

**City of Falcon Heights
Ramsey County, Minnesota**

Communications Letter

December 31, 2018

bergankDV

**City of Falcon Heights
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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
Sack Thongvanh, City Administrator
Roland Olson, Finance Director
City of Falcon Heights
Falcon Heights, Minnesota

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 of Falcon Heights, 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 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.

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 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 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 May 3, 2019, on such statements.

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

Bergan KDV Ltd .

Minneapolis, Minnesota
May 3, 2019

City of Falcon Heights Significant Deficiency

LACK OF SEGREGATION OF ACCOUNTING DUTIES

The City continued to evaluate and improve the segregation of accounting duties among City staff during 2018. Because of a limited number of office personnel, some areas of internal control still remain without proper segregation of accounting duties; however, we can report on the following processes. 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.

Revenue Cycle

The four areas of segregation in the revenue cycle include mailroom custody, treasurer custody, accounts receivable, and accounting.

We noted some overlap in the mailroom and treasurer custody, with one employee having job responsibilities in both areas.

We also noted overlapping duties between accounts receivable and accounting, in that the person responsible for accounts receivable also is responsible for bank reconciliations.

Purchasing Cycle

The five areas of segregation in the purchasing cycle include purchasing authorization, receiving authorization, accounts payable, treasurer responsibilities, and accounting.

We noted proper segregation between the responsibility of purchasing goods and services, the individual responsible for preparing the purchase order and the person responsible for approving the purchase order. However, we noted overlapping duties with the approval of purchase orders, input of invoices, and preparing of disbursements being performed by one individual.

Payroll Cycle

The five areas of segregation in the payroll cycle include human resources authorization, immediate supervisor authorization, payroll recording, paymaster custody, and accounting.

In addition to having responsibilities in payroll recording, paymaster custody, and accounting cycles noted above, the Finance Director has full general ledger access and the ability to write and post journal entries. While we believe this access is necessary to efficiently perform the financial duties required, this access has the ability to override many of the controls and segregation listed above.

Journal Entries

The three areas of segregation in journal entries include an employee to write the journal entry, another to post the entry, and finally another employee to review the entry.

We noted some journal entries were not approved by someone other than the person writing the entry.

We recommend a second review/approval to ensure accuracy.

**City of Falcon Heights
Significant Deficiency**

LACK OF SEGREGATION OF ACCOUNTING DUTIES (CONTINUED)

Bank Reconciliation Process

The two areas of segregation include an employee to prepare the cash reconciliation and another employee to review the reconciliation; ideally, the individual preparing the reconciliation has limited involvement in the revenue and purchasing cycles.

We noted The Finance Director has primary responsibility for bank reconciliations. These are generally delegated to other staff, however, still completed by the Finance Director to ensure accuracy.

We recommend each reconciliation be reviewed to help ensure accuracy.

City of Falcon Heights 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.

PLANNED SCOPE AND TIMING OF THE AUDIT

An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements; therefore, our audit involved judgment about the number of transactions to be examined and the areas to be tested.

Our audit included obtaining an understanding of the City and its environment, including internal control, sufficient to assess the risks of material misstatement of the financial statements and to design the nature, timing and extent of further audit procedures. Material misstatements may result from (1) errors, (2) fraudulent financial reporting, (3) misappropriation of assets, or (4) violations of laws or governmental regulations that are attributable to the City or to acts by management or employees acting on behalf of the City.

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.

City of Falcon Heights Required Communication

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.

Expense Allocation – Certain expenses are allocated to programs based on an estimate of the benefit to that particular program. Examples are salaries, benefits, and supplies.

Net Pension Liability, Deferred Outflows of Resources Related to Pensions, and Deferred Inflows of Resources Related 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.

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. We identified the following uncorrected misstatement of the financial statements. Management has determined its effect is immaterial, both individually and in the aggregate, to the financial statements taken as a whole.

