City of Dayton
Hennepin County and
Wright County, Minnesota

Communications Letter

December 31, 2018

bergankdv

City of Dayton
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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 Dayton
Dayton, 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 Dayton, Minnesota 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 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 have not been identified. In addition, because of inherent limitations in internal control, including the possibility of management override of controls, misstatements due to error, or fraud may occur and not be detected by such controls. However, as discussed below, we identified certain deficiencies 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 over financial reporting, 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. A reasonable possibility exists when the likelihood of an event occurring is either reasonably possible or probable as defined as follows: reasonably possible – the chance of the future event or events occurring is more than remote but less than likely; probable – the future event or events are likely to occur. 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 deficiency identified is stated within this letter.

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

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 11, 2019, on such statements.

This communication is intended solely for the information and use of the Members of the City Council and management and 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 11, 2019

City of Dayton
Significant Deficiency

LACK OF SEGREGATION OF ACCOUNTING DUTIES

The City has 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.

During our audit, the following access, verification and implementation issues were noted:

- The Accounting Clerk is the individual who prepares the deposits, enters deposits into accounting software and is responsible for delivering them to the bank.
- The Accounting Clerk is responsible for check stock and is the one preparing the checks.
- The Accounting Clerk duties related to payroll include custody, recording, and reconciliation. This is mitigated to a certain extent by separate authorization and monitoring of the reconciliation process.

Management and the City Council are aware of these conditions 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 these situations and should continually monitor the accounting system, including changes that occur.

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

City of Dayton
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, 2018. Professional standards require that we advise you of the following matters related to our audit.

OUR RESPONSIBILITY IN RELATION TO THE FINANCIAL STATEMENT AUDIT

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

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.

PLANNED SCOPE AND TIMING OF THE AUDIT (CONTINUED)

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.

COMPLIANCE WITH ALL ETHICS REQUIREMENTS REGARDING INDEPENDENCE

The engagement team, others in our firm, as appropriate, our firm, and our network firms have complied with all relevant ethical requirements regarding independence.

QUALITATIVE ASPECTS OF SIGNIFICANT ACCOUNTING PRACTICES

Management has the responsibility to select and use appropriate accounting policies. A summary of the significant accounting policies adopted by the City is included in the notes to financial statements. There have been no initial selection of accounting policies and no changes to significant accounting policies or their application during 2018. 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/Total Other Post Employment Benefits (OPEB) Liability, Deferred Outflows of Resources Related to OPEB and Deferred Inflows of Resources Related to OPEB – These balances are based on an actuarial study using the estimates of future obligations of the City for post employment benefits.
>
> Net Pension Asset, Net Pension Liability, Deferred Outflows/Inflows of Resources Relating to Pensions – These balances are based on an allocation by the pension plans using estimates based on contributions.

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.

City of Dayton
Required Communication

SIGNIFICANT DIFFICULTIES ENCOUNTERED DURING THE AUDIT

We encountered no significant difficulties in dealing with management relating to the performance of the audit.

UNCORRECTED AND CORRECTED 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. Further, professional standards require us to also communicate the effect of uncorrected misstatements related to prior periods on the relevant classes of transactions, account balances or disclosures, and the financial statements as a whole. Management did not identify, and we did not notify them of any uncorrected financial statement misstatements

In addition, none of the misstatements detected as a result of audit procedures and corrected by management were material, either individually or in the aggregate, to the financial statements taken as a whole.

DISAGREEMENTS WITH MANAGEMENT

For purposes of this letter, professional standards define a disagreement with management as a matter, whether or not resolved to our satisfaction, concerning a financial accounting, reporting, or auditing matter, which could be significant to the City's financial statements or the auditor's report. No such disagreements arose during the course of the audit.

REPRESENTATIONS REQUESTED FROM MANAGEMENT

We requested certain written representations from management, which are included in the management representation letter.

MANAGEMENT'S CONSULTATIONS WITH OTHER ACCOUNTANTS

In some cases, management may decide to consult with other accountants about auditing and accounting matters. Management has informed us that, and to our knowledge, there were no consultations with other accountants regarding auditing and accounting matters.

OTHER SIGNIFICANT MATTERS, FINDINGS, OR ISSUES

In the normal course of our professional association with the City, we generally discuss a variety of matters, including the application of accounting principles and auditing standards, operating conditions affecting the City, and operating plans and strategies that may affect the risks of material misstatement. None of the matters discussed resulted in a condition to our retention as the City's auditors.

