

**City of Osseo
Hennepin County, Minnesota**

Communications Letter

December 31, 2016



**City of Osseo
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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 Osseo
Osseo, Minnesota

In planning and performing our audit of the financial statements of the governmental activities, business-type activities, each major fund, and the aggregate remaining fund information of the City of Osseo, Minnesota as of and for the year ended December 31, 2016, in accordance with auditing standards generally accepted in the United States of America, we considered the City's internal control over financial reporting (internal control) as a basis for designing audit procedures that are appropriate in the circumstances for the purpose of expressing our opinion on the financial statements, but not for the purpose of expressing an opinion on the effectiveness of the City's internal control. Accordingly, we do not express an opinion on the effectiveness of the City's internal control.

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

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 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 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 April 27, 2017, on such statements.

This communication is intended solely for the information and use of management, 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.

BerganKDV Ltd.

Minneapolis, Minnesota
April 27, 2017

City of Osseo Material Weaknesses

IMPROVE SEGREGATION OF ACCOUNTING DUTIES

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.

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

- The Finance Officer enters utility billing receipts and makes adjustments to accounts. This individual also can receipt payments for utility bills and enter the receipts into the billing program, which upon exporting to the general ledger, is posted.
- The Finance Officer can receipt payments, reconcile the daily receipt batch, and post the batch to the general ledger.
- The City's contracted accountant reconciles cash and has full general ledger access, including the ability to initiate and record journal entries without review.
- Journal entries are not always formally approved.

Management and the City Council are aware of this condition and have taken certain steps to compensate for the lack of segregation but due to the number of staff needed to properly segregate all of the accounting duties, the costs of obtaining desirable segregation of accounting duties can often exceed benefits which could be derived. However, management and the City Council must remain aware of this situation and should continually monitor the accounting system, including changes that occur.

We recommend segregation or independent review be implemented whenever practical and cost effective.

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.

This condition increases the risk that errors could occur which would not be prevented, or detected and corrected, on a timely basis. 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 Osseo
Required Communication**

We have audited the financial statements of the governmental activities, business-type activities, each major fund, and the aggregate remaining fund information of the City as of and for the year ended December 31, 2016, and have issued our report dated April 27, 2017. 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

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

Generally accepted accounting principles provide for certain required supplementary information (RSI) to supplement the basic financial statements. Our responsibility with respect to the RSI, which supplement(s) the basic audit financial statements, is to apply certain limited procedures in accordance with generally accepted auditing standards. However, the RSI was not audited and, because the limited procedures do not provide us with sufficient evidence to express an opinion or provide any assurance, we do not express an opinion or provide any assurance on the RSI.

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.

QUALITATIVE ASPECTS OF ACCOUNTING PRACTICES

Management is responsible for the selection and use of appropriate accounting policies. The significant accounting policies used by the City are described in the notes to financial statements. No new accounting policies were adopted and the application of existing policies was not changed during the year ended December 31, 2016. 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.

**City of Osseo
Required Communication**

QUALITATIVE ASPECTS OF ACCOUNTING PRACTICES

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 Other Post Employment Benefit (OPEB) Obligation – This liability is based on an actuarial study using estimates of future obligations of the City for post-employment benefits.

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

Bad Debt Expense – Percentage of likelihood of collectability is based on management's best estimates.

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

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

DIFFICULTIES ENCOUNTERED IN PERFORMING THE AUDIT

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

CORRECTED AND UNCORRECTED MISSTATEMENTS

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

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.

**City of Osseo
Required Communication**

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 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 Osseo Financial Analysis

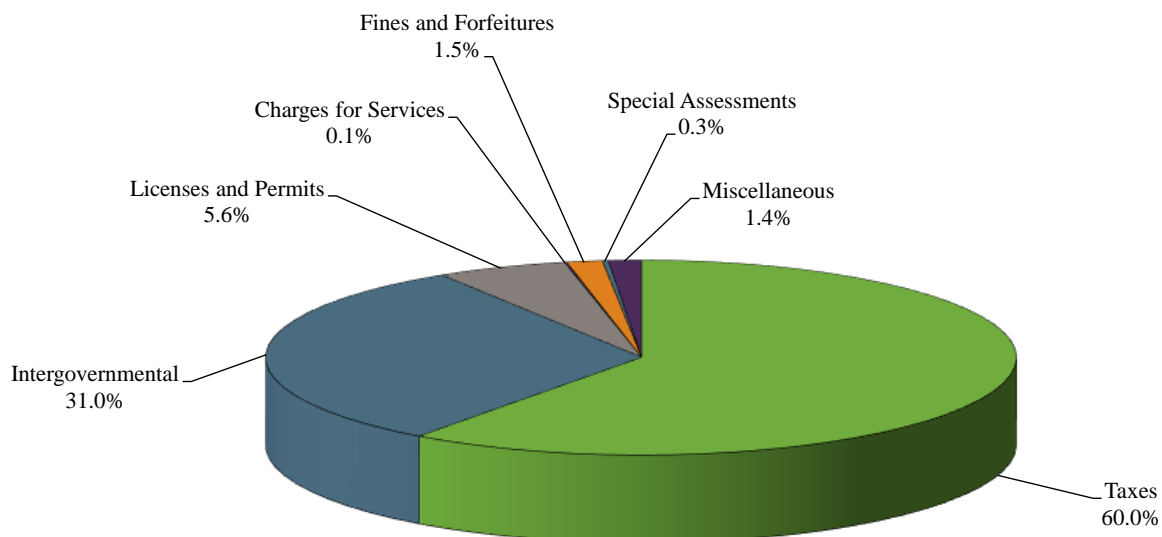
The following pages provide graphic representation of select data pertaining to the financial position and operations of the City for the past five years. Our analysis of each graph is presented to provide a basis for discussion of past performance and how implementing certain changes may enhance future 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

For the year ended December 31, 2016, revenues for the City's General Fund totaled \$2,295,594. This represents an increase of \$19,968, or 0.9%, compared to 2015. General Fund revenues allocated by source for 2016 are depicted in the following pie chart.

