DRAFT 05/12/2023

Reporting and insights from the 2022 audit:

Grand Rapids Public Utilities Commission

December 31, 2022

Executive summary

May 17, 2023

The Commissioners
Grand Rapids Public Utilities Commission
500 SE 4th Street
Grand Rapids, MN 55744

We have completed our audit of the financial statements of the Grand Rapids Public Utilities Commission (GRPUC) for the year ended December 31, 2022, and have issued our report thereon dated May 17, 2023. This letter presents communications required by our professional standards.

Your audit should provide you with confidence in your financial statements. The audit was performed based on information obtained from meetings with management, data from your systems, knowledge of GRPUC's operating environment and our risk assessment procedures. We strive to provide you clear, concise communication throughout the audit process and of the final results of our audit.

Additionally, we have included information on key risk areas GRPUC should be aware of in your strategic planning. We are available to discuss these risks as they relate to your organization's financial stability and future planning.

If you have questions at any point, please connect with us:

- Aaron Worthman, Partner: Aaron.Worthman@bakertilly.com or +1 (512) 975 7281
- Dan La Haye, Senior Manager: Dan.LaHaye@bakertilly.com or +1 (608) 240 2534

Sincerely,

Baker Tilly US, LLP

Aaron Worthman, CPA

Dan La Haye, CPA

Responsibilities

Our responsibilities

As your independent auditor, our responsibilities include:

- Planning and performing the audit to obtain reasonable assurance about whether the financial statements are free from material misstatement. Reasonable assurance is a high level of assurance.
- Assessing the risks of material misstatement of the financial statements, whether due to fraud or error. Included in that assessment is a consideration of GRPUC's internal control over financial reporting.
- Performing appropriate procedures based upon our risk assessment.
- Evaluating the appropriateness of the accounting policies used and the reasonableness of significant accounting estimates made by management.
- Forming and expressing an opinion based on our audit about whether the financial statements prepared by management, with the oversight of the Commissioners:
    - Are free from material misstatement
    - Present fairly, in all material respects and in accordance with accounting principles generally accepted in the United States of America
- Our audit does not relieve management or the Commissioners of their responsibilities.

We are also required to communicate significant matters related to our audit that are relevant to the responsibilities of the Commissioners, including:

- Internal control matters
- Qualitative aspects of GRPUC's accounting practice including policies, accounting estimates and financial statement disclosures
- Significant unusual transactions
- Significant difficulties encountered
- Disagreements with management
- Circumstances that affect the form and content of the auditors' report
- Audit consultations outside the engagement team
- Corrected and uncorrected misstatements
- Other audit findings or issues

Audit status

Significant changes to the audit plan

There were no significant changes made to either our planned audit strategy or to the significant risks and other areas of emphasis identified during the performance of our risk assessment procedures.

Audit approach and results

Planned scope and timing

Audit focus

Based on our understanding of the GRPUC and environment in which you operate, we focused our audit on the following key areas:

- Key transaction cycles
- Areas with significant estimates
- Implementation of new accounting standards

Our areas of audit focus were informed by, among other things, our assessment of materiality. Materiality in the context of our audit was determined based on specific qualitative and quantitative factors combined with our expectations about GRPUC's current year results.

Key areas of focus and significant findings

Significant risks of material misstatement

A significant risk is an identified and assessed risk of material misstatement that, in the auditor's professional judgment, requires special audit consideration. Within our audit, we focused on the following areas below.

Significant risk areas	Testing approach	Conclusion
Management override of controls	Incorporate unpredictability into audit procedures, emphasize professional skepticism and utilize audit team with industry expertise	Procedures identified provided sufficient evidence for our audit opinion
Improper revenue recognition due to fraud	Validation of certain revenues supplemented with detailed predictive analytics based on non-financial data and substantive testing of related receivables	Procedures identified provided sufficient evidence for our audit opinion

Other areas of emphasis

We also focused on other areas that did not meet the definition of a significant risk, but were determined to require specific awareness and a unique audit response.