OTHER MATTERS

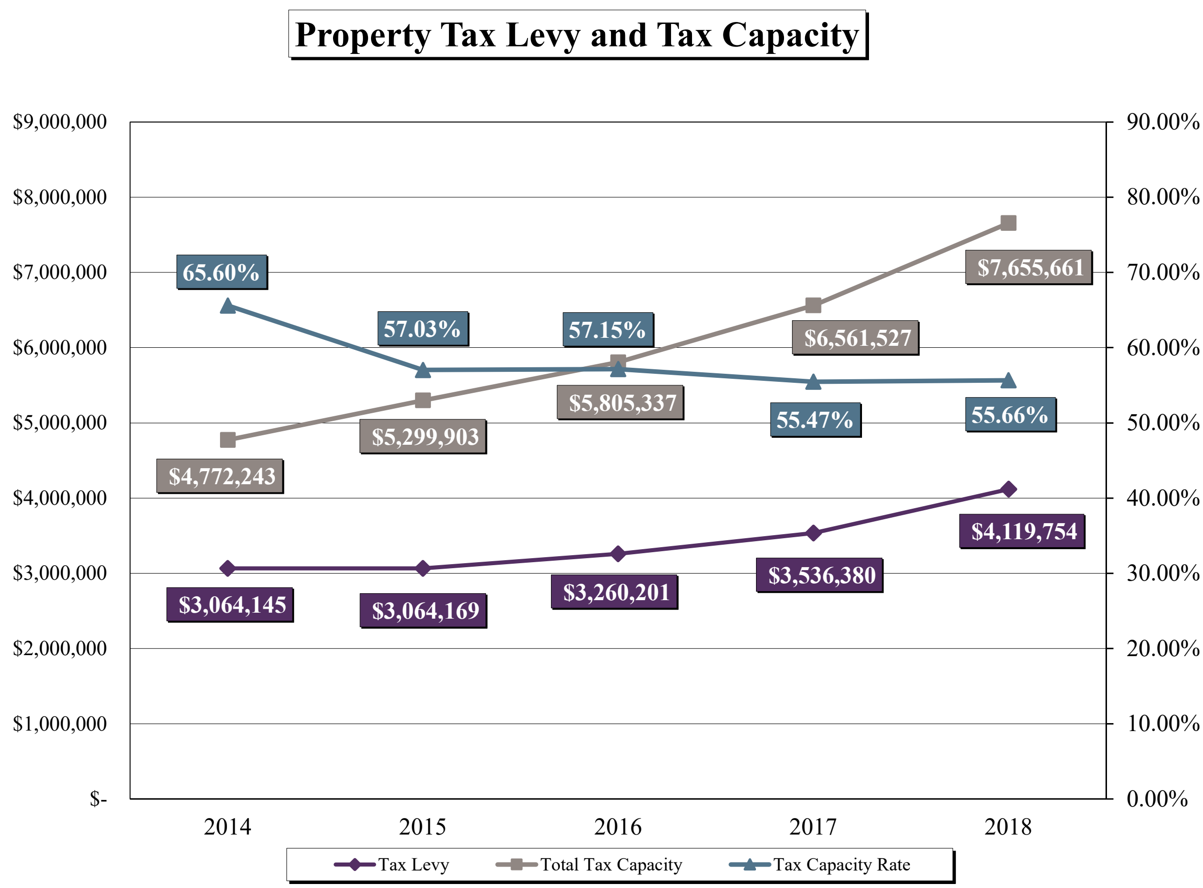
We applied certain limited procedures to the RSI that supplements the basic financial statements. Our procedures consisted of inquiries of management regarding the methods of preparing the information and comparing the information for consistency with management's responses to our inquiries, the basic financial statements, and other knowledge we obtained during our audit of the basic financial statements. We did not audit the RSI and do not express an opinion or provide any assurance on the RSI.

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.

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. We suggest you view each graph and document if our analysis is consistent with yours.