Tax revenues increased from 57.4% of total revenues in 2015 to 60.0% in 2016 due to an increase in the General Fund property tax levy. Licenses and permits decreased to 5.6% from 7.6% in the prior year. This decrease is due to the Right of Way project in 2015. The City's second largest source of revenue, intergovernmental revenues, remained fairly consistent with the prior year. The City's main revenue streams are taxes and intergovernmental revenues which is mostly Local Government Aid. Combined, these sources total 91.0% of total revenue in 2016, compared to 89.8% in 2015. The other revenue categories remained a consistent percentage of total revenues from the prior year.

2016 General Fund Revenues



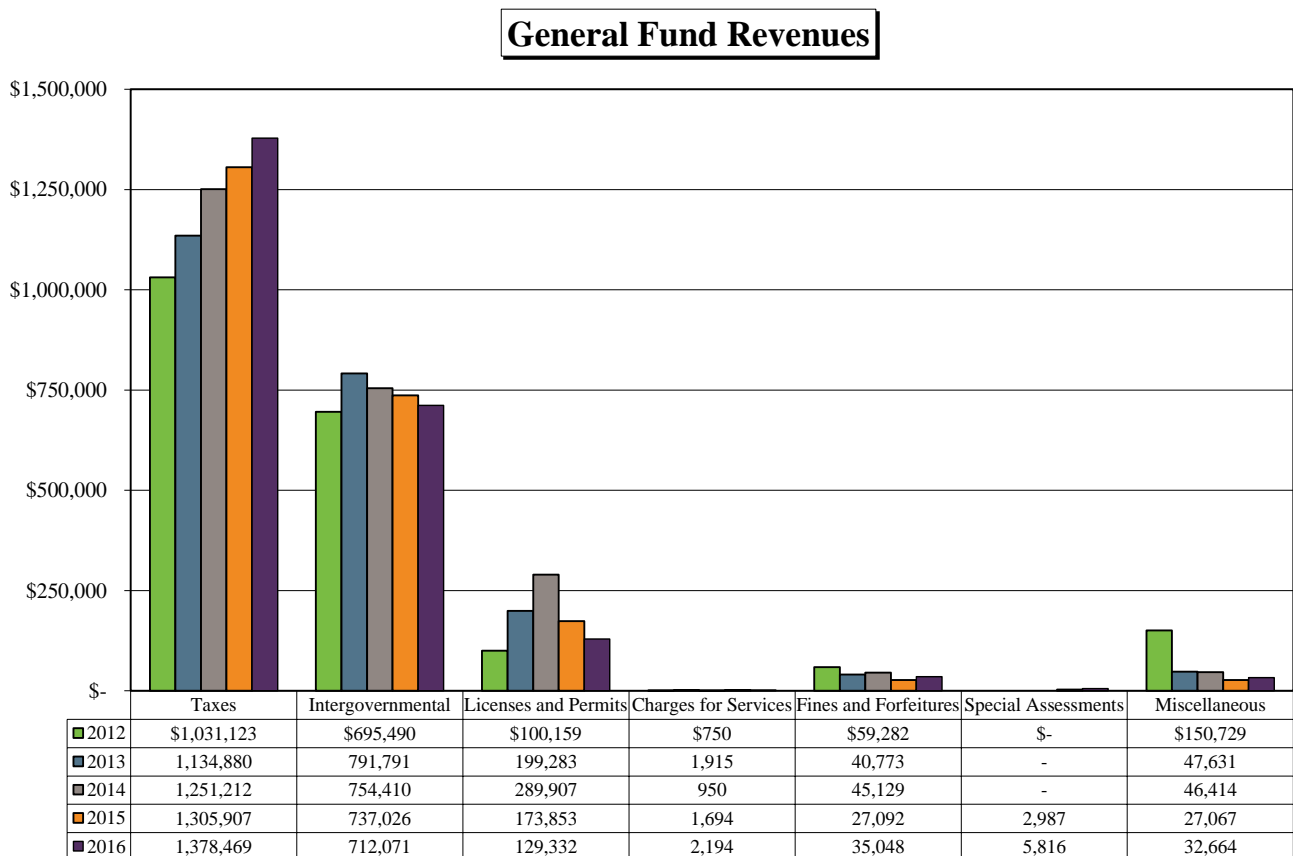
City of Osseo Financial Analysis

GENERAL FUND REVENUES (CONTINUED)

Trends for each of the City's major revenue classifications over the past five years are graphically portrayed in the bar chart below.

