

City of Homer, Alaska

AUDIT WRAP UP

December 31, 2017



The following communication was prepared as part of our audit, has consequential limitations, and is intended solely for the information and use of those charged with governance (e.g., Governing Board and Audit Committee) and, if appropriate, management of the Government and is not intended and should not be used by anyone other than these specified parties.

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XXXX, 2018

Honorable Mayor and City Council
City of Homer, Alaska

Professional standards require us to communicate with you regarding matters related to the audit, that are, in our professional judgment, significant and relevant to your responsibilities in overseeing the financial reporting process of City of Homer, Alaska (the City) as of and for the year ended December 31, 2017.

This communication is intended to elaborate on the significant findings from our audit, including our views on the qualitative aspects of the City's accounting practices and policies, management's judgments and estimates, financial statement disclosures, and other required matters.

We are pleased to be of service to the City and look forward to meeting with you to discuss our audit findings, as well as other matters that may be of interest to you, and to answer any questions you might have.

Respectfully,

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Discussion Outline

	Page
Status of Our Audit	3
Results of Our Audit	4
Internal Control Over Financial Reporting	5
Other Required Communications	7
Independence Communication	8
Significant Accounting and Reporting Matters.....	9
Attachments	13

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Status of Our Audit

We have completed our audit of the financial statements and federal awards as of and for the year ended December 31, 2017. Our audit was conducted in accordance with auditing standards generally accepted in the United States of America and *Government Auditing Standards*. This audit of the financial statements does not relieve management or those charged with governance of their responsibilities.

- ▶ The objective of our audit was to obtain reasonable - not absolute - assurance about whether the financial statements are free from material misstatements whether due to error or fraud.
- ▶ The scope of the work performed was substantially the same as that described to you in our earlier Audit Planning communications.
- ▶ We have issued an unmodified opinion on the financial statements and released our report on **XXXX, 2018**.
- ▶ We have issued an unmodified opinion on compliance requirements that could have a direct and material effect on each major federal program.
- ▶ Our responsibility for other information in documents containing the City's audited financial statements does not extend beyond the financial information identified in the audit report, and we are not required to perform procedures to corroborate such other information. However, in accordance with professional standards, we have read the information included by the City and considered whether such information, or the manner of its presentation, was materially inconsistent with its presentation in the financial statements. Our responsibility also includes calling to management's attention any information that we believe is a material misstatement of fact. We have not identified any material inconsistencies or concluded there are any material misstatements of facts in the other information that management has chosen not to correct.
- ▶ All records and information requested by BDO were freely available for our inspection.
- ▶ Management's cooperation was excellent. We received full access to all information that we requested while performing our audit, and we acknowledge the full cooperation extended to us by all levels of City personnel throughout the course of our work.

Results of Our Audit

ACCOUNTING PRACTICES, POLICIES, AND ESTIMATES

The following summarizes the more significant required communications related to our audit concerning the City's accounting practices, policies, and estimates:

The City's significant accounting practices and policies are those included in Note 1 to the financial statements. These accounting practices and policies are appropriate, comply with generally accepted accounting principles and industry practice, were consistently applied, and are adequately described within Note 1 to the financial statements.

- ▶ A summary of recently issued accounting pronouncements is included in Note 15 to the City's financial statements.
- ▶ There were no changes in significant accounting policies and practices during 2017.

Significant estimates are those that require management's most difficult, subjective, or complex judgments, often as a result of the need to make estimates about the effects of matters that are inherently uncertain. The City's significant accounting estimates, including a description of management's processes and significant assumptions used in development of the estimates, are disclosed in Note 1 of the financial statements.

Significant accounting estimates include:

Net Pension Liability - The Net Pension Liability is estimated based on actuarial information and actual contribution data provided to the City by the PERS Plan Administrator.

- ▶ Management did not make any significant changes to the processes or significant assumptions used to develop the significant accounting estimates in 2017.

