

City of Merrill, Wisconsin
MANAGEMENT COMMUNICATIONS

December 31, 2018

City of Merrill, Wisconsin

DECEMBER 31, 2018

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To the City Council
City of Merrill, Wisconsin

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 Merrill, Wisconsin (the "City") as of and for the year ended December 31, 2018. The City's financial statements, including our report thereon dated May 8, 2019, are presented in a separate audit report document. Professional standards require that we provide you with the following information related to our audit.

OUR RESPONSIBILITIES UNDER U.S. GENERALLY ACCEPTED AUDITING STANDARDS AND GOVERNMENT AUDITING STANDARDS

As stated in our engagement letter, our responsibility, as described by professional standards, is to express opinions about whether the financial statements 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.

In planning and performing our audit, we considered the City's internal control over financial reporting in order to determine our auditing procedures for the purpose of expressing our opinions on the financial statements and not to provide assurance on the internal control over financial reporting.

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

PLANNED SCOPE AND TIMING OF THE AUDIT

We performed the audit according to the planned scope and timing previously communicated to you in our correspondence about planning matters.

SIGNIFICANT AUDIT FINDINGS

Consideration of Internal Control

FINANCIAL STATEMENTS

In planning and performing our audit of the financial statements of the governmental activities, the business-type activities, each major fund, and the aggregate remaining fund information of the City as of and for the year ended December 31, 2018, 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 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 report on internal control over financial reporting and on compliance and other matters is presented on pages 52 – 53 of the annual report.

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 discussed below, we identified a certain deficiency in internal control that we consider to be a significant deficiency.

A deficiency in internal control exists when the design or operation of a control does not allow management or employees, in the normal course of performing their assigned functions, to prevent, or detect and correct, misstatements on a timely basis. A material weakness is a deficiency or 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 over financial reporting 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. We consider the following deficiency in the City's internal control to be a significant deficiency:

Finding 2018-001 Preparation of Annual Financial Report

These findings are described in detail in the schedule of findings and responses on page 54 of the annual report.

The City's written response to the significant deficiency and material weakness identified in our audit has not been subjected to the audit procedures applied in the audit of the financial statements and, accordingly, we express no opinion on it.

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. As described in Note 3.G to the financial statements, the City changed accounting policies related to postemployment benefits by adopting Statement of Governmental Accounting Standards Board (GASB) No. 75, *Accounting and Financial Reporting for Postemployment Benefits Other Than Pensions*, in 2018. Accordingly, the cumulative effect of the accounting change as of the beginning of the year is reported in the statement of activities. We noted no transactions entered into by the City during the year for which there is a lack of authoritative guidance or consensus. To the best of our knowledge, 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 included in the financial statements were:

- ▶ Management's estimate of the unbilled water and sewer charges is based upon analysis of billings in the first quarter of 2019. We evaluated the key factors and assumptions and the consistency in these factors and assumptions used to develop the unbilled water and sewer charges in determining that it is reasonable in relation to the financial statements taken as a whole.
- ▶ Management's estimate of the depreciable life of the capital assets is based upon analysis of the expected useful life of the capital assets. We evaluated the key factors and assumptions and the consistency in these factors and assumptions used to develop the depreciable life in determining that it is reasonable in relation to the financial statements taken as a whole.
- ▶ Management's estimate of the net pension liability (asset) and related deferred outflows/inflows of resources is based on information received from the Wisconsin Retirement System. We evaluated the key factors and assumptions used to develop the net pension liability (asset) and related deferred outflows/inflows of resources in determining that they are reasonable in relation to the financial statements taken as a whole.

- ▶ Management's estimate of accumulated sick leave is based upon analysis of the employees sick leave balance. We evaluated the key factors and assumptions and the consistency in these factors and assumptions used to develop the estimate in determining that it is reasonable in relation to the financial statements taken as a whole.
- ▶ Management's estimate of the other postemployment benefits is based on an actuarial report. We evaluated the key factors and assumptions used to develop the other postemployment benefits in determining that it is reasonable in relation to the financial statements taken as a whole.