TAX LEVY, TAX CAPACITY, AND TAX CAPACITY RATES

In basic terms, the City's tax capacity rate is a percentage amount, which when multiplied by the City's tax capacity, results in the gross property tax levy. Since 2014, the City's levy has increased 34.5% while the tax capacity has increased 60.4%. During 2018, the City's levy increased $583,374, or 16.5%. The total tax capacity also increased, resulting in a slight increase in the tax capacity rate.

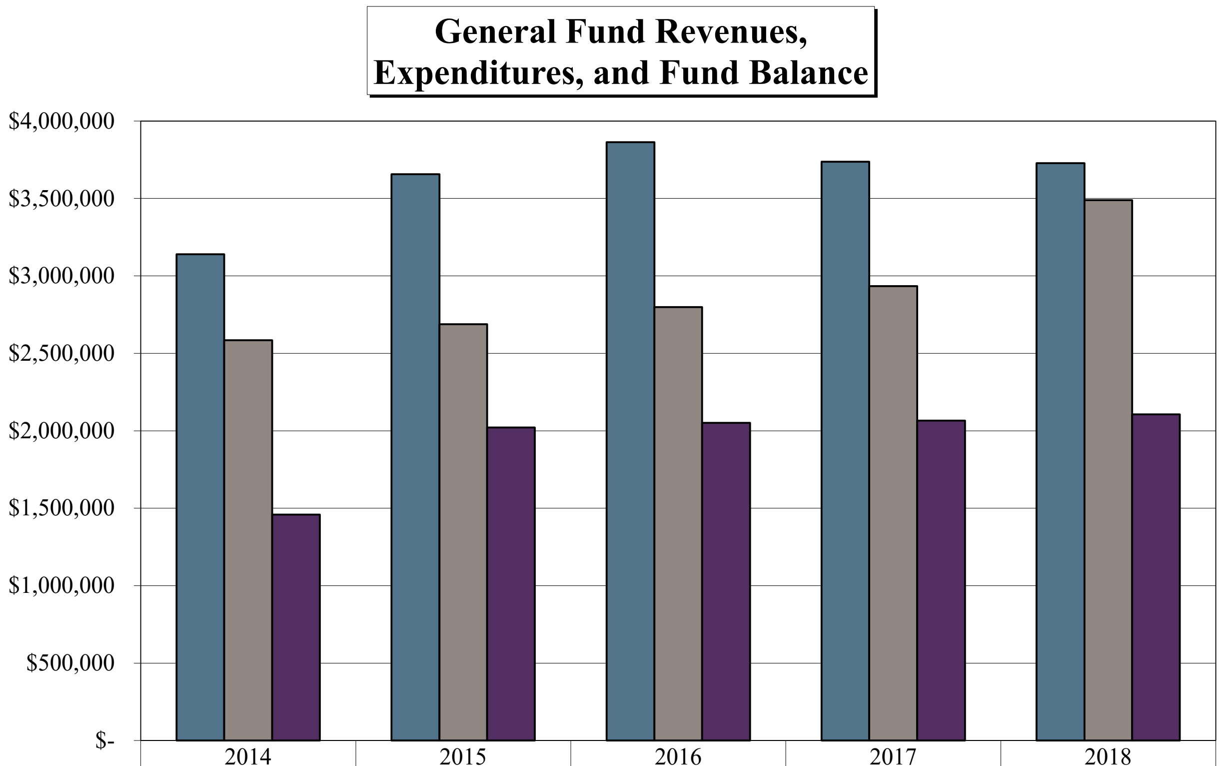


Data obtained from the *Hennepin County Taxing District Information* (www.hennepin.us.).

City of Dayton
Financial Analysis

GENERAL FUND

The following chart presents the City's General Fund data for the past five years:



	2014	2015	2016	2017	2018
Total Revenues	$3,140,488	$3,656,233	$3,863,767	$3,736,813	$3,728,370
Total Expenditures	2,584,255	2,687,817	2,798,906	2,933,829	3,489,064
Fund Balance	1,457,808	2,020,749	2,051,132	2,066,323	2,105,583