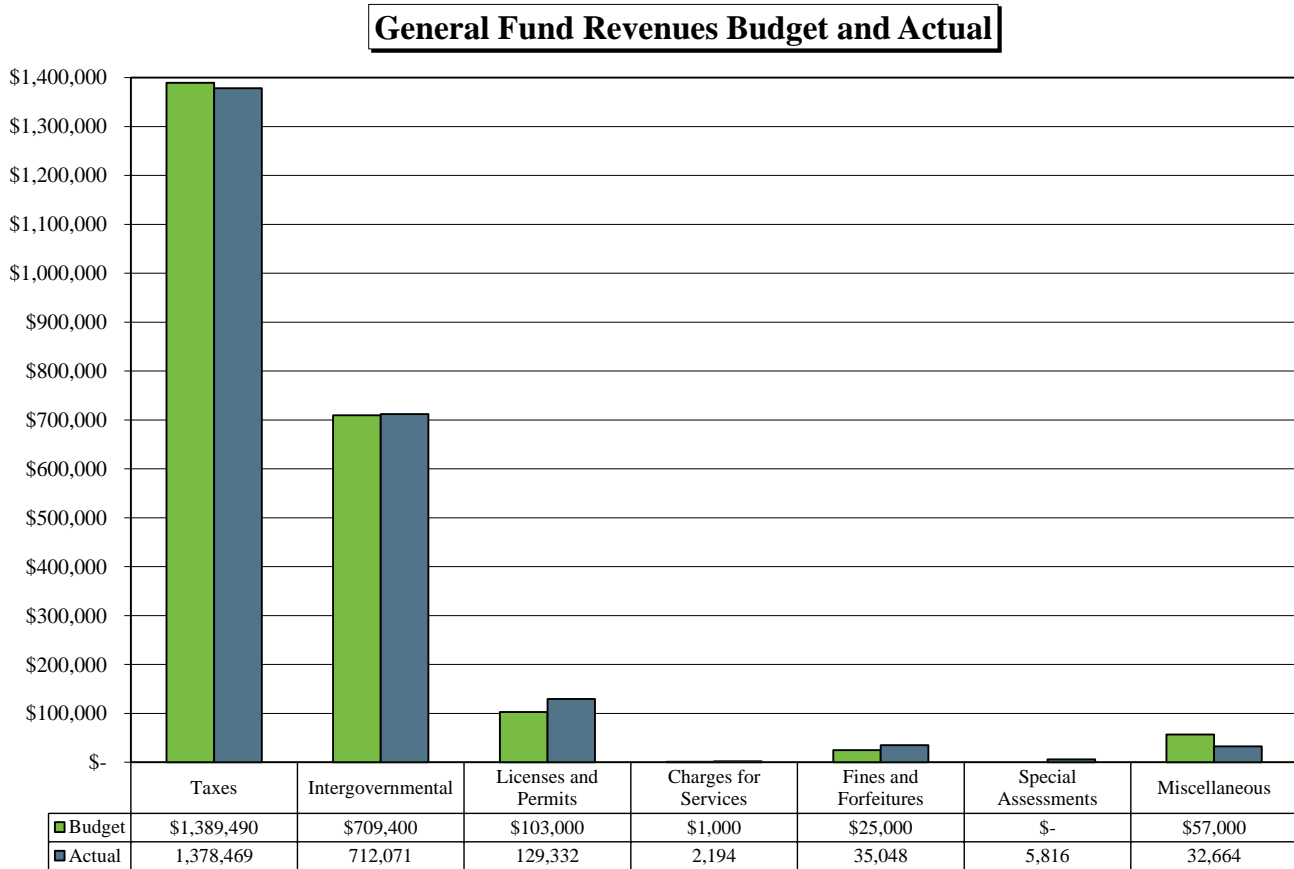
As stated earlier, total revenues increased \$19,968 from 2015 to 2016. This increase was due to an increase in property taxes, which was offset by a decrease in licenses and permits and intergovernmental revenue. Property taxes increased \$72,562 due to an increase in levy. Licenses and permits decreased due to a decrease in building permits during the year, which are down \$44,521 from the prior year. 2015 had large permits related to the Right of Way project. Intergovernmental revenue decreased \$24,955 due to a decrease in local government aid.

The other revenue categories remained fairly consistent with 2015 amounts as noted in the bar chart below.



City of Osseo Financial Analysis

GENERAL FUND REVENUES (CONTINUED)



In total, the City's revenues were \$10,704 over budget. The largest variance was in licenses and permits, which came in \$26,332 over budget. This was due to the City budgeting conservatively for these revenues as they can vary greatly from year to year.

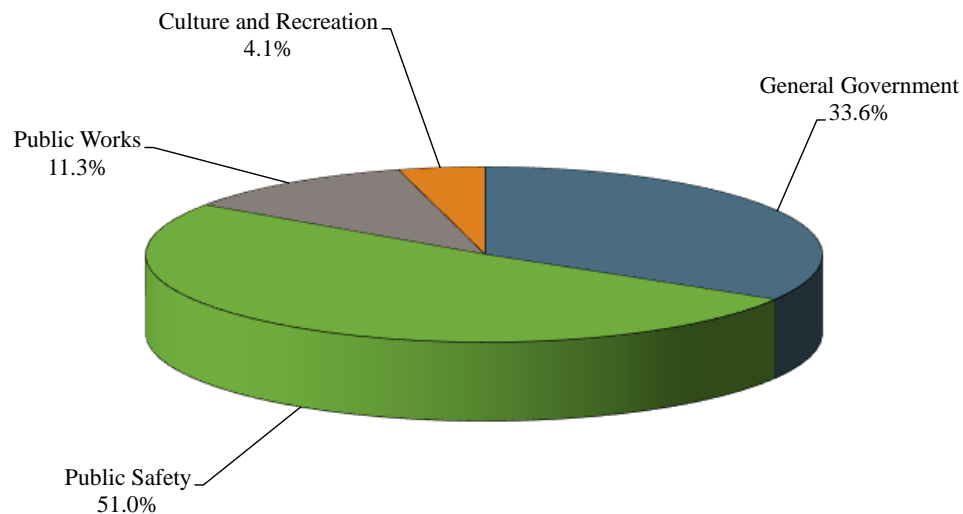
Miscellaneous revenues were \$24,336 under budget due to budgeting based on prior year revenues. Other revenues were consistent with the amounts that were budgeted for them.