CORRECTED AND UNCORRECTED MISSTATEMENTS

There were 4 corrected misstatements, other than those that were clearly trivial, related to accounts and/or disclosures that we brought to the attention of management. These entries affected sales tax revenues, charges for services, receivables and cash. There were also reclassification entries and entries provided to us by the City after we received the trial balance. Please refer the schedule of adjustments included with the attached management representation letter.

There were also two proposed adjusting entries. Please refer to the schedule of Proposed Adjusting Journal Entries (PAJEs). We concur with management's assessment that the effects of not recording such adjustments are, both individually and in the aggregate, immaterial to the consolidated financial statements taken as a whole, considering both qualitative and quantitative factors. None of the proposed adjustments could potentially cause future-period financial statements to be materially misstated.

Internal Control Over Financial Reporting

QUALITY OF THE CITY'S FINANCIAL REPORTING

The following items represent required audit communications:

- ▶ Qualitative aspects of significant accounting policies and practices
 - We concur with the City's interpretation and application of generally accepted accounting principles and practices derived from the standards set by the Governmental Accounting Standards Board (GASB).
- ▶ Our conclusions regarding significant accounting estimates
 - The nature of the City's Operations reduces the need for numerous significant estimates within the accounting records. See comment about estimates above. We believe the City's estimates are reasonable in the circumstances.
- ▶ Significant unusual transactions
 - We did not identify any significant unusual items.
- ▶ Financial statement presentation
 - To our knowledge all necessary disclosures have been included in the footnotes to the financial statements.
- ▶ New accounting pronouncements
 - As noted on previous pages, the City did not adopt any new GASB statements during 2017.
- ▶ Alternative accounting treatments
 - We did not identify any accounting treatments that did not comply with generally accepted accounting principles and standards set by GASB.

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Internal Control Over Financial Reporting

We are required to communicate, in writing and in a timely manner, to those charged with governance all material weaknesses and significant deficiencies that have been identified in the City's internal controls over financial reporting. The definitions of control deficiency, significant deficiency and material weakness follow:

Category	Definition
Deficiency in Internal Control	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.
Significant Deficiency	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.
Material Weakness	A deficiency or 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.

In conjunction with our audit of the financial statements, we noted no material weaknesses.

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Other Required Communications

Following is a summary of those required items, along with specific discussion points as they pertain to the City:

Requirement	Discussion Points
Significant changes to planned audit strategy or significant risks initially identified	There were no significant changes to the planned audit strategy or significant risks initially identified and previously communicated to those charged with governance as part of our Audit Planning communications.
Obtain information from those charged with governance relevant to the audit	There were no matters noted relevant to the audit, including, but not limited to: violations or possible violations of laws or regulations; risk of material misstatements, including fraud risks; or tips or complaints regarding the City's financial reporting that we were made aware of as a result of our inquiry of those charged with governance.
Nature and extent of specialized skills or knowledge needed related to significant risks	There were no specialized skills or knowledge needed, outside of the core engagement team, to perform the planned audit procedures or evaluate audit results related to significant risks.
Consultations with other accountants	We are not aware of any consultations about significant accounting or auditing matters between management and other accountants where we have identified a concern regarding such matters.
Our evaluation of the City's relationships and transactions with related parties and their impact on the financial statements	We have evaluated the City's process to identify, authorize and approve, account for, and disclose its relationships and transactions with related parties and noted no significant issues.
Disagreements with management	There were no disagreements with management about matters, whether or not satisfactorily resolved, that individually or in aggregate could be significant to the City's financial statements or to our auditor's report.
Significant difficulties encountered during the audit	The City did not properly reconcile all its general ledger accounts on a timely basis and delayed the issuance of the financial statements. We received 14 journal entries on September 10, 2018 that we needed to post and the run through our audit work papers.
Other matters significant to the oversight of the City's financial reporting process, including complaints or concerns regarding accounting or auditing matters	There are no other matters that we consider significant to the oversight of the City's financial reporting process that have not been previously communicated.
Representations requested from management	Please refer to the management representation letter.