**City of Falcon Heights
Required Communication**

UNCORRECTED AND CORRECTED MISSTATEMENTS (CONTINUED)

- Total Other Post Employment Benefits (OPEB) Liability

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

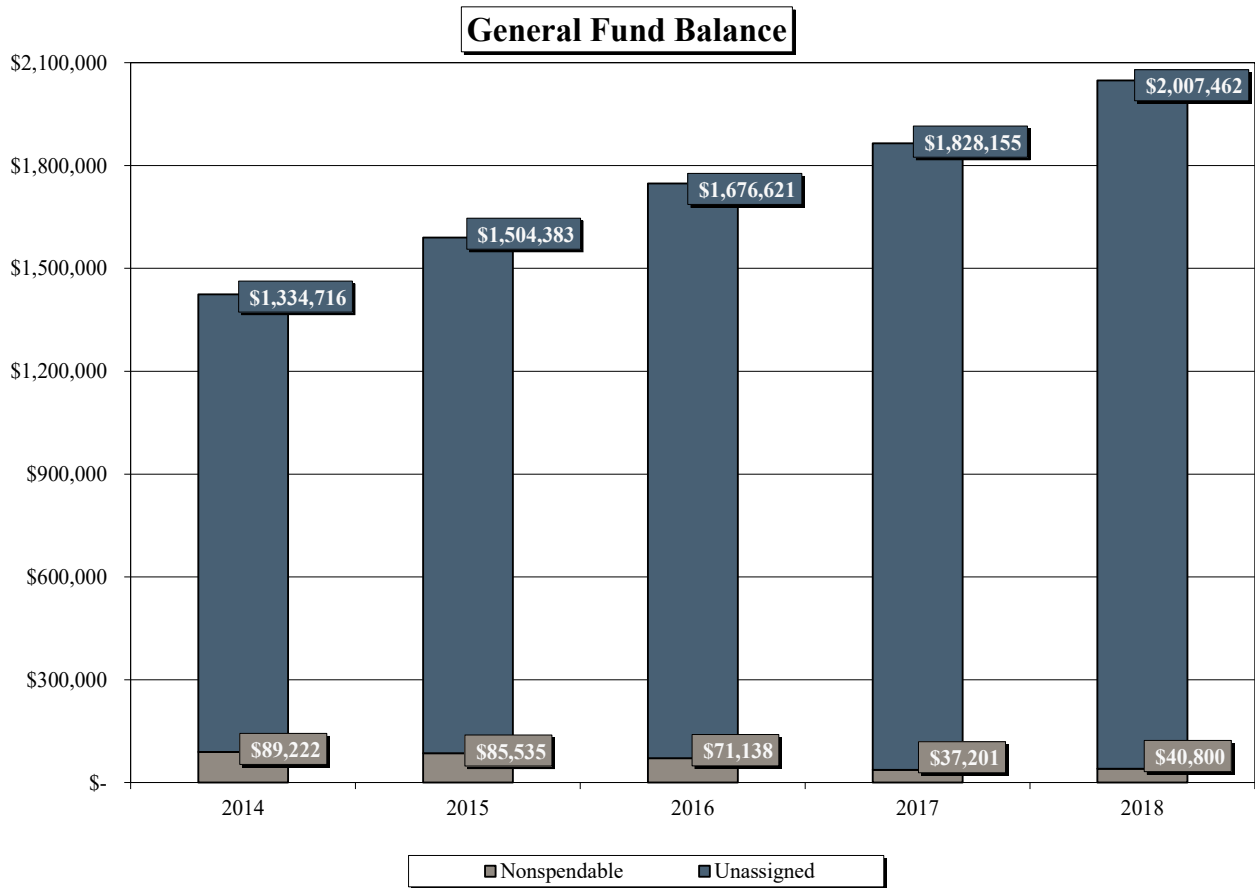
We applied certain limited procedures to the RSI that supplements the basic financial statements. Our procedures consisted of inquiries of management regarding the methods of preparing the information and comparing the information for consistency with management's responses to our inquiries, the basic 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.