Certain financial statement disclosures are particularly sensitive because of their significance to financial statement users. There were no particularly sensitive financial statement disclosures.

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.

The following material misstatements detected as a result of the audit procedures were corrected by management;

- ▶ Adjusted deferred inflows/outflows and net pension liability in the Water and Sewer Utility based on WRS provided data
- ▶ Adjusted deferred inflows/outflows and other postemployment benefits liability in the Water and Sewer Utility based on WRS provided date
- ▶ Adjusted beginning balance in TID #9
- ▶ Adjusted library accounts for annual activity
- ▶ Recorded depreciation expense in Water and Sewer Utility

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 auditors' report. 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 May 8, 2019. The management representation letter follows this communication.

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 auditors' 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, to the best of our knowledge, our responses were not a condition to our retention.

In addition, during our audit, we noted certain other matters that are presented for your consideration. We will review the status of these comments during our next audit engagement. Our comments and recommendations are intended to improve the internal control or result in other operating efficiencies. We will be pleased to discuss these matters in further detail at your convenience, to perform any additional study of these matters, or to assist you in implementing the recommendations. Our comments are summarized in the comments and observations section of this report.

Other Matters

We applied certain limited procedures to the schedules relating to pensions and other postemployment benefits liabilities, which are required supplementary information (RSI) that supplements the basic financial statements. Our procedures consisted of inquiries of management regarding the methods of preparing the information, including whether the RSI has been measured and presented in accordance with prescribed guidelines, whether the methods of measurement and preparation have been changed from the prior period and the reasons for any such changes, and whether there were any significant assumptions or interpretations underlying the measurement or presentation of the RSI. We compared 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, which accompanies the financial statements but is 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.

Restriction on Use

This information is intended solely for the information and use of the City Council, and management of City of Merrill and is not intended to be, and should not be, used by anyone other than these specified parties.

Sincerely,

CliftonLarsonAllen LLP

Green Bay, Wisconsin
May 8, 2019

Summary Financial Information

GOVERNMENTAL FUND BALANCES

Presented below is a summary of the City's governmental fund balances on December 31, 2018 and 2017. This information is provided for assessing financial results for 2018 and for indicating financial resources available at the start of the 2019 budget year.

	<u>12/31/18</u>	<u>12/31/17</u>
General Fund		
Nonspendable for		
Inventories and prepaid items	\$ 158,781	\$ 130,030
Restricted for		
Capital improvements	380,014	226,459
Committed for		
Nonlapsing reserves	808,223	773,535
Unassigned	<u>1,699,745</u>	<u>1,687,571</u>
Total General Fund Balance	<u>3,046,763</u>	<u>2,817,595</u>
Debt Service Fund		
Restricted for debt service	<u>53,163</u>	<u>55,117</u>
Special Revenue Funds		
Restricted for		
Community development	516,643	455,884
Library endowment	405,798	448,217
Remedial action	384,896	409,752
Total Special Revenue Funds	<u>1,307,337</u>	<u>1,313,853</u>
Capital Projects Funds		
Restricted for TID project plan		
TIF No. 3	533,870	33,228
TIF No. 4	14,529	-
TIF No. 5	7,680	3,080
Unassigned		
TIF No. 4	-	(112,812)
TIF No. 6	(504,491)	(417,887)
TIF No. 7	(45,237)	(45,237)
TIF No. 8	(476,247)	(355,407)
TIF No. 9	(545,093)	(508,599)
TIF No. 10	(31,387)	(7,535)
TIF No. 11	(154,338)	(89,154)
TIF No. 12	(13,031)	(12,056)
Total Capital Projects Funds	<u>(1,213,745)</u>	<u>(1,512,379)</u>
Total Governmental Fund Balances	<u>\$ 3,193,518</u>	<u>\$ 2,674,186</u>

Overall the general fund increased by \$229,168 with unassigned fund balance of \$1,699,745. The general fund, as reported, incorporates both operating and capital components, as summarized below:

