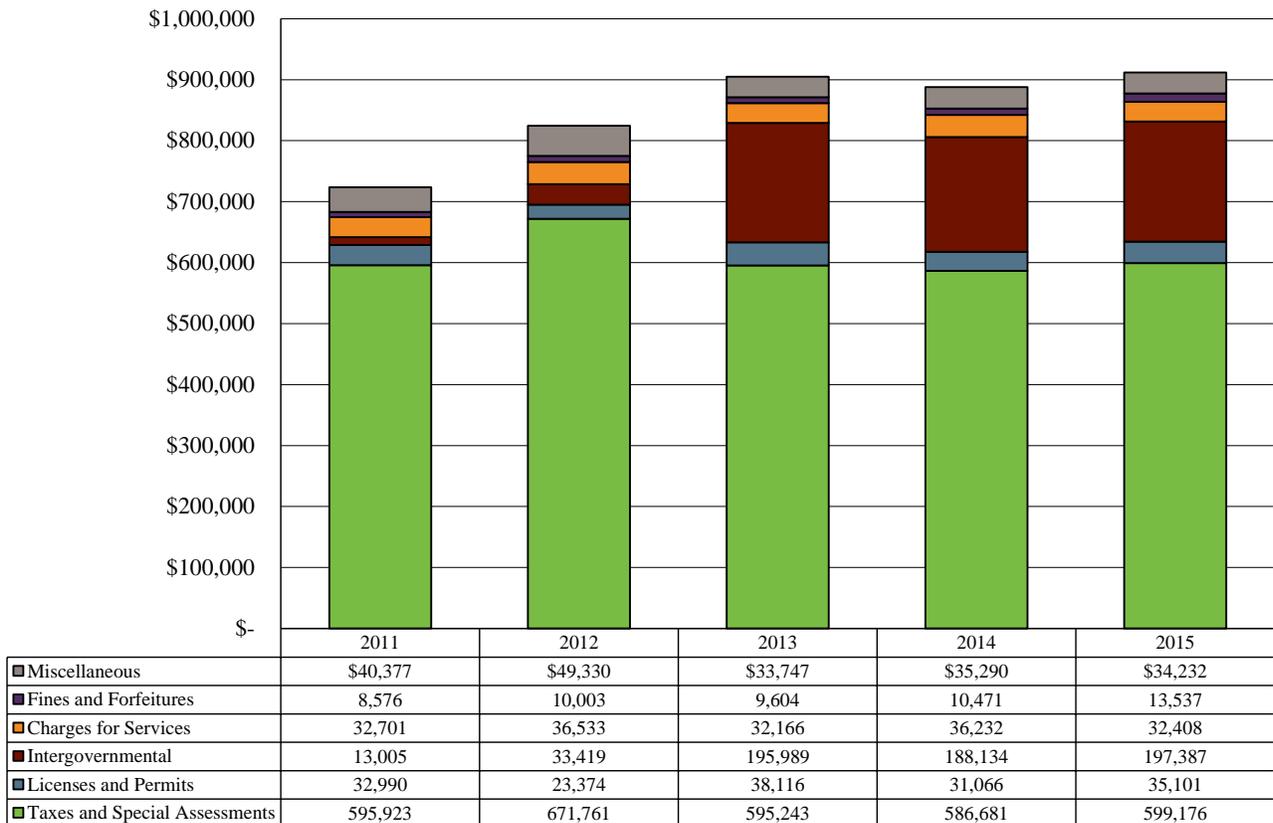
GENERAL FUND

During the year ended December 31, 2015, the City experienced a 2.7% increase in General Fund revenues from \$887,874 in 2014 to \$911,841 in 2015.

The change from 2014 to 2015 was spread evenly across all sources of revenue.

Overall, in the five years presented below, the General Fund revenues have changed from \$723,572 in 2011 to \$911,841 in 2015, an increase of 26.0%. A significant variance was due to the City receiving little to no LGA in 2011.