Other areas of emphasis		
Cash and investments	Revenues and receivables	General disbursements
Landfill post closure costs	Pension liability	Long-term debt
Capital assets	Net position calculations	Financial reporting and required disclosures

Internal control matters

We considered GRPUC's internal control over financial reporting as a basis for designing our audit procedures for the purpose of expressing an opinion on the financial statements. We are not expressing an opinion on the effectiveness of GRPUC'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 combination of deficiencies in internal control such that there is a reasonable possibility that a material misstatement of the entity's financial statements will not be prevented, or detected and corrected, on a timely basis. We identified the following deficiency as a material weakness.

During the audit, a material misstatement was identified in the general ledger relative to recognition of grant revenues. During our testing, we noted a FEMA grant was awarded in December 2022; however, no funds were received and no allowable costs had yet to be incurred. The result was an overstatement of grant revenue and accounts receivable by $412,000. We recommend GRPUC review grant agreements and the related allowable costs in order to assess and properly account for revenue recognition.

Due to the identification of a material journal entry as described above, we need to communicate a material weakness relative to financial reporting.

Required communications

Qualitative aspect of accounting practices

- Accounting policies: Management is responsible for the selection and use of appropriate accounting policies. In accordance with the terms of our engagement letter, we have advised management about the appropriateness of accounting policies and their application. The significant accounting policies used by GRPUC are described in Note 1 to the financial statements. As described in Note 1, GRPUC changed accounting policies related to lease accounting by adopting GASB Statement No. 87, *Leases* effective January 1, 2022. We noted no transactions entered into by GRPUC during the year for which accounting policies are controversial or for which there is a lack of authoritative guidance or consensus or diversity in practice.

- Accounting estimates: Accounting estimates, including fair value 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, the degree of subjectivity involved in their development and because of the possibility that future events affecting them may differ significantly from those expected. The following estimates are of most significance to the financial statements:

Estimate	Management's process to determine	Baker Tilly's conclusions regarding reasonableness
Landfill closure/post closure liabilities	Evaluation of changes in assumptions, provided by management, from the closure cost study prepared by an external specialist	Reasonable in relation to the financial statements as a whole
Net pension liability and related deferrals	Evaluation of information provided by the Minnesota Public Employees Retirement Association	Reasonable in relation to the financial statements as a whole
Allowance for doubtful accounts	Evaluation of historical revenues and loss levels with the analysis on collectability of individual amounts	Reasonable in relation to the financial statements as a whole
Depreciation	Evaluate estimated useful life of the asset and original acquisition value	Reasonable in relation to the financial statements as a whole
Lease receivable and related deferred inflow	Evaluation of leases by management and incremental borrowing rate used for present value calculation	Reasonable in relation to the financial statements as a whole

There have been no significant changes made by management to either the processes used to develop the particularly sensitive accounting estimates, or to the significant assumptions used to develop the estimates, noted above.

- Financial statement disclosures: The disclosures in the financial statements are neutral, consistent and clear.

Significant unusual transactions

There have been no significant transactions that are outside the normal course of business for GRPUC or that otherwise appear to be unusual due to their timing, size or nature.

Significant difficulties encountered during the audit

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

Disagreements with management

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 that could be significant to the financial statements or the auditors' report. We are pleased to report that no such disagreements arose during the course of our audit.

Audit report

There have been no departures from the auditors’ standard report.

Audit consultations outside the engagement team

We encountered no difficult or contentious matters for which we consulted outside of the engagement team.

Uncorrected misstatements and corrected misstatements

Professional standards require us to accumulate misstatements identified during the audit, other than those that are clearly trivial, and to communicate accumulated misstatements to management. The schedule within the Appendix summarizes the uncorrected misstatements, other than those that are clearly trivial, that we presented to management and the material corrected misstatements that, in our judgment, may not have been detected except through our auditing procedures. The internal control matters section of this report describes the effects on the financial reporting process indicated by the uncorrected misstatements and corrected misstatements, other than those that we consider to be of a lesser magnitude than significant deficiencies and material weaknesses.

Management has determined that the effects of the uncorrected misstatements are immaterial, both individually and in the aggregate, to the financial statements as a whole. The uncorrected misstatements or the matters underlying them could potentially cause future period financial statements to be materially misstated, even though, in our judgment, such uncorrected misstatements are immaterial to the basic financial statements under audit.

Other audit findings or issues

We encountered no other audit findings or issues that require communication at this time.