City of Osseo Financial Analysis

GENERAL FUND EXPENDITURES

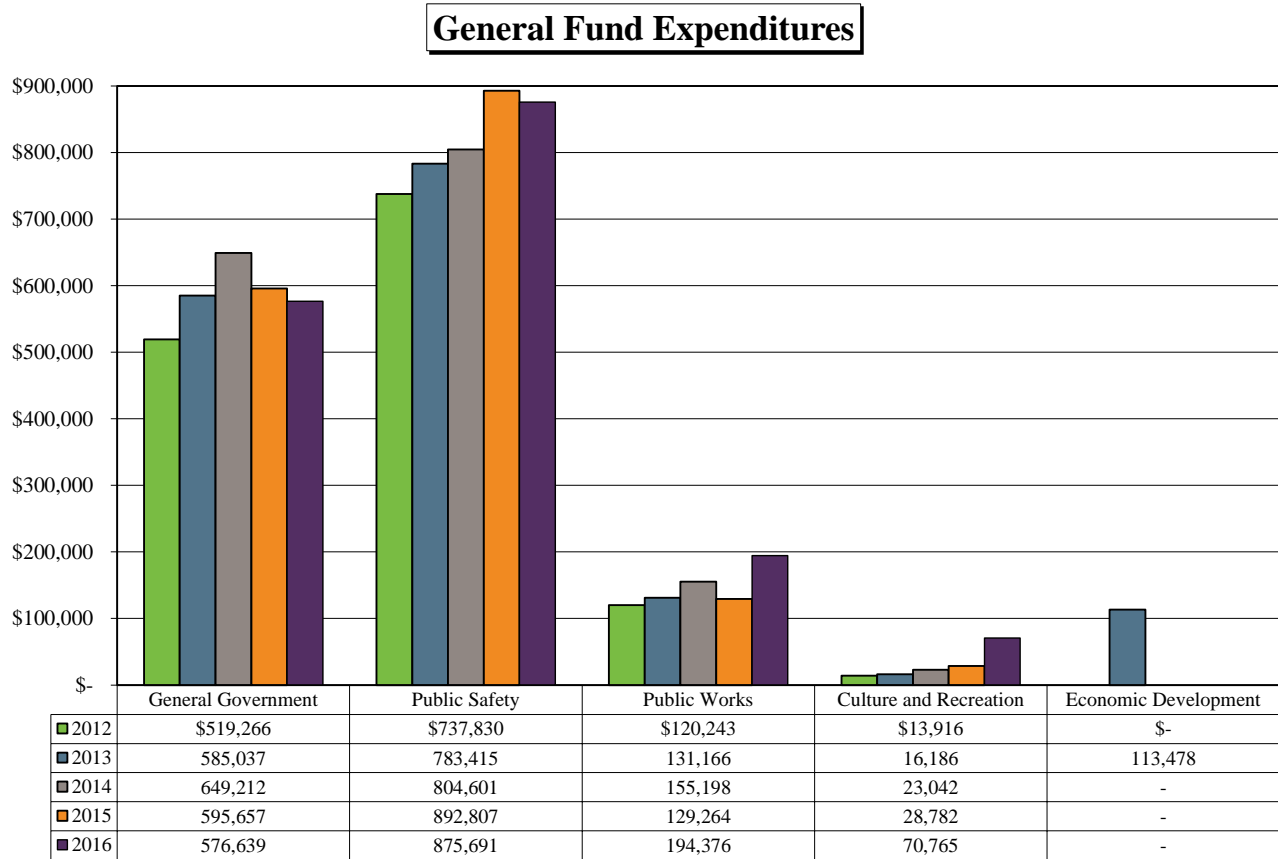
The pie chart below and the graph on the following page present an allocation of General Fund expenditures by department. Total expenditures in 2016 were \$1,717,471. As the pie chart indicates, public safety comprised the largest percentage of General Fund expenditures at approximately 51.0%. General government expenditures made up the second largest portion of the General Fund expenditures at 33.6%. Expenditures in public works and culture and recreation increased while general government and public safety decreased from 2015, as discussed on the following page.

2016 General Fund Expenditures



City of Osseo Financial Analysis

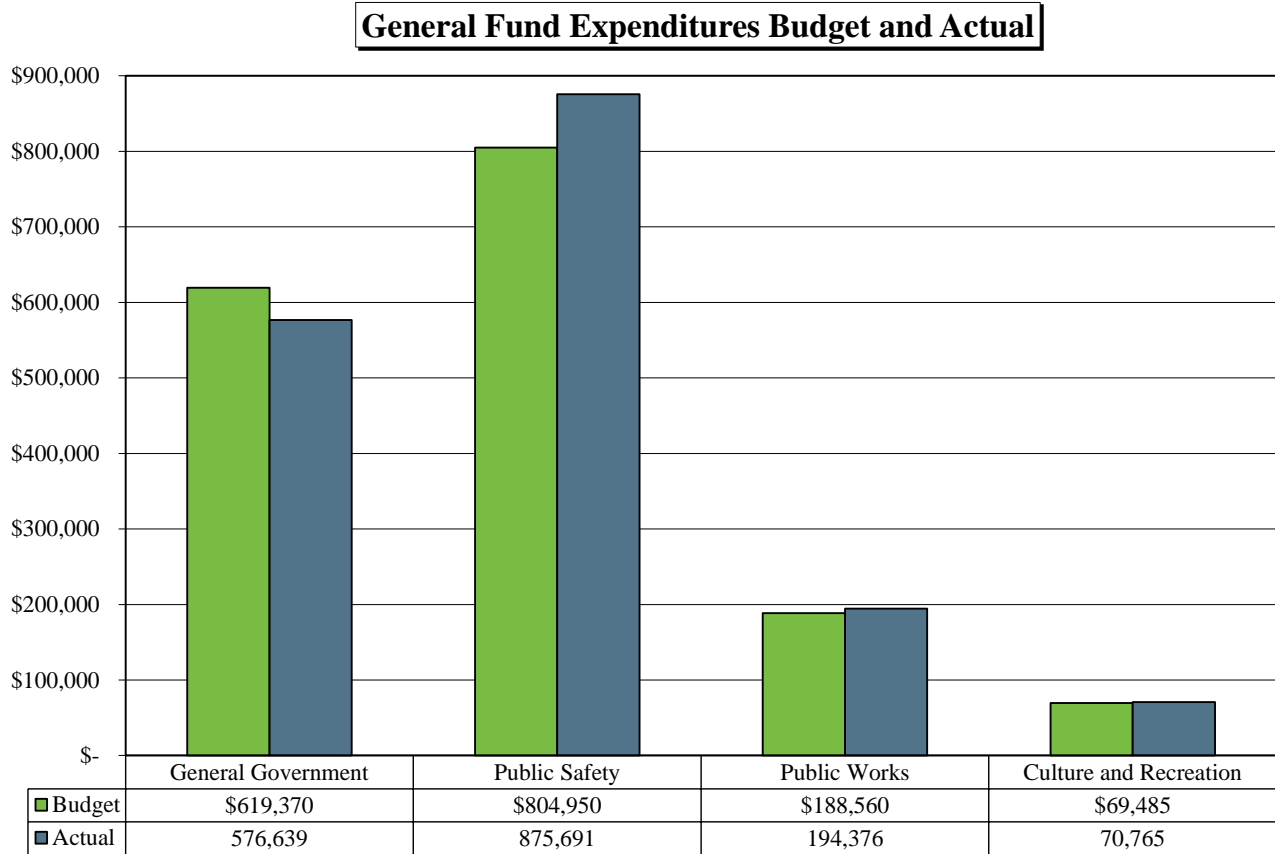
GENERAL FUND EXPENDITURES (CONTINUED)