General Fund Revenue

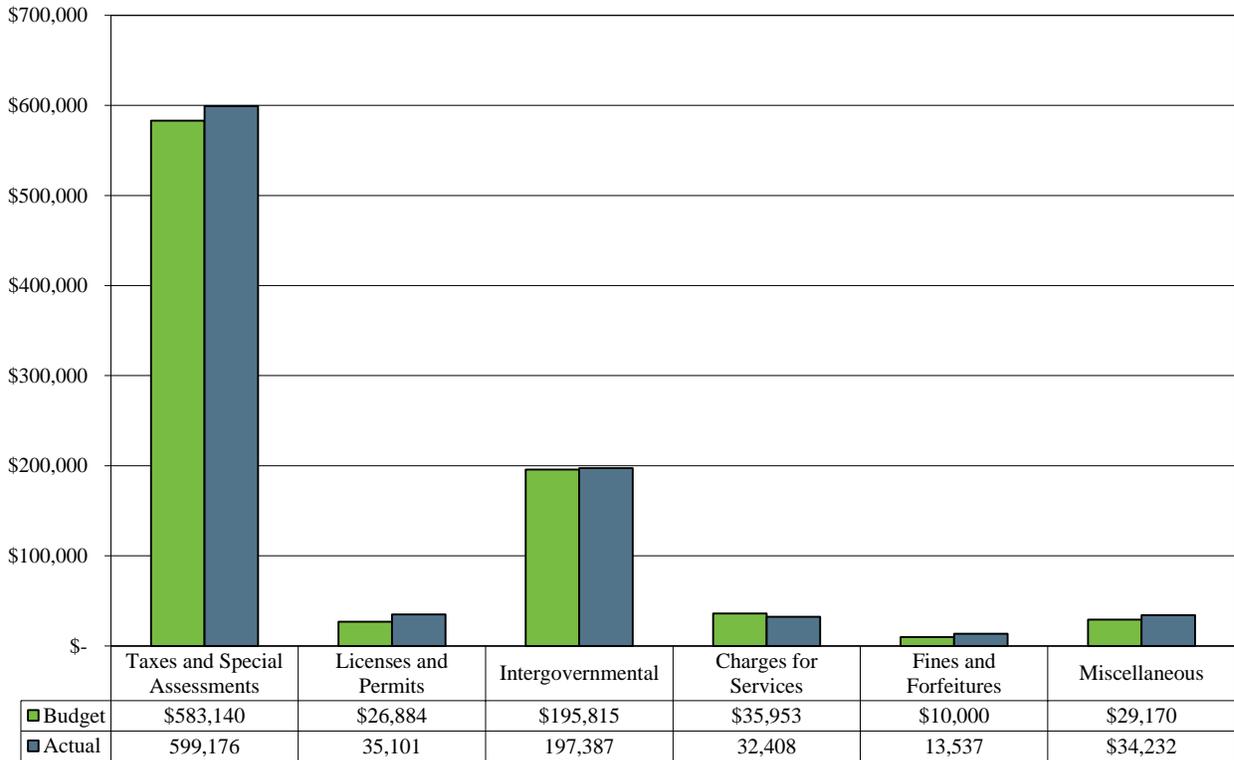


**City of Rockville
Financial Analysis**

GENERAL FUND (CONTINUED)

The graph below represents the budgeted and actual revenues of the General Fund for 2015.

**General Fund Revenue
Budget to Actual**



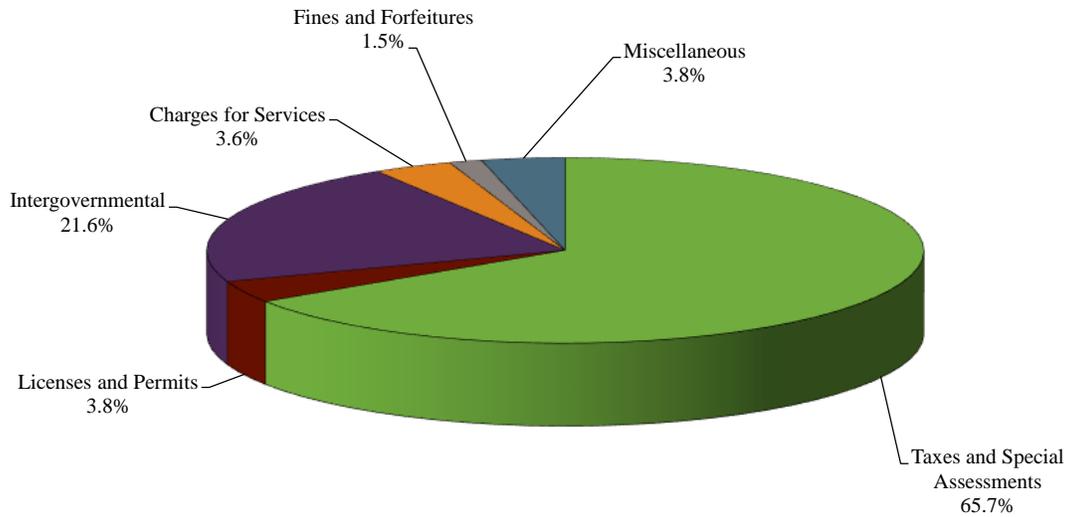
Total revenues in the General Fund were \$911,841, which is \$30,879, or 3.5%, higher than the budgeted amount. Taxes and special assessments were over budget \$16,036 due to budgeting conservatively for delinquencies. All other sources of revenue were consistent with budgeted amounts.

The graph on the following page shows General Fund revenues by source as a percentage of total revenues. General Fund revenues by source for 2015 were very consistent with 2014. Overall, taxes and assessments and intergovernmental revenues account for 87.3% of General Fund revenue, in 2015 and 2014.