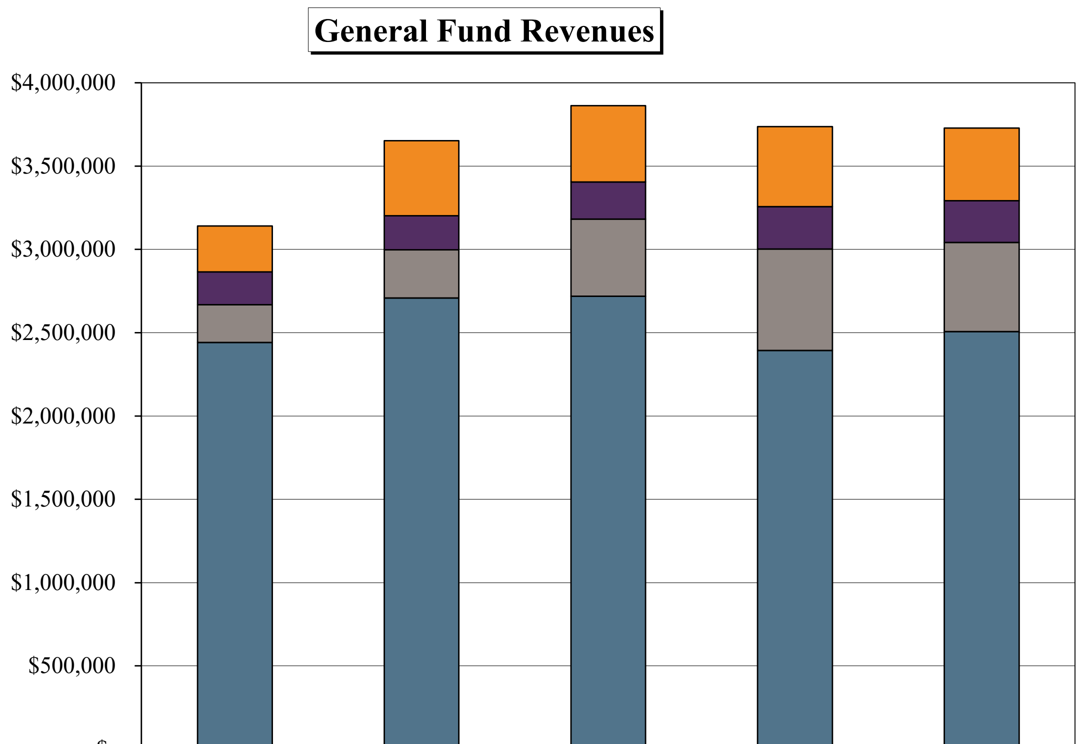
In all five years presented above, revenues have exceeded expenditures in the General Fund. Details for revenues and expenditures are discussed on the following pages.

At year-end, the fund balance level increased $39,260 from 2017, due to the excess of revenues over expenditures. Revenues for the General Fund stayed consistent only decreasing $8,443. There was an increase in general fund expenditures of $555,235 from 2017. The Office of the State Auditor's recommended level for a city's fund balance is between 35% and 50%. The City's fund balance level was 60.3%, or seven months of expenditures, based on 2018 spending levels. This level is down from 70.4% at December 31, 2017.

GENERAL FUND REVENUES

The chart below depicts the General Fund revenues by source for the past five years. Overall, revenues decreased from $3,736,813 in 2017 to $3,728,370 in 2018, a decrease of 0.2%.

This decrease was due to a decrease in license and permit revenue, which decreased $72,809 from 2017 due to fewer building permits being issued in 2018. This decrease was offset by an increase in property taxes. Property Tax revenue increased $112,823 due to an increase in the property tax levy. All other revenue sources were consistent when compared to 2017.



	2014	2015	2016	2017	2018
Fines, Charges for Services, and Miscellaneous	$275,660	$450,484	$459,066	$479,391	$436,655
Intergovernmental Revenues	196,004	204,087	222,467	255,597	249,876
Licenses and Permits	227,609	289,369	463,569	607,760	534,951
Taxes and Assessments	2,441,215	2,708,584	2,718,665	2,394,065	2,506,888