Independence Communication

Our engagement letter to you dated March 7, 2018 describes our responsibilities in accordance with professional standards, certain regulatory authorities, and *Government Auditing Standards* with regard to independence and the performance of our services. This letter also stipulates the responsibilities of the City with respect to independence as agreed to by the City. Please refer to that letter for further information.

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Significant Accounting and Reporting Matters

GASB STANDARDS EFFECTIVE IN 2018

GASB STATEMENT NO. 75, *ACCOUNTING AND FINANCIAL REPORTING FOR POSTEMPLOYMENT BENEFITS OTHER THAN PENSIONS*

- ▶ Establishes measurement criteria for the Other Postemployment Benefits (OPEB) liability of state and local governments and mirrors the requirements of GASB 68.
- ▶ For plans administered through a trust, governments must recognize the net OPEB liability.
- ▶ For plans not administered through a trust, the government must recognize the total OPEB liability.
- ▶ The pronouncement will be effective starting with years ending June 30, 2018.

GASB STATEMENT NO. 85, *OMNIBUS 2017*

- ▶ Addresses several practice issues that have been identified during implementation of certain GASB Statements:
 1. Blending a component unit when the primary government is a business-type activity that reports in a single column.
 2. Reporting amounts previously reported as goodwill and negative goodwill.
 3. Classifying real estate held by insurance entities.
 4. Measuring certain money market instruments at amortized cost.
 5. Timing of the measurement of pension or OPEB liabilities and expenditures in governmental fund financial statements.
 6. Recognizing on-behalf payments for pensions or OPEB in employer financial statements.
 7. Presenting payroll-related measures in Required Supplementary Information for OPEB plans and employers that provide OPEB.
 8. Classifying employer-paid member contributions for OPEB.
 9. Simplifying certain aspects of the alternative measurement method for OPEB.
 10. Accounting and reporting for OPEB provided through certain multiple-employer defined benefit OPEB plans.
- ▶ The pronouncement will be effective starting with years ending June 30, 2018.

GASB STATEMENT NO. 86, *CERTAIN DEBT EXTINGUISHMENT ISSUES*

- ▶ Resolves issue of how to record in-substance defeasance of debt when only existing resources are used.
- ▶ Current standards only address reporting requirements when debt is extinguished using bond proceeds.
- ▶ When cash or other existing resources are placed in an irrevocable trust to extinguish debt, it is considered to be in-substance defeasance, assuming all criteria are met.
- ▶ The difference between the reacquisition price and the net carrying amount of the debt will be recognized as a separately identified gain or loss in the period of defeasance. This differs from current practice when debt is extinguished using bond proceeds, whereby the difference is deferred.
- ▶ Payments to the escrow agent from existing resources should be reported as debt service expenditures in governmental fund types.
- ▶ The pronouncement will be effective starting with years ending June 30, 2018.

Significant Accounting and Reporting Matters

GASB STANDARDS EFFECTIVE IN 2019

GASB STATEMENT NO. 83, *CERTAIN ASSET RETIREMENT OBLIGATIONS*

- ▶ Establishes measurement criteria for recording a liability for the retirement or removal of certain assets such as:
 - ✓ Nuclear power plants
 - ✓ Sewage treatment facilities
 - ✓ Coal-fired power plant
 - ✓ Wind turbines
 - ✓ X-ray machines
- ▶ Governments with legal obligations to perform future asset retirement activities related to its tangible capital assets would be required to recognize a liability.
- ▶ A liability and corresponding deferred outflow is recorded when the liability is both incurred and reasonable estimable.
- ▶ The liability is based on the best estimate of the current value of outlays expected to be incurred.
- ▶ Must be both an external obligating event, such as a court judgment or federal, state or local law; and an internal obligating event, such as contamination or retirement.
- ▶ The pronouncement will be effective starting with years ending June 30, 2019.