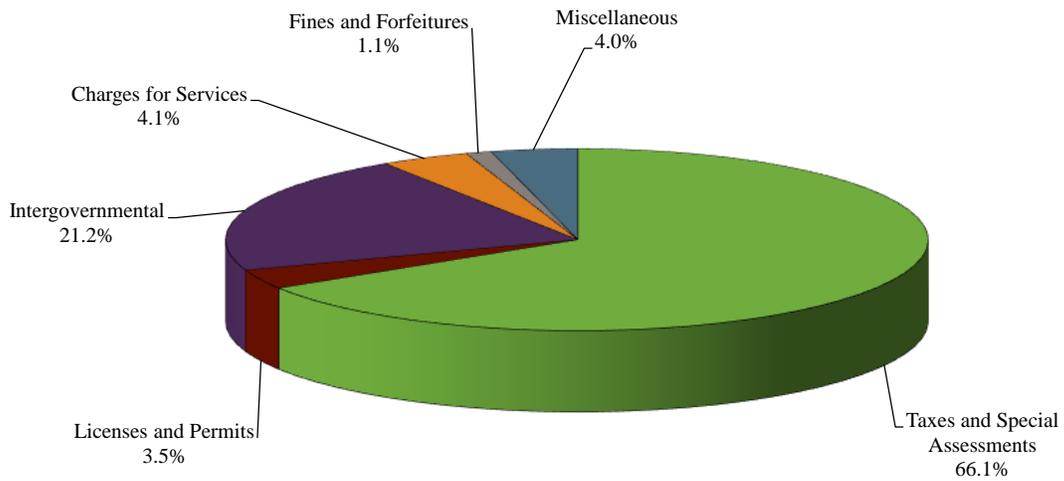
City of Rockville Financial Analysis

GENERAL FUND (CONTINUED)

General Fund 2015 Revenues



General Fund 2014 Revenues

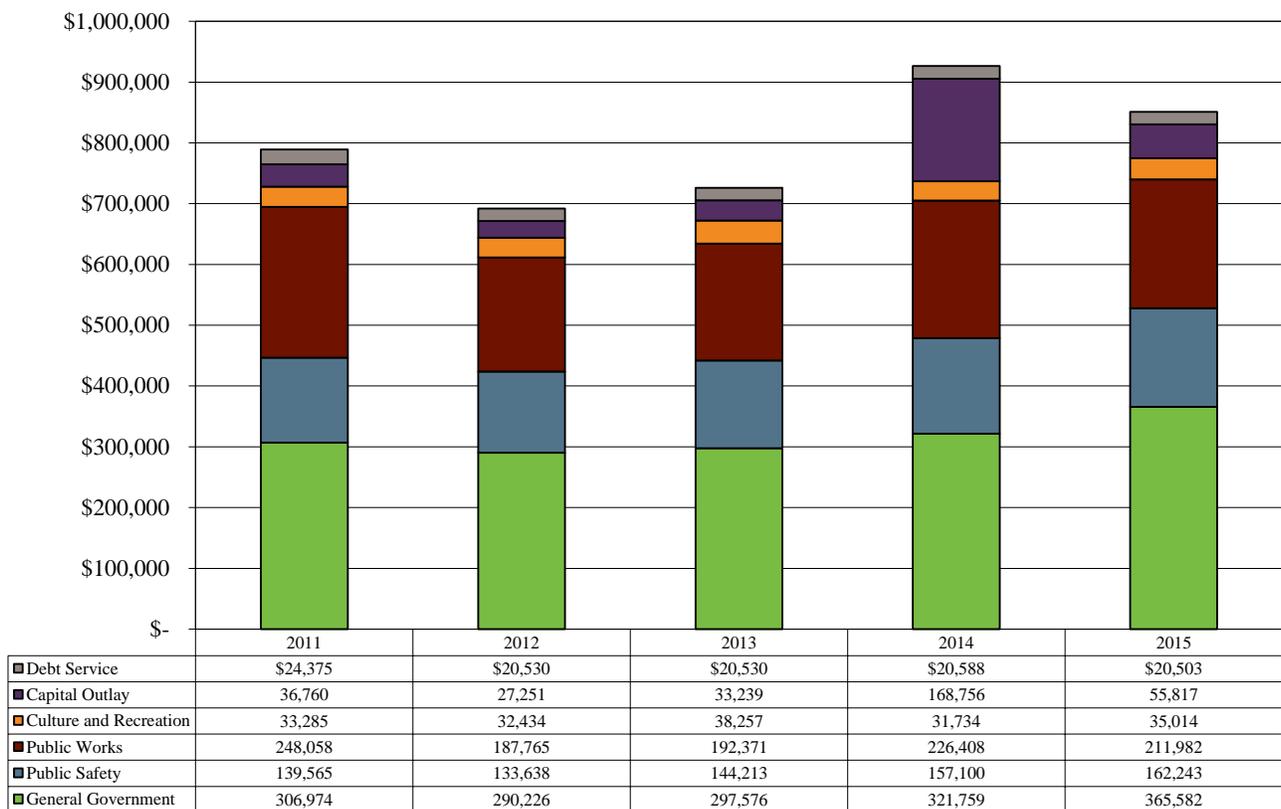


City of Rockville Financial Analysis

GENERAL FUND (CONTINUED)

Total General Fund expenditures have fluctuated over the five years presented. From 2014 to 2015, expenditures decreased by \$75,204 to \$851,141. General government increased \$43,823 as a result of pay increases and the related benefit increase, increased legal costs and severance payments. Capital outlay decreased \$112,939 with the purchase of a snowplow, bobcat, and truck in 2014, and SCBA units and other minimal purchases in 2015. All other functions were consistent from the prior year. From 2011 to 2015, expenditures have increased \$62,124.