In total, General Fund expenditures increased \$70,961, or 4.3% from 2015. Expenditures increased in public works and culture and recreation in 2016. Public Works increased \$65,112 due to being fully staffed in 2016. Culture and recreation expenditures increased \$41,983 due to a reallocation of personnel costs and insurance along with the City doing summer recreation for the first time in 2016. All other expenditures remained consistent with the prior year.

City of Osseo Financial Analysis

GENERAL FUND EXPENDITURES (CONTINUED)



In total, the City's expenditures were under budget by \$35,106 or a budget variance of 2.1%.

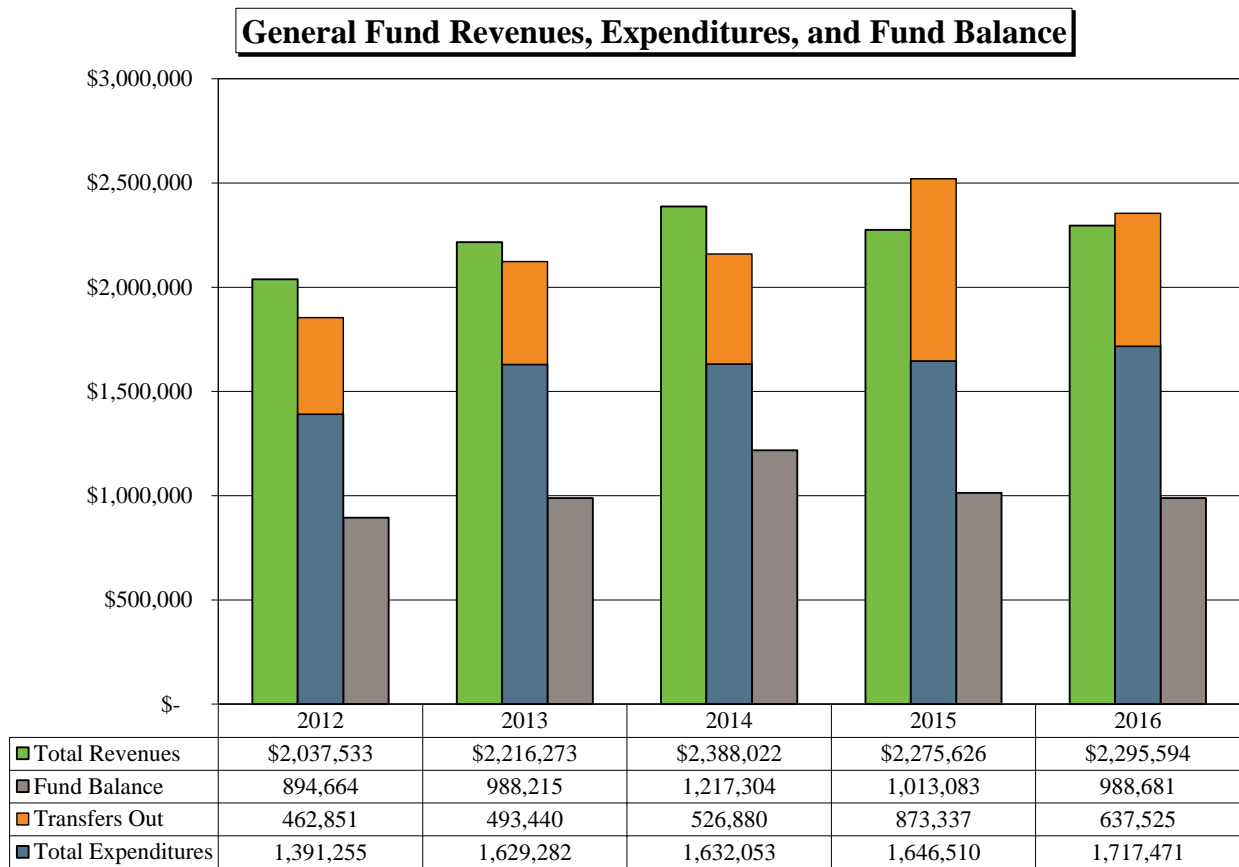
Public safety was over budget by \$70,741 due to budgeting based on prior years. In 2016, worker's compensation insurance was allocated out to each department.

City of Osseo Financial Analysis

GENERAL FUND REVENUES, EXPENDITURES, AND FUND BALANCE

As illustrated in the graph below, total revenues have exceeded total expenditures in the General Fund each of the last five years. The ending fund balance represents just under seven months of 2016 General Fund expenditures, excluding transfers out. It is important to carryover an adequate fund balance as the City relies on year-end fund balance to finance much of the subsequent year's expenditures, since Local Government Aid (LGA) and major property tax settlements are not received until May and June.