	<u>12/31/18</u>	<u>12/31/17</u>
General Fund		
General operations	\$ 1,845,600	\$ 1,848,275
Nonlapsing reserve	808,223	773,535
School resource officer	372	(22,251)
Merrill festival grounds	5,274	4,025
Airport aviation fuel	7,280	(12,448)
Capital improvements	<u>380,014</u>	<u>226,459</u>
Total	<u>\$ 3,046,763</u>	<u>\$ 2,817,595</u>

The general fund is currently advancing funds to TID capital projects funds with deficit cash positions, providing the financing source for project plan expenditures. If these advances are not anticipated to be repaid within a year, or borrowing reimbursements made portions of general fund balance should be segregated and shown as not available for appropriation, as they are committed to covering cash deficits of these funds.

The increase in fund balance of TID No. 3 relates to borrowings received in 2018 but financing 2019 infrastructure improvements of \$530,000.

WATER UTILITY

A comparative summary of the Water Utility's change in net position for the years ended December 31, 2018 and 2017 appears below:

	<u>2018</u>	<u>2017</u>
Operating revenues		
Charges for services	\$ 1,505,277	\$ 1,442,458
Other	<u>137,373</u>	<u>136,102</u>
Total operating revenues	<u>1,642,650</u>	<u>1,578,560</u>
Operating expenses		
Operation and Maintenance	795,510	808,980
Depreciation	418,284	412,817
Taxes	<u>16,846</u>	<u>22,027</u>
Total operating expenses	<u>1,230,640</u>	<u>1,243,824</u>
Operating income	<u>412,010</u>	<u>334,736</u>
Nonoperating revenues (expenses)		
Interest income	8,913	3,027
Interest and fiscal charges	(26,403)	(28,465)
Other income	<u>16,265</u>	<u>2,865</u>
Total nonoperating revenues (expenses)	<u>(1,225)</u>	<u>(22,573)</u>
Income before contributions and transfers	410,785	312,163
Capital contributions	146,550	28,931
Transfers out - payment in lieu of taxes	<u>(374,442)</u>	<u>(363,612)</u>
Change in net position	<u>\$ 182,893</u>	<u>\$ (22,518)</u>

The City's water utility reported an operating income of \$412,010 compared to \$334,736 for the prior year. To further evaluate the operating activities, we have calculated the water utility's rate of return below.

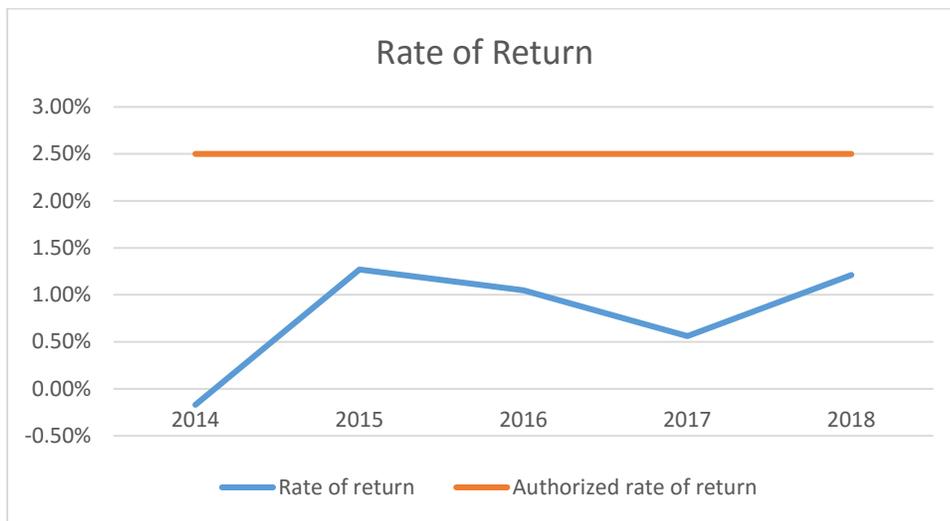
Rate of Return: The Public Service Commission of Wisconsin (PSC) determines rates charged to customers of the water utility by calculating rate of return on the water utility's average net rate base. Presented below is the calculation of the rates of return for 2018 and 2017 for the water utility based on the format used by the PSC: The PSC operating income differs from the above operating income by the following items:

- ▶ The PSC considers the property tax equivalent to be an expense in the year accrued while the property tax equivalent is considered an expense for financial reporting purposes in the year transferred to the City.
- ▶ The PSC no longer allows the water utility to recover depreciation on contributed plant from current rates; therefore, this depreciation expense is removed from PSC operating income.

	2018	2017
Rate of Return	1.21%	0.56%

Rate of Return

An analysis of rate of return for the last five years follows:



Summary Comment: The rate of return generated was lower than the authorized rate of return (2.50%). The water utility reported a cash and investment balance at December 31, 2018 of \$804, 817, compared to a balance of \$804,513 at December 31, 2017. The water utility generated cash flows from operations of \$846,014 in 2018 compared to \$691,611 in 2017 and a positive net cash inflow from all activities of \$304 in 2018 compared to a negative \$73,242 in 2017.

SEWER UTILITY

A comparative summary of the Sewer Utility's change in net position for the years ended December 31, 2018 and 2017 appears below:

	2018	2017
Operating revenues		
Charges for services	\$ 1,495,239	\$ 1,461,055
Other	142,820	139,805
Total operating revenues	<u>1,638,059</u>	<u>1,600,860</u>
Operating expenses		
Operation and maintenance	1,145,937	961,974
Depreciation	392,036	378,135
Taxes	42,401	41,859
Total operating expenses	<u>1,580,374</u>	<u>1,381,968</u>
Operating income	<u>57,685</u>	<u>218,892</u>
Nonoperating revenues (expenses)		
Interest income	14,090	3,460
Interest expense	(10,836)	(3,121)
Other income	-	84
Total nonoperating revenues (expenses)	<u>3,254</u>	<u>423</u>
Income before contributions	60,939	219,315
Capital contributions	<u>107,673</u>	<u>7,596</u>
Change in net position	<u>\$ 168,612</u>	<u>\$ 226,911</u>

Because the sewer utility is not regulated by the PSC and treatment plants are typically capital intensive with depreciation expense being a significant component of operating expenses, it is important to consider cash flows when evaluating the sewer utility operating results. For the year ended December 31, 2018, the cash generated by operating activities totaled \$495,529 compared to \$578,020 for 2017. As of December 31, 2018, the sewer utility had cash from operations of \$62,022, a decrease of \$239,814 from the prior year, and restricted cash and investment balance of \$1,032,007. As of December 31, 2018, the future debt services are as follows:

December 31	Obligation	Interest	Total
2019	\$ 28,343	\$ 2,156	\$ 30,499
2020	28,741	1,282	30,023
	<u>\$ 57,084</u>	<u>\$ 3,438</u>	<u>\$ 60,522</u>

New Accounting Standard

ACCOUNTING AND REPORTING FOR LEASES

In June 2017, the Governmental Accounting Standards Board (GASB) issued GASB Statement No. 87, *Leases* which establishes a single model for lease accounting and revises reporting requirements.

Lease accounting is required when a government contracts to use another entity's equipment, building, or other nonfinancial assets for a specific period of time. Under the new guidance, a lease asset and a lease liability are recorded in the government-wide and proprietary financial statements for this contract. The lease liability is calculated by including the following: fixed payments, variable payments, interest rate, purchase options, residual value guarantees, and termination or extension options. The lease liability is discounted and is amortized over the lease term. The lease asset is calculated by starting with the lease liability amount and adjusting for incentives and other costs and is amortized over the shorter of the lease term or the useful life of the underlying asset. The lease asset is reported in the financial statements as an intangible right to use asset, rather than a capital asset under current guidance. Footnote disclosures including lease assets by asset class and related accumulated amortization and future minimum payments among other details are required under the new Statement.