General Fund Expenditures

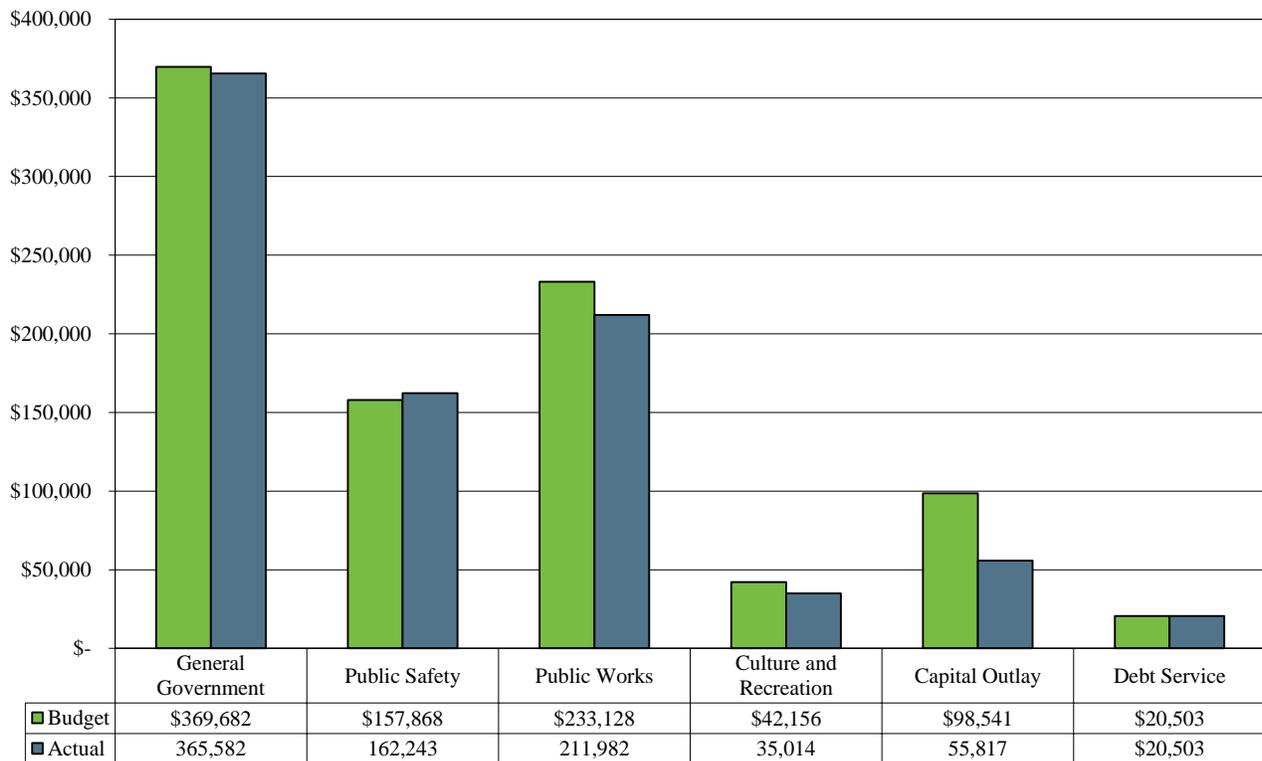


**City of Rockville
Financial Analysis**

GENERAL FUND

The graph below represents the budgeted and actual expenditures of the General Fund for 2015.

**General Fund Expenditures
Budget to Actual**



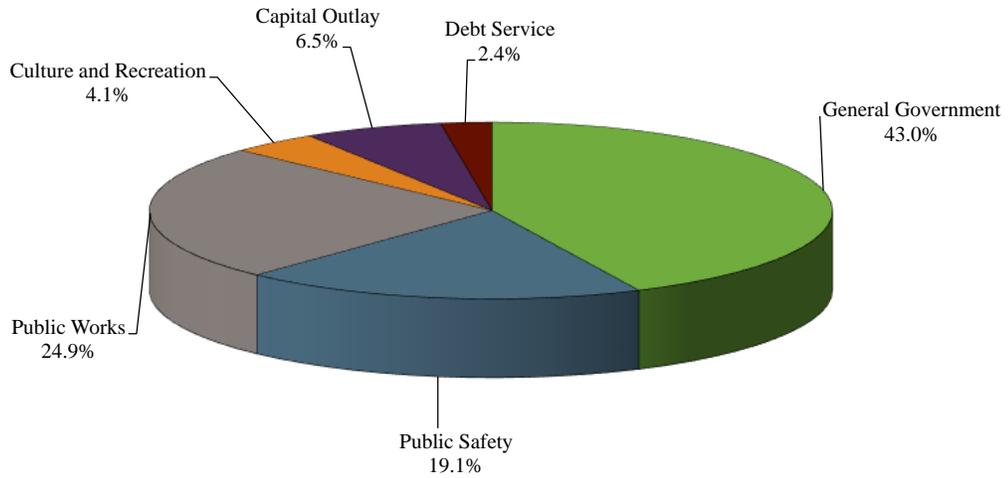
Total General Fund expenditures were under budget by \$70,737 in 2015 or 7.7%. Public works was under budget \$21,146 with fuel prices being lower than budgeted and fewer snow falls resulting in less sand and salt being used than budgeted for. Capital outlay was under budget \$42,724 due to setting aside funds for the future purchase of a fire truck. Other functions were close to their budgeted amounts.