We generally discuss a variety of matters, including the application of accounting principles and auditing standards, with management each year prior to retention as GRPUC'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 information in documents containing audited basic financial statements

GRPUC's audited financial statements will be included in the Annual Comprehensive Financial Report (ACFR). Our responsibility for this information does not extend beyond the financial information identified in the audit report, and we are not required to perform any procedures to corroborate such other information. We have read the Introductory Section and Statistical Section of the ACFR to determine whether a material inconsistency exists between the other information and the financial statements. Nothing came to our attention that caused us to believe that such information, or its manner of presentation, was materially inconsistent with the information, or manner of its presentation, in the financial statements.

GRPUC's audited financial statements are "general purpose" financial statements. General purpose financial statements consist of the basic financial statements that can be used by a broad group of people for a broad range of activities. Once we have issued our audit report, we have no further obligation to update our report for events occurring subsequent to the date of our report. GRPUC can use the audited financial statements in other client prepare documents, such as official statements related to the issuance of debt, without our acknowledgement. Unless we have been engaged to perform services in connection with any subsequent transaction requiring the inclusion of our audit report, as well as to issue an auditor's acknowledgment letter, we have neither read the document nor performed subsequent event procedures in order to determine whether or not our report remains appropriate.

Management's consultations with other accountants

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

Written communications between management and Baker Tilly

The Appendix includes copies of other material written communications, including a copy of the management representation letter.

Compliance with laws and regulations

We did not identify any non-compliance with laws and regulations during our audit.

Fraud

We did not identify any known or suspected fraud during our audit.

Going concern

Pursuant to professional standards, we are required to communicate to you, when applicable, certain matters relating to our evaluation of GRPUC's ability to continue as a going concern for a reasonable period of time but no less than 12 months from the date of the financial statements, including the effects on the financial statements and the adequacy of the related disclosures, and the effects on the auditor's report. No such matters or conditions have come to our attention during our engagement.

Independence

We are not aware of any relationships between Baker Tilly and the GRPUC that, in our professional judgment, may reasonably be thought to bear on our independence.

Related parties

We did not have any significant findings or issues arise during the audit in connection with GRPUC's related parties.

Other matters

We applied certain limited procedures to the required supplementary information (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.

We were engaged to report on the supplementary information which accompanies the basic financial statements but is not RSI. With respect to the 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 basic financial statements. We compared and reconciled the supplementary information to the underlying accounting records used to prepare the basic financial statements or to the basic financial statements themselves.

We were not engaged to report on the other information, which accompanies the basic financial statements but are not RSI. We did not audit or perform other procedures on this other information, and we do not express an opinion or provide any assurance on it.

Nonattest services

The following nonattest services were provided by Baker Tilly:

- Financial statement preparation
- Adjusting journal entries

None of these nonattest services constitute an audit under generally accepted auditing standards, including *Government Auditing Standards*.

Audit committee resources

Visit our resource page for regulatory updates, trending challenges and opportunities in your industry and other timely updates.

Visit the resource page at https://www.bakertilly.com/page/audit-committee-resource-center.

Management representation letter

Note: Signed Management Representation letter and PAJE Summary will follow here

Accounting changes relevant to Grand Rapids Public Utilities Commission

Future accounting standards update

GASB Statement Number	Description	Potentially Impacts You	Effective Date
94	Public-Private and Public-Public Partnerships and Availability Payment Arrangements	✓	12/31/23
96	Subscription-Based Information Technology Arrangements	✓	12/31/23
99	Omnibus 2022	✓	12/31/23
100	Accounting Changes and Error Corrections		12/31/24
101	Compensated Absences	✓	12/31/24

Further information on upcoming GASB pronouncements.

Determining if GASB 94 applies for your organization

GASB 94, *Public-Private and Public-Public Partnerships and Availability Payment Arrangements* provides guidance related to public-private and public-public partnerships (PPP) and availability payment arrangements (APA).

A PPP is an arrangement in which an entity contracts with an operator to provide public services by conveying control of the right to operate or use infrastructure or other capital asset. A common example of PPP is a service concession arrangement.

An APA is an arrangement in which an entity compensates an operator for services that may include designing, constructing, financing, maintaining, or operating an asset.

GRPUC should start to identify any contracts that could meet either definition to ensure they are reviewed for applicability and accounted for correctly when the standard is effective. Initial steps include reviewing contracts that didn't meet the definition of a lease under GASB 87 and identifying any other agreements where the organization contracts with or partners with another entity to provide services. Once these contracts or agreements are identified they will need to be analyzed using the criteria in GASB No. 94.