City of Falcon Heights Financial Analysis

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

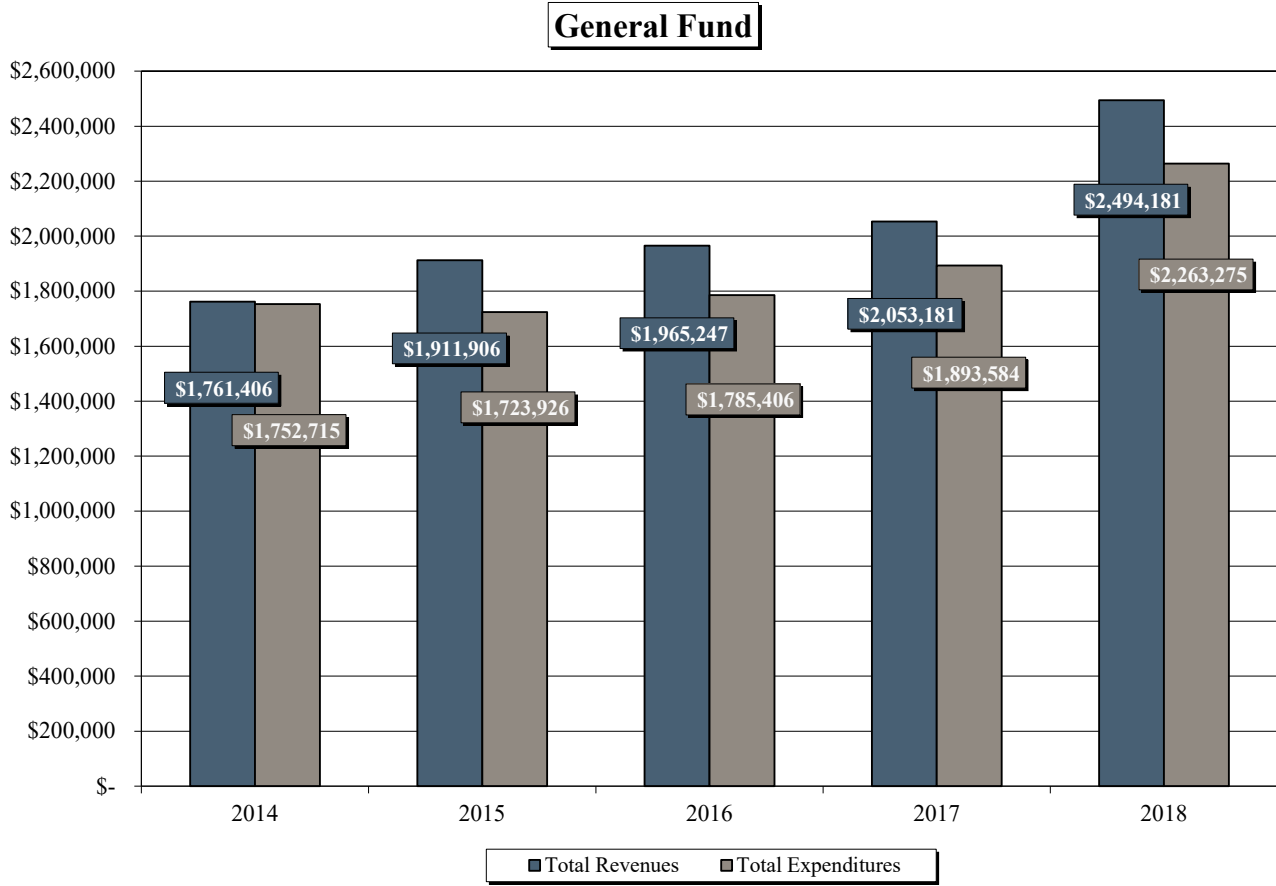
GENERAL FUND BALANCE

At December 31, 2018, the General Fund balance was \$2,048,262 which is an increase of \$182,806 from 2017. Based on current expenditure levels, the fund balance represents just under 11 months of expenditures.