Expenditures by function, as a percentage of total expenditures, are depicted on the graphs on the following page. General government expenditures are the largest component within the General Fund, accounting for 43.0% of the total, followed by public works with 24.9% and public safety with 19.1%. Capital outlay had a significant decrease from 2014 to 2015, due to the purchase of the snowplow, bobcat, and truck in the prior year.

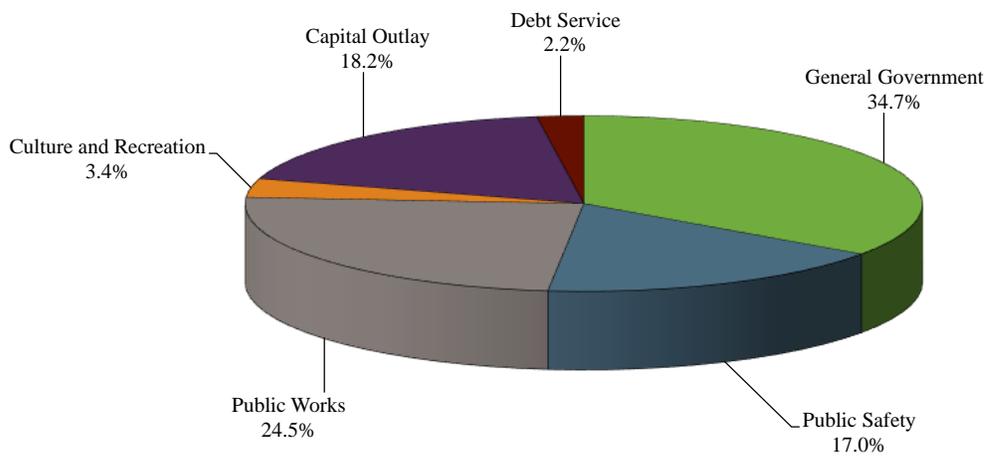
City of Rockville Financial Analysis

GENERAL FUND (CONTINUED)