Future accounting for subscription-based IT arrangements

Subscription-based IT arrangements include contracts that convey control of the right to use another party's IT software. It would not include any licensing arrangements that provide a perpetual license, which would still be accounted for as an intangible asset. Subscription-based IT arrangements are becoming more and more popular with IT vendors. This standard mirrors the new lease standard. GRPUC will be able to utilize the systems put into place to implement the lease standard to properly account for these contracts. Common examples of these contracts in the utility industry include:

- Leasing space in the cloud
- GIS systems
- SCADA systems
- Some work order or inventory systems as well as some general ledger or billing systems

GRPUC should work with its IT department and department managers to determine a population listing of contracts that would fall under this standard to determine the potential future impact to financial reporting.

Two-way audit communications

As part of our audit of your financial statements, we are providing communications to you throughout the audit process. Auditing requirements provide for two-way communication and are important in assisting the auditor and you with more information relevant to the audit.

As this past audit is concluded, we use what we have learned to begin the planning process for next year's audit. It is important that you understand the following points about the scope and timing of our next audit:

a. We address the significant risks of material misstatement, whether due to fraud or error, through our detailed audit procedures.

b. We will obtain an understanding of the five components of internal control sufficient to assess the risk of material misstatement of the financial statements whether due to error or fraud, and to design the nature, timing and extent of further audit procedures. We will obtain a sufficient understanding by performing risk assessment procedures to evaluate the design of controls relevant to an audit of financial statements and to determine whether they have been implemented. We will use such knowledge to:

   - Identify types of potential misstatements.
   - Consider factors that affect the risks of material misstatement.
   - Design tests of controls, when applicable, and substantive procedures.

c. We will not express an opinion on the effectiveness of internal control over financial reporting or compliance with laws, regulations and provisions of contracts or grant programs.

d. The concept of materiality recognizes that some matters, either individually or in the aggregate, are important for fair presentation of financial statements in conformity with generally accepted accounting principles while other matters are not important. In performing the audit, we are concerned with matters that, either individually or in the aggregate, could be material to the financial statements. Our responsibility is to plan and perform the audit to obtain reasonable assurance that material misstatements, whether caused by errors or fraud, are detected.

Our audit will be performed in accordance with auditing standards generally accepted in the United States of America.

We are very interested in your views regarding certain matters. Those matters are listed here:

a. We typically will communicate with your top level of management unless you tell us otherwise.

b. We understand that the governing board has the responsibility to oversee the strategic direction of your organization, as well as the overall accountability of the entity. Management has the responsibility for achieving the objectives of the entity.

c. We need to know your views about your organization's objectives and strategies, and the related business risks that may result in material misstatements.

d. We anticipate that GRPUC will receive an unmodified opinion on its financial statements.

e. Which matters do you consider warrant particular attention during the audit, and are there any areas where you request additional procedures to be undertaken?

f. Have you had any significant communications with regulators or grantor agencies?

g. Are there other matters that you believe are relevant to the audit of the financial statements?

Also, is there anything that we need to know about the attitudes, awareness and actions of the governing body concerning:

a. The entity's internal control and its importance in the entity, including how those charged with governance oversee the effectiveness of internal control?

b. The detection or the possibility of fraud?

We also need to know if you have taken actions in response to developments in financial reporting, laws, accounting standards, governance practices, or other related matters, or in response to previous communications with us.

With regard to the timing of our audit, here is some general information. If necessary, we may do preliminary financial audit work during the months of October-December, and sometimes early in January. Our final financial fieldwork is scheduled during the spring to best coincide with your readiness and report deadlines. After fieldwork, we wrap up our financial audit procedures at our office and may issue drafts of our report for your review. Final copies of our report and other communications are issued after approval by your staff. This is typically 6-12 weeks after final fieldwork, but may vary depending on a number of factors.

Keep in mind that while this communication may assist us with planning the scope and timing of the audit, it does not change the auditor's sole responsibility to determine the overall audit strategy and the audit plan, including the nature, timing and extent of procedures necessary to obtain sufficient appropriate audit evidence.

We realize that you may have questions on what this all means, or wish to provide other feedback. We welcome the opportunity to hear from you.