City of Falcon Heights Financial Analysis

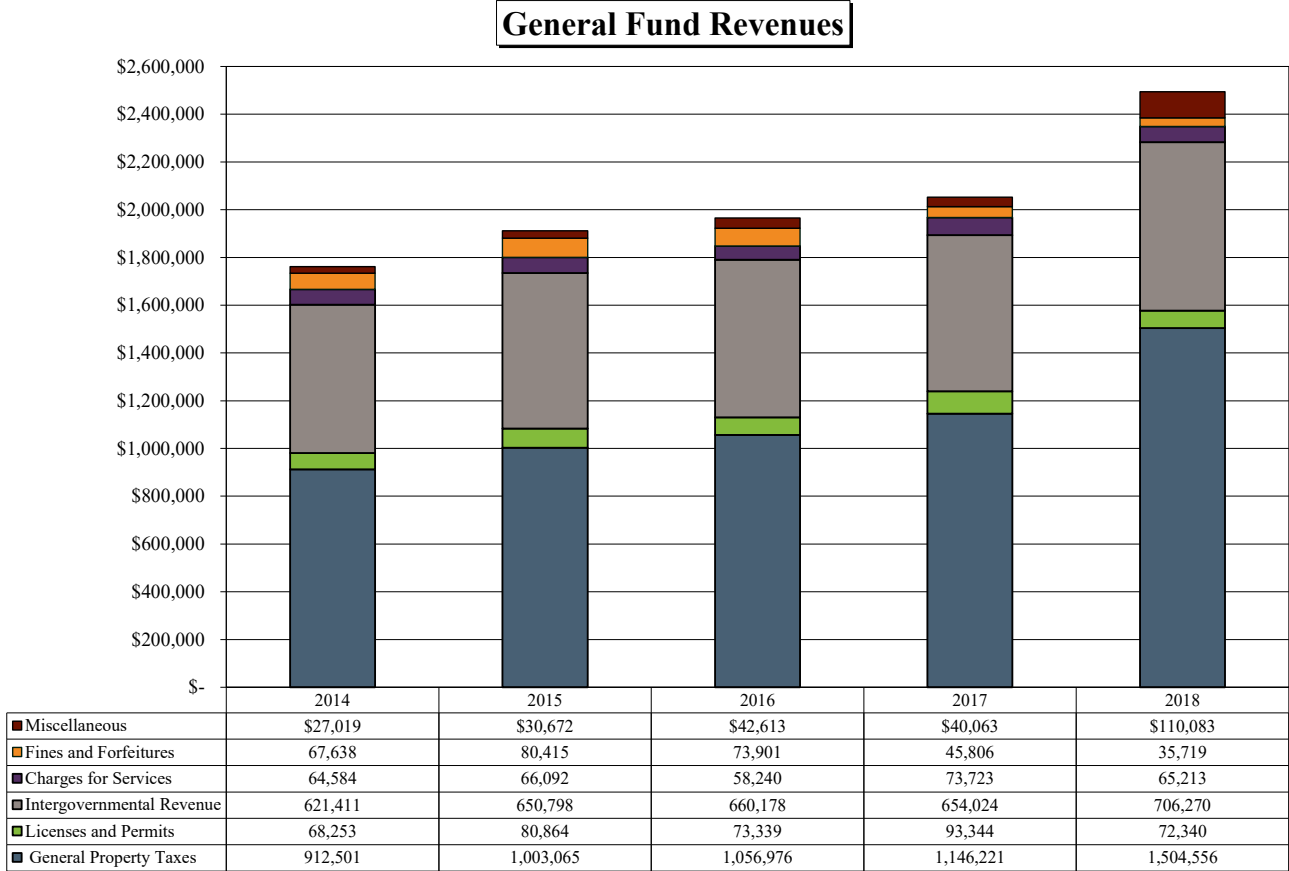
GENERAL FUND



General Fund revenues increased by \$441,000, or 21.5%, in 2018. Expenditures in the General Fund increased by \$369,691, or 19.5%, and resulted in total revenues exceeding expenditures by \$230,906. Further detailed explanations regarding variances will follow in subsequent charts.