**General Fund
2015 Expenditures**



**General Fund
2014 Expenditures**

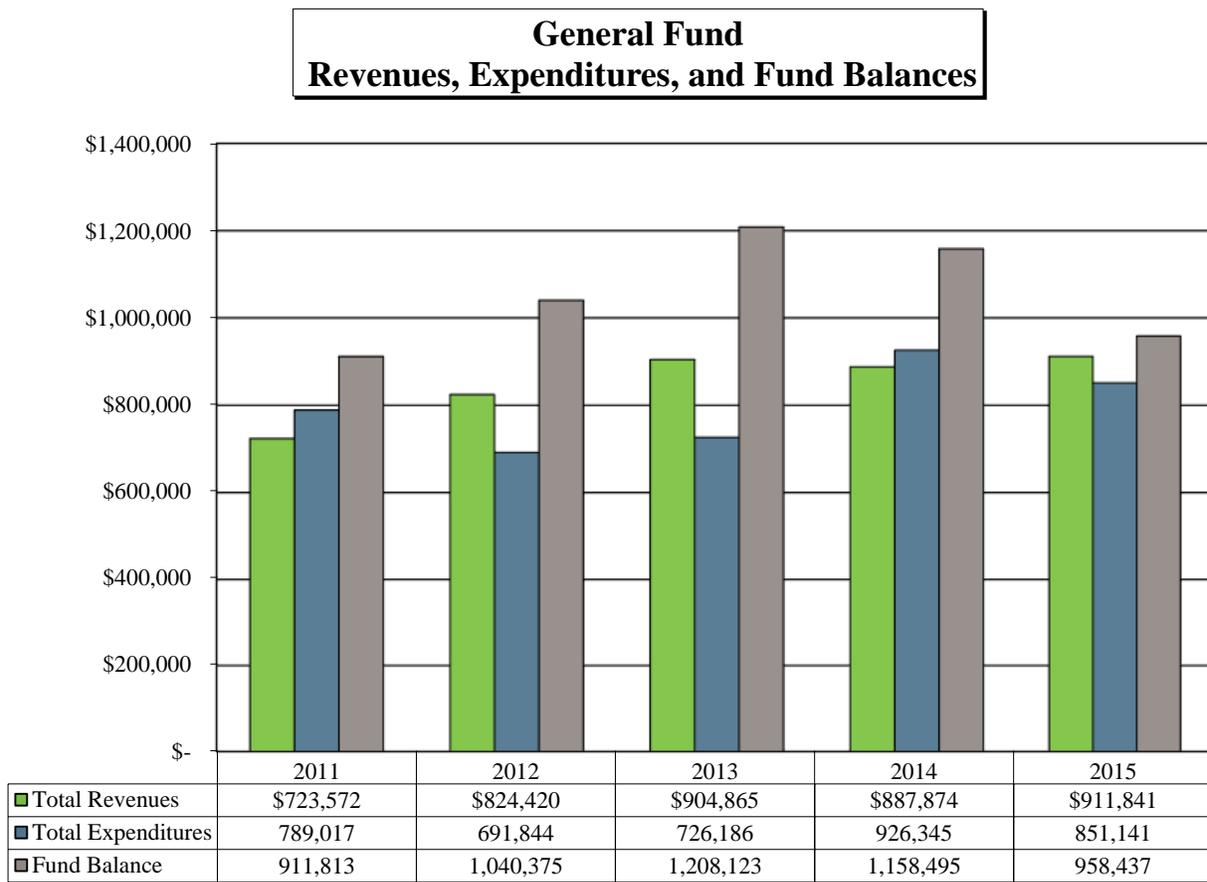


City of Rockville Financial Analysis

GENERAL FUND (CONTINUED)

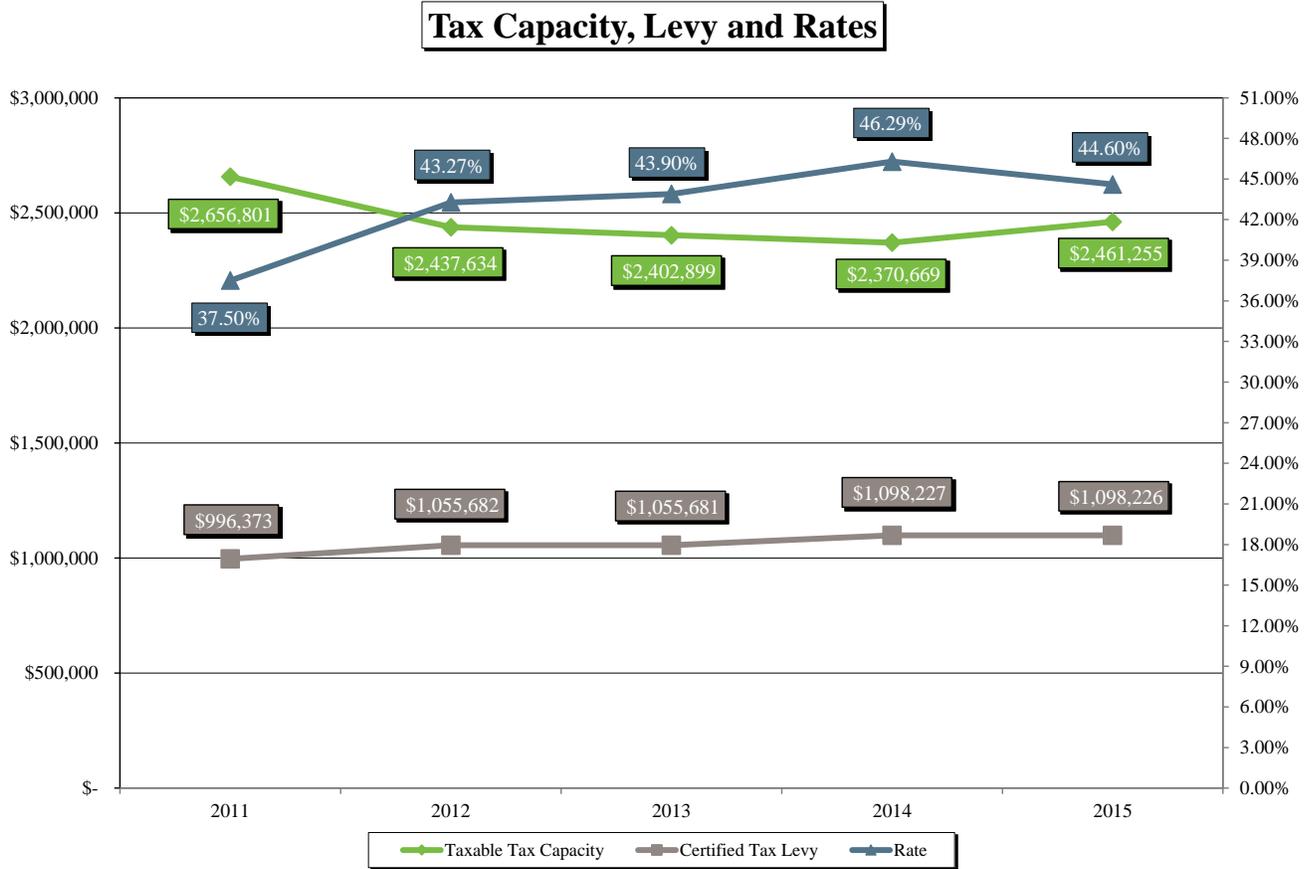
As illustrated in the following graph, revenues have exceeded expenditures for three of the five years shown. After taking into consideration transfers out, fund balance decreased \$200,058 during 2015. This is a result of covering the deficit in Fund 305 when the fund closed due to the debt being paid off. With the reinstatement of the LGA, the City's reliance on property tax revenue has decreased. In 2011, property taxes accounted for 82.4% of total revenues, while in 2015, this revenue accounted for 65.7% of all General Fund revenues.