City of Dayton
Financial Analysis

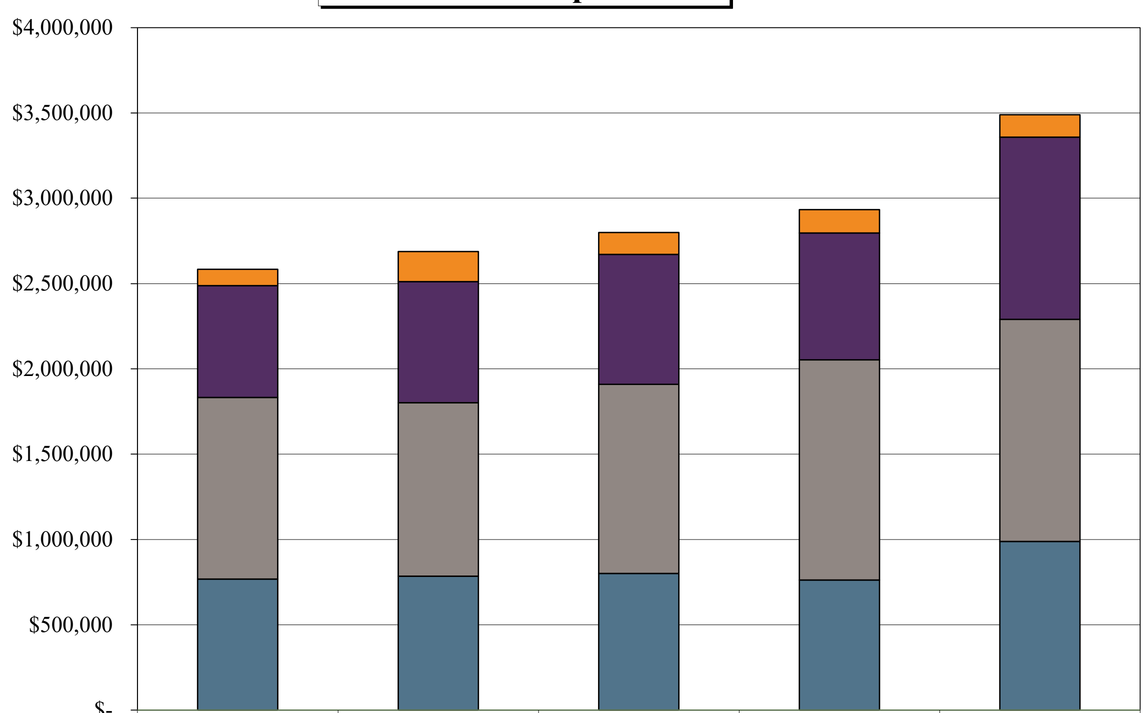
GENERAL FUND EXPENDITURES

The chart below presents General Fund expenditures by function for the past five years. In total, General Fund expenditures increased by $555,235 or 18.8%, from $2,933,829 in 2017, to $3,489,064 in 2018.

General government expenditures increased $226,268 or 29.6% from the prior year. This increase was primarily due to a rise in salaries and benefit expenditures in 2018. The City had new contracts that were settled at the beginning of 2017 which included wage increases as well as cost of living adjustments. There were also two additional employees hired in 2018. Public works expenditures increased $324,382, or 43.64% from the prior year. This increase was due to an additional employee being hired, increased engineering and building inspection costs and increased repair and street maintenance costs.

All other expenditures stayed consistent with the prior year.

General Fund Expenditures



	2014	2015	2016	2017	2018
Parks and Recreation	$96,729	$176,072	$128,649	$137,734	$131,145
Public Works	655,056	710,673	761,464	743,362	1,067,744
Public Safety	1,064,590	1,015,315	1,107,678	1,289,783	1,300,957
General Government	767,880	785,757	801,115	762,950	989,218

GENERAL FUND BUDGET AND ACTUAL

For the 2018 operating year, the City Council provided a balanced budget. In the end, revenues were 10.0% over budget and expenditures were 3.0% over budgeted amounts. The resulting surplus was transferred to other funds for capital purposes.

Overall, General Fund revenue were over budget by $342,715. This variance is due to charges for services and licenses and permits coming in over budget due to an increase in development activity, the City typically budgets conservatively for these areas. Charges for services were overbudget $118,287 due to budgeting conservatively. Intergovernmental revenue was over budget $78,373 due to budgeting conservatively for federal and state grants received. All other revenue categories were in line with budgeted amounts.