City of Falcon Heights Financial Analysis

GENERAL FUND REVENUES



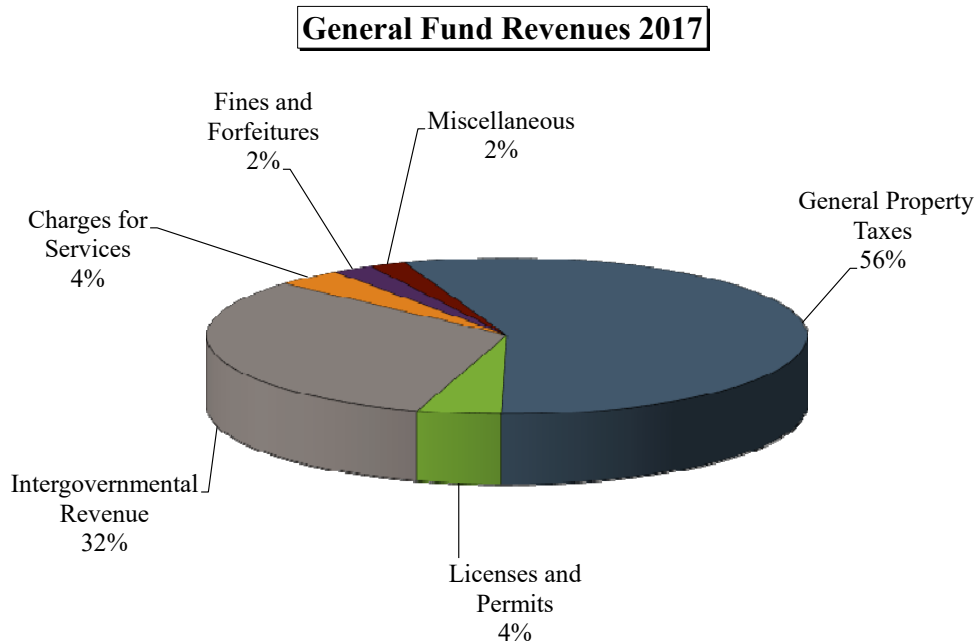
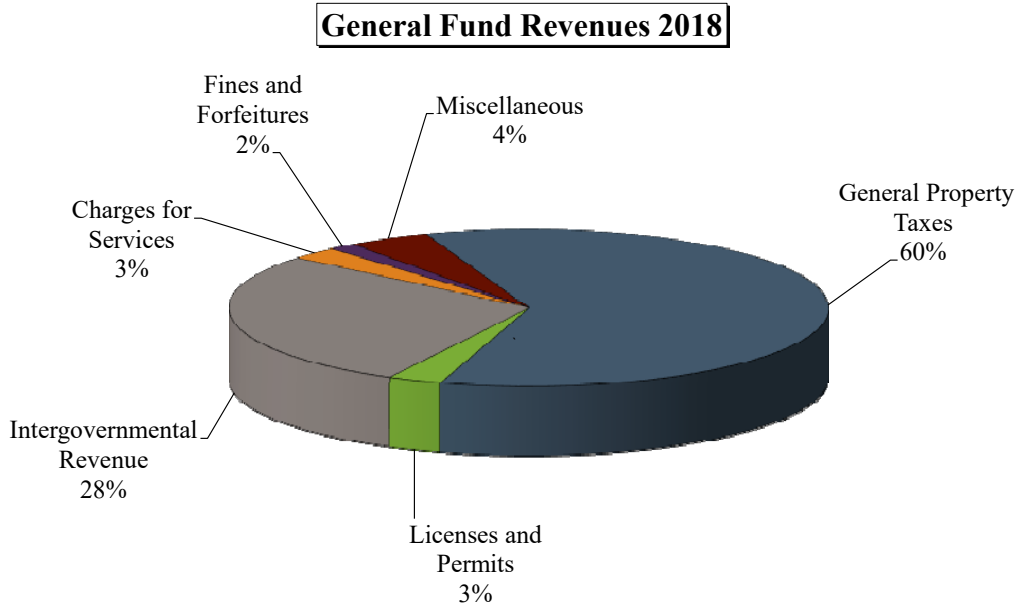
Property taxes increased \$358,335, or 31.3%, from 2017 due to an increase in the total amount levied in the fund in 2018. Intergovernmental revenues increased \$52,246 from the prior year, due to an increase in local government aid. Miscellaneous revenues increased \$70,020 in 2018 as a result of an increase in investment income and the City receiving a reimbursement from the State Fair for its share in police activity.

The other remaining General Fund revenues in 2018 stayed relatively consistent with the prior year.

City of Falcon Heights Financial Analysis

GENERAL FUND REVENUES (CONTINUED)

The following charts depict the components of the General Fund revenues by percentages.