The unassigned fund balance of \$488,245 as of December 31, 2015, represents approximately seven months of expenditures at the 2015 level. The total fund balance of \$958,437 as of December 31, 2015, represents approximately 13 months of expenditures at the 2015 level. The State Auditor has issued a Statement of Position recommending cities maintain an unreserved fund balance of approximately 35% to 50% of fund operating revenues, or no less than five months of operating expenditures. The City's Fund Balance Policy states that they will strive to maintain 50% of the budgeted expenditures in their unassigned fund balance. At December 31, 2015, the City was slightly under their minimum fund balance by \$824.



City of Rockville Financial Analysis

GENERAL FUND (CONTINUED)



The chart above graphs the tax capacity, certified tax levy, and City tax rate for 2011 through 2015. The tax capacity is based on total tax capacity, prior to adjustments for captured Tax Increment Financing (TIF) and fiscal disparities. The certified tax levy amount is also prior to fiscal disparity adjustments.

Comparing 2011 through 2015, the City's tax capacity has decreased from \$2,656,801 to \$2,461,255, or 7.4%, in five years, after three years of decreases, tax capacity did increase in 2015. The City's certified levy over this same five year time frame has increased from \$996,373 to \$1,098,226, or 10.2%. As a result, the City's tax capacity rate has increased from 37.50% in 2011 to 44.60% in 2015. The state average tax rate in 2014 was 46.90%.

City of Rockville Financial Analysis

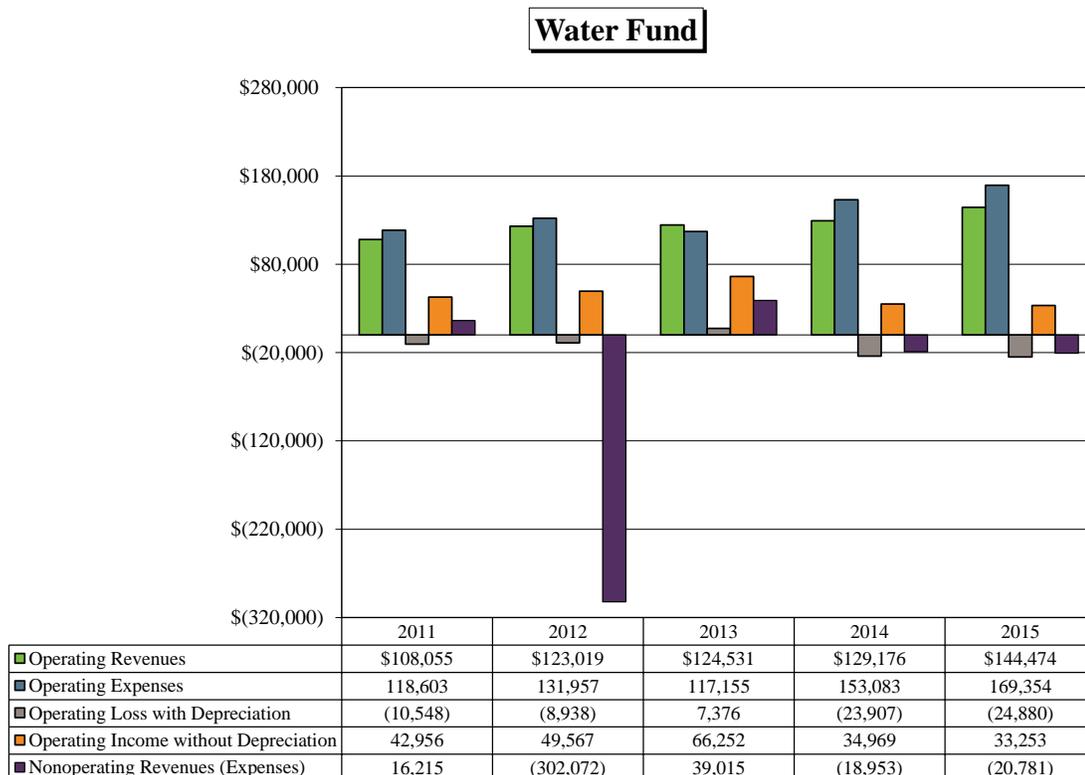
WATER FUND

The following graph illustrates the operations of the Water Fund from 2011 to 2015. In four of the five years shown, the Water Fund has shown an operating loss. In 2015, the Water Fund showed an operating loss of \$24,880, which includes depreciation expense of \$58,133. Operating revenues increased \$15,298, while operating expenses increased \$16,271.

Nonoperating revenues and expenses consist of special assessments, special assessment forfeitures, investment earnings, interest expense, and other miscellaneous revenues and expenses. In 2013, there was a significant amount of special assessments levied, causing the spike in nonoperating revenues. In 2012, there was a significant amount of special assessment forfeitures therefore resulting in a large increase in non-operating expenses. The City also needs to be aware of the debt principal payments which are not included in current or nonoperating expenses, which amounted to \$105,000 for 2015.

Enterprise funds may be used to account for any activity in which a fee is charged. It is not required to have the fee support the entire activity; however, the basic premise in establishing an enterprise fund is that the activity will be operated similar to a business. Therefore, it is expected the Enterprise Fund would at least be able to meet its obligations currently and in the future.