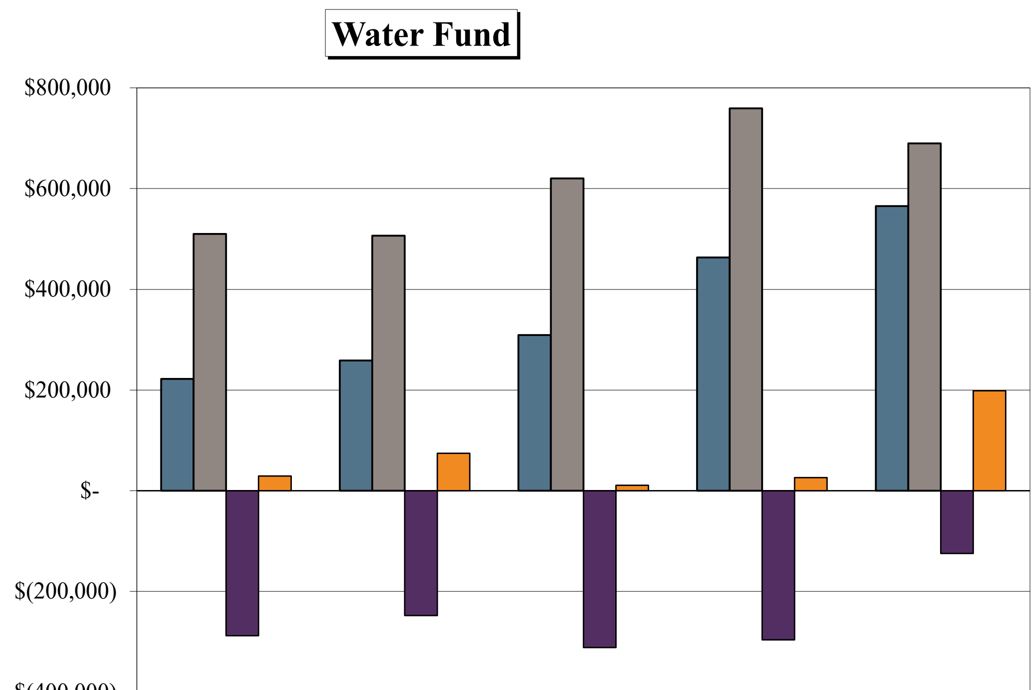
In total, the City's expenditures were $103,409 over the projected amounts. General Government was $74,111 over budget due to the County's assessing fees being higher than anticipated. Public safety was underbudget $64,116 mostly due to a police officer leaving early in the year and not being replaced until late in the year. Public works was $154,564 over budget due to more building inspection costs and repairs and maintenance costs than budgeted. Parks and recreation is $61,150 under budget due to the City expecting to start projects in 2018 that ended up not happening.

	Budget	Actual Amounts	Over (Under) Budget	Budget Variance
Revenues				
Property taxes	$ 2,540,276	$ 2,506,888	$ (33,388)	-1.3%
Licenses and permits	358,227	534,951	176,724	49.3%
Intergovernmental revenues	171,503	249,876	78,373	45.7%
Charges for services	216,849	335,136	118,287	54.5%
Fines and forfeitures	51,500	35,639	(15,861)	-30.8%
Miscellaneous	47,300	65,880	18,580	39.3%
Total revenues	3,385,655	3,728,370	342,715	10.1%
Expenditures				
General government	915,107	989,218	74,111	8.1%
Public safety	1,365,073	1,300,957	(64,116)	-4.7%
Public works	913,180	1,067,744	154,564	16.9%
Parks and recreation	192,295	131,145	(61,150)	-31.8%
Total expenditures	3,385,655	3,489,064	103,409	3.1%
Other Financing Sources (Uses)				
Proceeds from sale of capital asset	-	50,082	50,082	N/A
Transfers in	-	64,546	64,546	N/A
Transfers out	-	(314,674)	(314,674)	N/A
Total other financing sources (uses)	-	(200,046)	(200,046)	N/A
Net change in fund balances	$ -	$ 39,260	$ 39,260	N/A