When the government is leasing one of its assets to another entity, a lease receivable and deferred inflow of resources related to the lease receivable is recorded. The lease receivable is calculated similar to the lease asset described above. The lease receivable is discounted and is amortized over the lease term. The deferred inflow of resources is calculated by starting with the lease receivable and adjusting for incentives and other payments. The deferred inflow would be recognized as an inflow of resources in a systematic and rational manner over the lease term.

Some contracts include a nonlease component such as maintenance services. The government will need to allocate the contract cost between the lease component and the nonlease component, unless it is not practicable to do so. If it is not practicable, the entire contract should be treated as a lease.

This new standard is effective for fiscal years beginning after December 15, 2019. Early adoption is encouraged by GASB. We recommend the City review the new standard, gather all lease contracts, and identify the terms and conditions of each contract, noting the lease term, all payments, and options in order to properly determine the value of each lease. The City should also review contracts that have both lease and nonlease components to determine if a price allocation is practicable.

ACCOUNTING AND REPORTING FOR FIDUCIARY ACTIVITIES

In January 2017, the Governmental Accounting Standards Board (GASB) issued GASB Statement No. 84, *Fiduciary Activities*, which establishes criteria for identifying fiduciary activities and revises reporting requirements. The standard is effective for fiscal years ending on or after December 31, 2019. In addition, the GASB expects to issue an implementation guide in 2019.

Identifying Fiduciary Activities

Activities other than pension and postemployment arrangements are considered fiduciary activities if all of the following criteria are met:

- ▶ The government controls the assets or can direct their use.
- ▶ The activity must not be solely based on the government's own-source revenue. Own-source revenue includes exchange transactions such as user charges, sales taxes and property taxes.
- ▶ The government does not have administrative involvement such as determining eligibility, monitoring compliance or approval of expenditures.
- ▶ The government does not have direct financial involvement such as matching requirements or liability for disallowed costs.

Activities meeting these criteria would be required to be reported as fiduciary funds. An exception is made for funds held in enterprise funds which are expected to be held for three months or less. These funds can continue to be reported in the enterprise fund. Activities not meeting these criteria would be reported as part of the governmental or proprietary funds.

The administrative involvement criteria is likely to have the most impact on reclassification of fiduciary activities. Policies on the expenditures of funds and approval of expenditures by an employee of the government may be considered administrative involvement and preclude the classification as a fiduciary activity.

Financial Reporting

An activity meeting the above criteria should be reported in one of the following four fiduciary funds:

- ▶ Pension and other employee benefit trust funds
- ▶ Investment trust funds
- ▶ Private-purpose trust funds
- ▶ Custodial funds

Fiduciary assets administered through a trust agreement are recorded in a pension and other employee benefit trust, investment or private-purpose trust fund. Custodial funds are used to report all other fiduciary activities not held in a trust or equivalent arrangement. Agency funds have been eliminated with GASB No. 84 and replaced with custodial funds.

Fiduciary funds will present a statement of fiduciary net position, including assets, deferred outflows of resources, liabilities, deferred inflows of resources and net position. Liabilities to beneficiaries should be recognized when an event occurs that compels the government to disburse fiduciary resources, when a demand for the resources has been made or when no further action, approval, or condition is required to be taken or met by the beneficiary to release the assets. A statement of changes in fiduciary net position should present additions by source and deductions by type.

Implementation

As mentioned previously, this new standard is effective for fiscal years ending on or after December 31, 2019. However, due to the potential reclassification of funds, the impact may need to be considered during budget preparation. We recommend the City begin to determine the impact of the Statement by:

1. Identifying potential fiduciary activities. Some activities to consider include:
 - a. Tax collection funds
 - b. Cemetery trust funds
2. Gathering facts regarding each activity, including the government's administrative involvement.
3. Evaluating whether each activity meets the fiduciary activity criteria and determine how it should be reported. An appendix to the Statement includes flowcharts for the evaluation process.

These changes will affect your 2019 financial statements. This comment is for informational purposes.

APPENDIX