During 2015, operations were able to cover 57.2% of depreciation expense. We recommend the City continue to monitor operating costs in the Water Fund to ensure rates are sufficient to provide revenues to cover operating costs and fund future capital improvements of the water system. The Cash and Investments balance of December 31, 2015, was \$103,439, a decrease of \$89,974 from 2014.



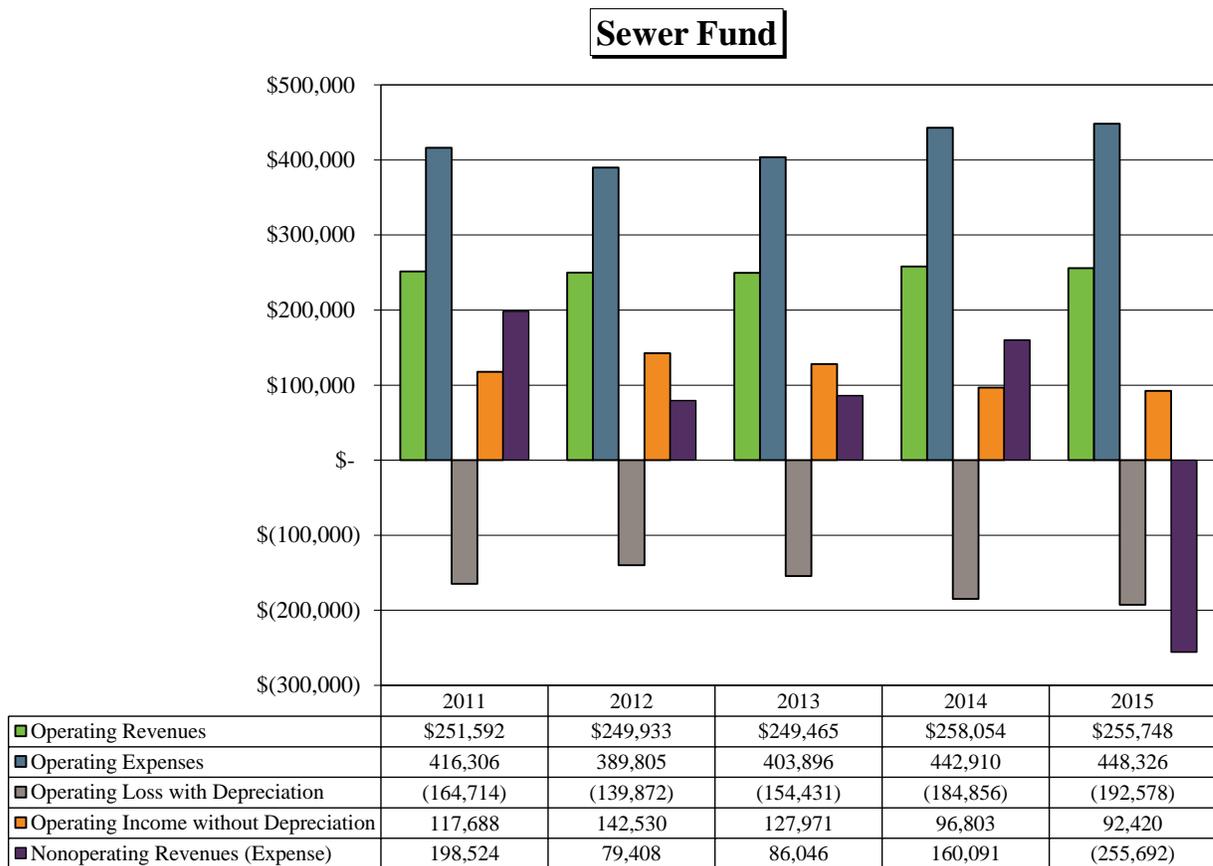
City of Rockville Financial Analysis

SEWER FUND

The Sewer Fund experienced an operating loss for the fifth consecutive year due to depreciation expense charged on capital assets. Operating revenues decreased \$2,306 while operating expenses increased \$5,416 from 2014.

Nonoperating revenues and expenses consist of special assessments, special assessment forfeitures, investment earnings, interest expense, and other miscellaneous revenues and expenses. During 2015, there was a write off of assessments due to a settlement on outstanding and delinquent assessments, therefore accounting for the large decrease in nonoperating expense. The City also needs to be aware of the debt principal payments which are not included in current or nonoperating expenses, which amounted to \$485,479 for 2015.

During 2015, Sewer Fund operations covered 32.4% of depreciation expense. We recommend the City Council and administration continue to monitor the Sewer Fund closely to determine if future sewer fees will be adequate to return the Fund to a positive operating position. The following chart illustrates the sewer operating revenues and expenses over the past five years. The Cash and Investment balance at December 31, 2015, was \$2,163,512, an increase of \$130,218 from 2014.



City of Rockville 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 – GASB Statement No. 75 - Accounting and Financial Reporting for Postemployment Benefits Other Than Pensions** – Governmental Accounting Standards Board (GASB) has issued GASB statement 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 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 Rockville
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 75 carries forward from Statement 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 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.