City of Dayton
Financial Analysis

WATER FUND

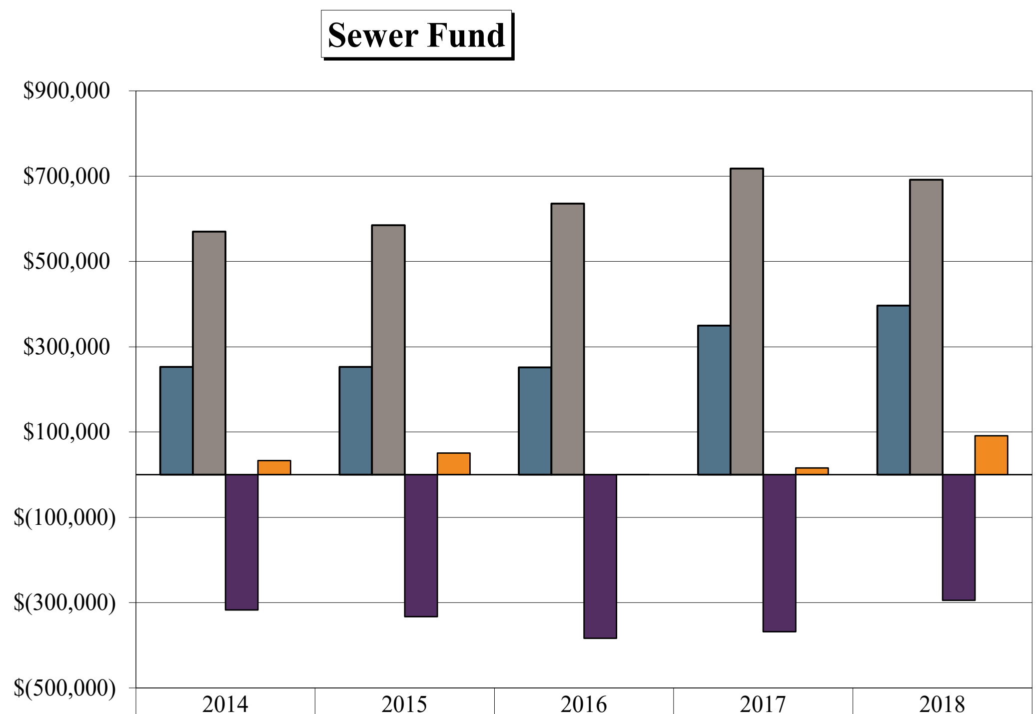
The financial activity of the City's Water Fund has increased significantly over the course of the last five years as new users continue to be added. While the financial statements indicate operating losses each of the past five years, with depreciation included, the fund shows positive cash flows from operations. The liquid, or unrestricted, net position of the fund increased over $440 thousand dollars during 2018 to $1.75 million.



	2014	2015	2016	2017	2018
Operating Revenues	$221,869	$258,813	$308,787	$463,404	$565,274
Operating Expenses	509,655	506,740	620,149	759,474	689,748
Operating Loss with Depreciation	(287,786)	(247,927)	(311,362)	(296,070)	(124,474)
Operating Income without Depreciation	29,347	74,179	10,744	26,036	198,292

SEWER FUND

As with the Water Fund, depreciation is a significant driver of the operating losses in the Sewer Fund. This fund also cash flows positively from operations, although its unrestricted, net position at year end of $188 thousand is significantly below the reserves in the Water Fund.



	2014	2015	2016	2017	2018
Operating Revenues	$252,782	$252,652	$252,005	$349,724	$396,729
Operating Expenses	569,799	585,257	635,605	717,840	691,561
Operating Loss with Depreciation	(317,017)	(332,605)	(383,600)	(368,116)	(294,832)
Operating Income without Depreciation	33,061	51,004	9	15,493	90,960

City of Dayton
Emerging Issues

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. 84 – Fiduciary Activities** – GASB has issued GASB Statement No. 84 relating to accounting and financial reporting for fiduciary activities. This new statement establishes clarity to determine when a government has fiduciary responsibility for a certain activity.
- **Accounting Standard Update – GASB Statement No. 87 – Leases** – GASB has issued GASB Statement No. 87 relating to accounting and financial reporting for leases. This new statement establishes a single model for lease accounting based on the principle that leases are financing of the right to use an underlying asset.

The following is an extensive summary 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. 84 – *FIDUCIARY ACTIVITIES*

The objective of this Statement is to improve guidance regarding the identification of fiduciary activities for accounting and financial reporting purposes and how those activities should be reported.

This Statement establishes criteria for identifying fiduciary activities of all state and local governments. The focus of the criteria generally is on (1) whether a government is controlling the assets of the fiduciary activity and (2) the beneficiaries with whom a fiduciary relationship exists. Separate criteria are included to identify fiduciary component units and postemployment benefit arrangements that are fiduciary activities. An activity meeting the criteria should be reported in a fiduciary fund in the basic financial statements. Governments with activities meeting the criteria should present a statement of fiduciary net position and a statement of changes in fiduciary net position. An exception to that requirement is provided for a business-type activity that normally expects to hold custodial assets for three months or less.