GASB STATEMENT NO. 84, *FIDUCIARY ACTIVITIES*

- ▶ Establishes criteria for reporting fiduciary activities that focuses on whether the government controls the assets and the fiduciary relationship with the beneficiaries.
- ▶ The statement describes four fiduciary funds:
 1. Pension and OPEB funds
 2. Investment trust funds
 3. Private-purpose trust funds
 4. Custodial funds
- ▶ Custodial funds replace agency funds for activities that are not held in trust.
- ▶ For activities for which a trust agreement exists, an investment trust fund or private purpose trust fund will be used.
- ▶ Pension funds not held in trust would be classified as custodial funds.
- ▶ GASB is working on an Implementation Guide for which an Exposure Draft likely will be issued in December 2018.
- ▶ The pronouncement will be effective starting with years ending December 31, 2019.

Significant Accounting and Reporting Matters

GASB STANDARDS EFFECTIVE IN 2019, CONTINUED

GASB STATEMENT 88, CERTAIN DISCLOSURES RELATED TO DEBT, INCLUDING DIRECT BORROWINGS AND DIRECT PLACEMENTS

- ▶ Defines debt for purposes of disclosure as a liability that arises from a contractual obligation to pay cash or other assets in one or more payments to settle an amount that is fixed as of the date the obligation is established.
- ▶ Would exclude pension and OPEB liabilities, leases and accounts payable as those should be disclosed in separate notes.
- ▶ Includes capital appreciation bonds and variable rate debt.
- ▶ Additional note disclosures required for unused lines of credit, assets pledged as collateral, specific debt agreement terms.
- ▶ The pronouncement will be effective starting with years ending June 30, 2019.

GASB EXPOSURE DRAFT, ACCOUNTING AND REPORTING FOR MAJORITY EQUITY INTERESTS

- ▶ Will report majority equity interest as an investment if it meets the definition.
- ▶ Measured using the equity method, unless held by a special-purpose government engaged only in fiduciary activities, fiduciary fund or endowment/permanent fund. These funds would utilize fair value.
- ▶ For all other majority equity interests, report as component unit and fund that holds the equity interest reports an asset using the equity method.
- ▶ Acquisition of a component unit in which government holds 100% interest would be measured using acquisition value.
- ▶ Expected effective date: Years ending December 31, 2019.

GASB EXPOSURE DRAFT, ACCOUNTING FOR INTEREST COST DURING PERIOD OF CONSTRUCTION

- ▶ In financial statements using the economic resources measurement focus, interest incurred during construction should be recognized as an expense of the period.
- ▶ In financial statements using the current financial resources measurement focus, interest incurred during construction should be recognized as an expenditure.
- ▶ Interest cost should not be capitalized.
- ▶ Interest does not meet the definition of an asset or a deferred outflow.
- ▶ Expected effective date: Years ending December 31, 2019.

Significant Accounting and Reporting Matters

GASB STANDARDS EFFECTIVE IN 2020

GASB STATEMENT NO. 87, *LEASES*

- ▶ This standard will require recognition of certain lease assets and liabilities for leases that are currently classified as operating leases.
- ▶ Eliminates the distinction between operating and capital leases - all leases will be recorded on the statement of net position/balance sheet.
- ▶ New definition of a lease - a contract that conveys the right to use another entity's nonfinancial asset for a period of time in an exchange or exchange-like transaction.
- ▶ Excludes leases that transfer ownership under a bargain purchase option or service concession arrangements that are covered by GASB Statement No. 60.
- ▶ Lessees would recognize a lease liability and an intangible right-to-use lease asset which would be amortized in a systematic and reasonable manner over the shorter of the lease term or the useful life of the underlying asset. Short-term leases are excluded.
- ▶ Lessors would recognize lease receivable and deferred inflow of resources which would be recognized as revenue in a systematic and rational manner over the term of the lease.
- ▶ The pronouncement will be effective starting with years ending December 31, 2020.

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Attachments

- ▶ Schedule of Proposed Adjusting Journal Entries
- ▶ Management Representation Letter

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