The City's fund balance policy is to have 40-50% of the subsequent year's budgeted expenditures in unassigned fund balance at year-end. The City's unassigned fund balance of \$971,738 at December 31, 2016, did not exceed this goal. The fund balance represents 39.2% of 2017 budgeted expenditures.



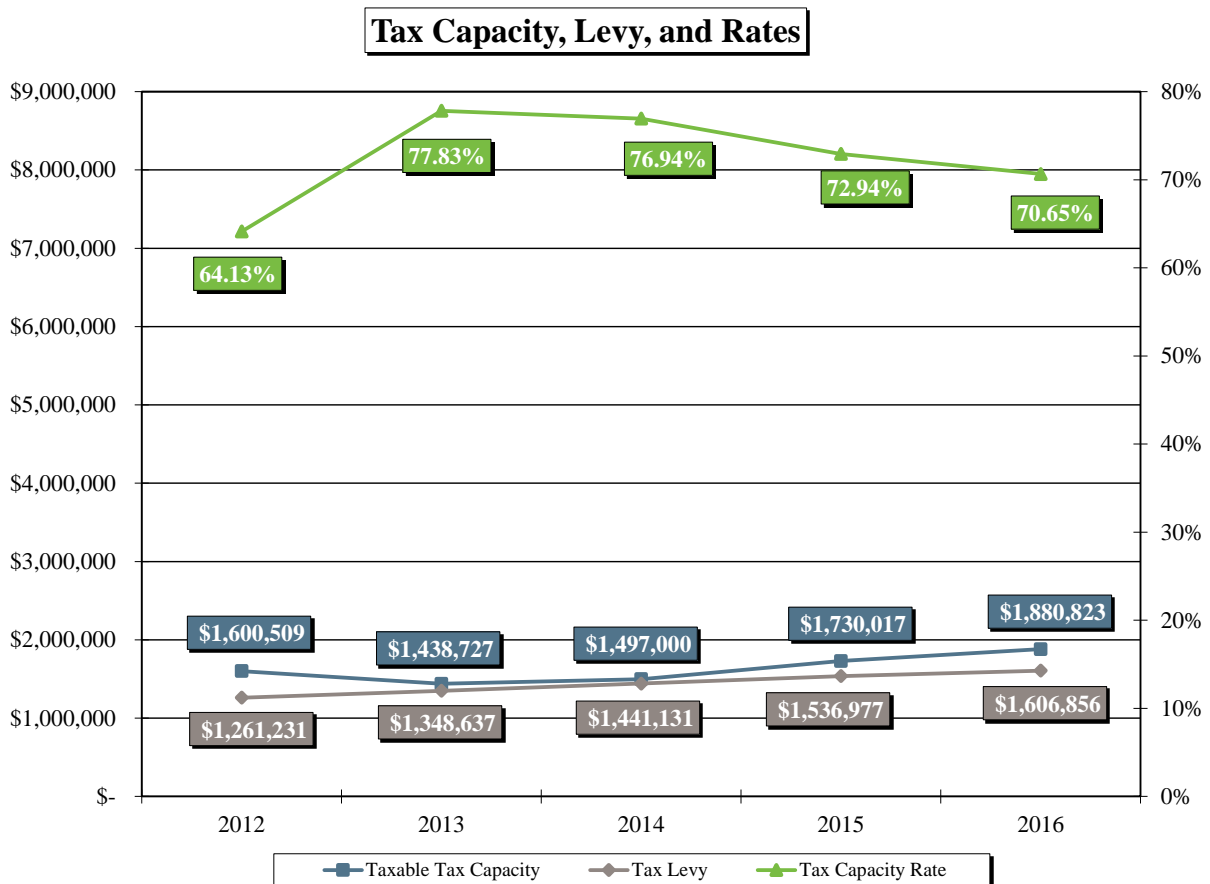
City of Osseo Financial Analysis

TAX CAPACITY, LEVY, AND RATES

The graph below presents information relating to the City's tax levy, tax capacity, and rates.

The levy for 2016 includes the General Fund levy of \$1,207,490, plus a levy for the Debt Service Funds of \$399,366.

As illustrated below, the taxable tax capacity of the City is at its highest point in the five year shown, with an increase of \$280,314, or 17.5% from 2012. In 2013, the City's taxable tax capacity dropped due to decreasing property value. Over the past three years, property value has increased, causing the taxable tax capacity to rise above the level it was at in 2012. The City's property tax levy has increased \$345,625, or 27.4%, over the same time frame. Because the levy has increased while the City's tax capacity has also increased, the tax capacity rate has increased from 64.13% to 70.65% from 2012 to 2016.