GASB Statement No. 84 describes four fiduciary funds that should be reported, if applicable: (1) pension (and other employee benefit) trust funds, (2) investment trust funds, (3) private-purpose trust funds, and (4) custodial funds. Custodial funds generally should report fiduciary activities that are not held in a trust or equivalent arrangement that meets specific criteria.

This Statement also provides for recognition of a liability to the beneficiaries in a fiduciary fund when an event has occurred that compels the government to disburse fiduciary resources. Events that compel a government to disburse fiduciary resources occur 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.

ACCOUNTING STANDARD UPDATE – GASB STATEMENT NO. 84 – *FIDUCIARY ACTIVITIES* (CONTINUED)

GASB Statement No. 84 is effective for reporting periods beginning after December 15, 2018. Earlier application is encouraged.

Information provided above was obtained from www.gasb.org.

ACCOUNTING STANDARD UPDATE – GASB STATEMENT NO. 87 – *LEASES*

The objective of this Statement is to better meet the information needs of financial statement users by improving accounting and financial reporting for leases by governments. This Statement increases the usefulness of governments' financial statements by requiring recognition of certain lease assets and liabilities for leases that previously were classified as operating leases and recognized as inflows of resources or outflows of resources based on the payment provisions of the contract. It establishes a single model for lease accounting based on the foundational principle that leases are financings of the right to use an underlying asset. Under this Statement, a lessee is required to recognize a lease liability and an intangible right-to-use lease asset, and a lessor is required to recognize a lease receivable and a deferred inflow of resources, thereby enhancing the relevance and consistency of information about governments' leasing activities.

A lease is defined as a contract that conveys control of the right to use another entity's nonfinancial asset (the underlying asset) as specified in the contract for a period of time in an exchange or exchange-like transaction. Examples of nonfinancial assets include buildings, land, vehicles, and equipment. Any contract that meets this definition should be accounted for under the leases guidance, unless specifically excluded in this Statement.

A short-term lease is defined as a lease that, at the commencement of the lease term, has a maximum possible term under the lease contract of 12 months (or less), including any options to extend, regardless of their probability of being exercised. Lessees and lessors should recognize short-term lease payments as outflows of resources or inflows of resources, respectively, based on the payment provisions of the lease contract.

A lessee should recognize a lease liability and a lease asset at the commencement of the lease term, unless the lease is a short-term lease or it transfers ownership of the underlying asset. The lease liability should be measured at the present value of payments expected to be made during the lease term (less any lease incentives). The lease asset should be measured at the amount of the initial measurement of the lease liability, plus any payments made to the lessor at or before the commencement of the lease term and certain direct costs. A lessee should reduce the lease liability as payments are made and recognize an outflow of resources (for example, expense) for interest on the liability. The lessee should amortize the lease asset in a systematic and rational manner over the shorter of the lease term or the useful life of the underlying asset. The notes to financial statements should include a description of leasing arrangements, the amount of lease assets recognized, and a schedule of future lease payments to be made.

ACCOUNTING STANDARD UPDATE – GASB STATEMENT NO. 87 – *LEASES* (CONTINUED)

A lessor should recognize a lease receivable and a deferred inflow of resources at the commencement of the lease term, with certain exceptions for leases of assets held as investments, certain regulated leases, short-term leases, and leases that transfer ownership of the underlying asset. A lessor should not derecognize the asset underlying the lease. The lease receivable should be measured at the present value of lease payments expected to be received during the lease term. The deferred inflow of resources should be measured at the value of the lease receivable plus any payments received at or before the commencement of the lease term that relate to future periods. A lessor should recognize interest revenue on the lease receivable and an inflow of resources (for example, revenue) from the deferred inflows of resources in a systematic and rational manner over the term of the lease. The notes to financial statements should include a description of leasing arrangements and the total amount of inflows of resources recognized from leases.

GASB Statement No. 87 is effective for reporting periods beginning after December 15, 2019. Earlier application is encouraged.

Information provided above was obtained from www.gasb.org.