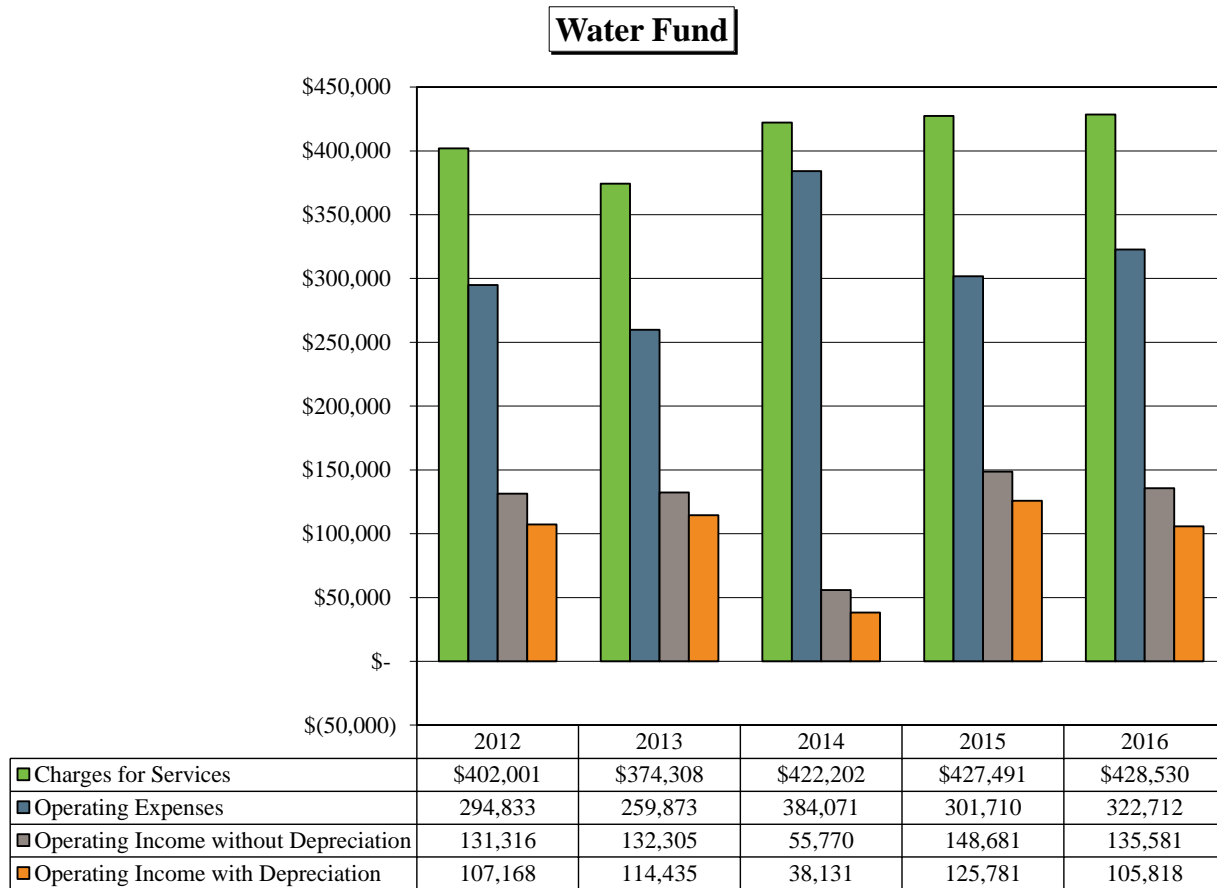


City of Osseo Financial Analysis

WATER FUND

The graph below illustrates the operations of the Water Fund for the past five years.

The City's Water Fund had operating income of \$105,818 in 2016 with depreciation. Charges for services stayed consistent, increasing only 0.24%, or \$1,039. Operating expenses increased 6.96%, or \$21,003, mainly due to an increase in employee benefits as a result of an increase in pension expense related to GASB 68 due to a significant increase in the State's net pension liability. Adding nonoperating revenues, capital contributions, and transfers out, the Water Fund experienced an increase in net position of \$205,742.

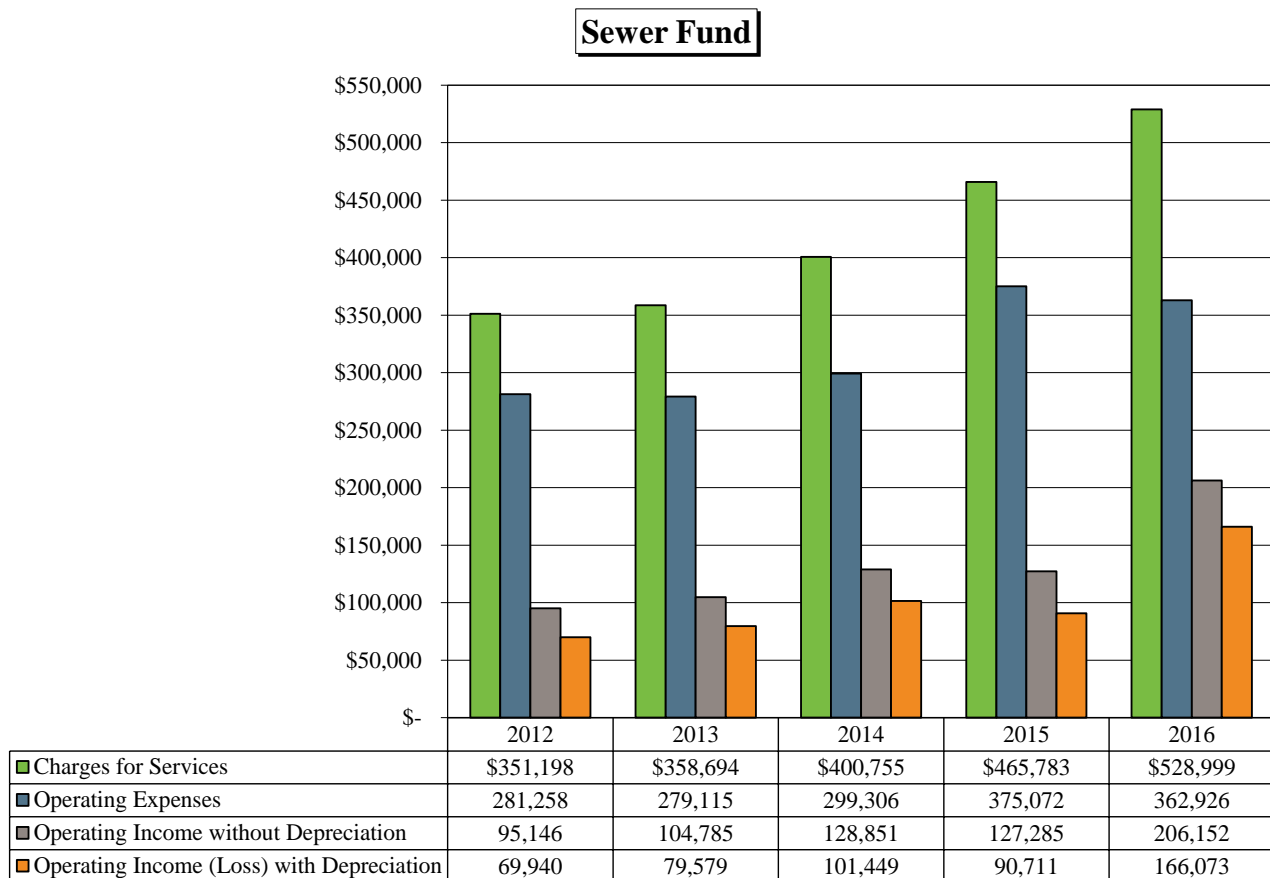


City of Osseo Financial Analysis

SEWER FUND

The graph below illustrates the operations of the Sewer Fund for the past five years.

The Sewer Fund's showed positive operations again in 2016, showing an increase in operating income to \$166,073, which includes depreciation expense. This was mainly due to a 1% rate increase in 2016, as well as an increase in usage. There was also a clean-up of billing calculation errors from prior years in 2016. Adding nonoperating revenues, capital contributions, and transfers out, the Sewer Fund experienced an increase in net position of \$162,006.

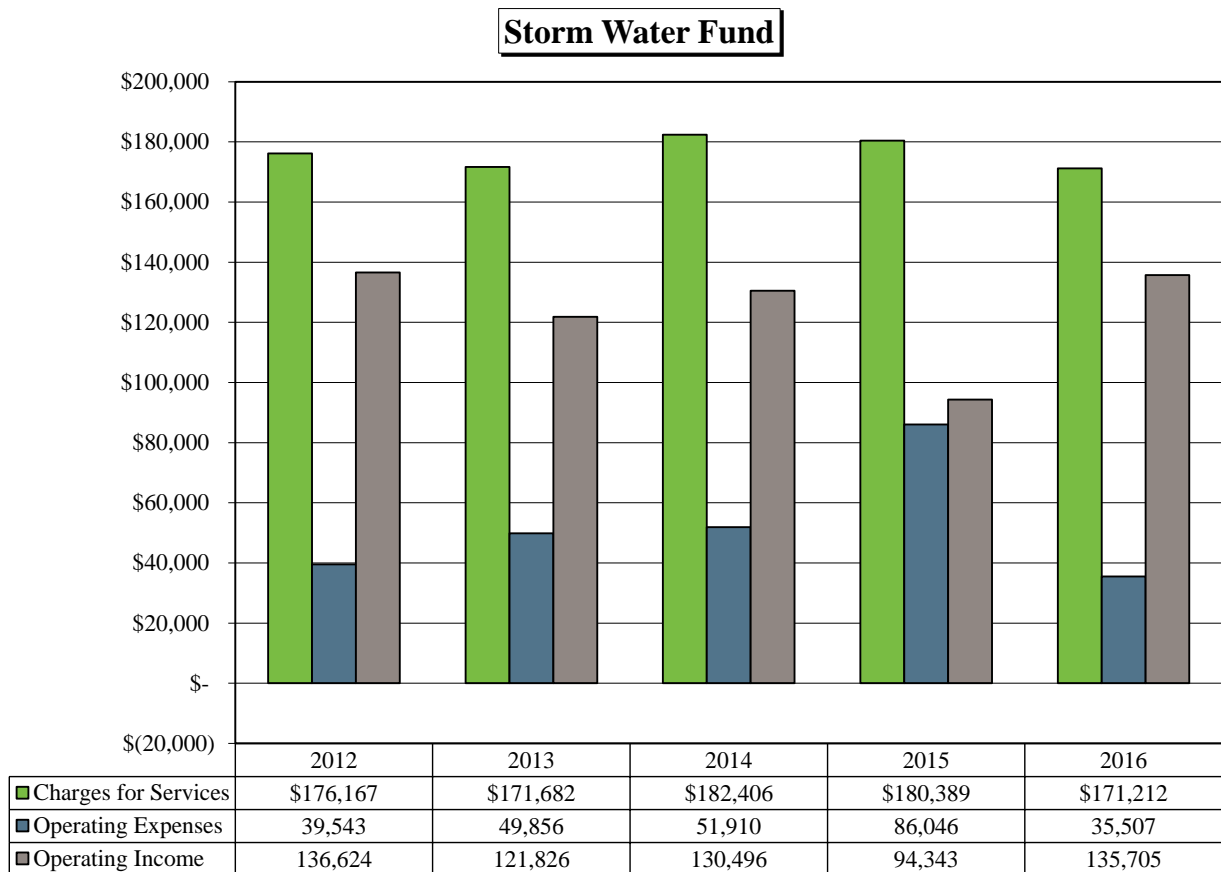


City of Osseo Financial Analysis

STORM WATER FUND

The graph below illustrates the operations of the Storm Water Fund for the past five years.

The Storm Water Fund operating receipts decreased 5.1% or \$9,177 from 2015. This was due to less permit revenue that was received in 2016. Operating expenses decreased \$50,539, or 58.7%, from 2015 to 2016 due to a decrease in wages and benefits as there were more time coded to the fund in 2015. There were also higher professional service costs related to MS4/SWPPP reporting in 2015. Adding nonoperating revenues, capital contributions, and transfers out, the Storm Water Fund experienced an increase in net position of \$91,373.



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 the activity will be operated similar to a business. Therefore, it is expected for the enterprise fund to at least be able to meet its current and future obligations.

We recommend the City continue to evaluate water, sewer, and storm water rates to continue generating sufficient operating income in the future.