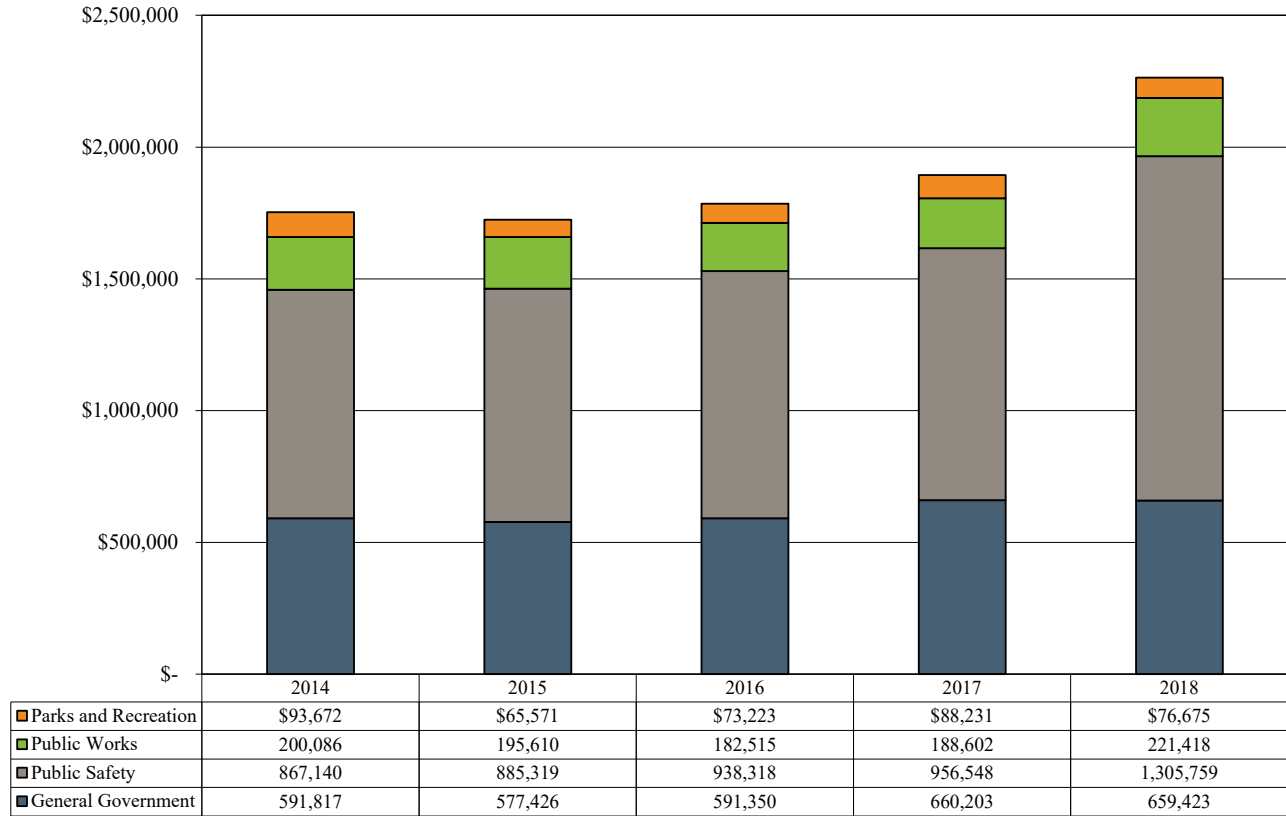


General Fund sources of revenue remained consistent in 2018 compared to 2017.

City of Falcon Heights Financial Analysis

GENERAL FUND EXPENDITURES

General Fund Expenditures



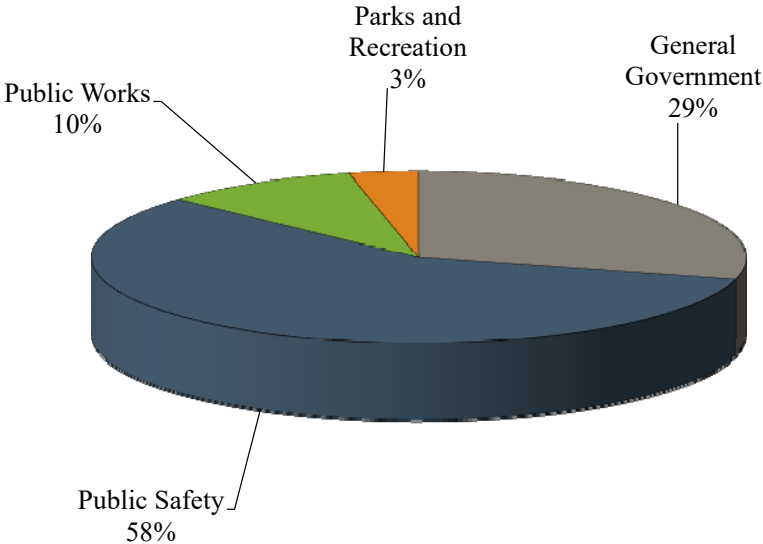
In 2018, expenditures increased \$369,691, or 19.5%, from 2017. Public safety expenditures increased \$349,211, or 36.5% in 2018. This increase was due to increasing police service charges from Ramsey County. Public works expenditures increased \$32,816, or 17.4% in 2018. This increase was due to more engineering fees in 2018 and an increase in snow removal costs.

Other expenditures stayed relatively consistent with the prior year.

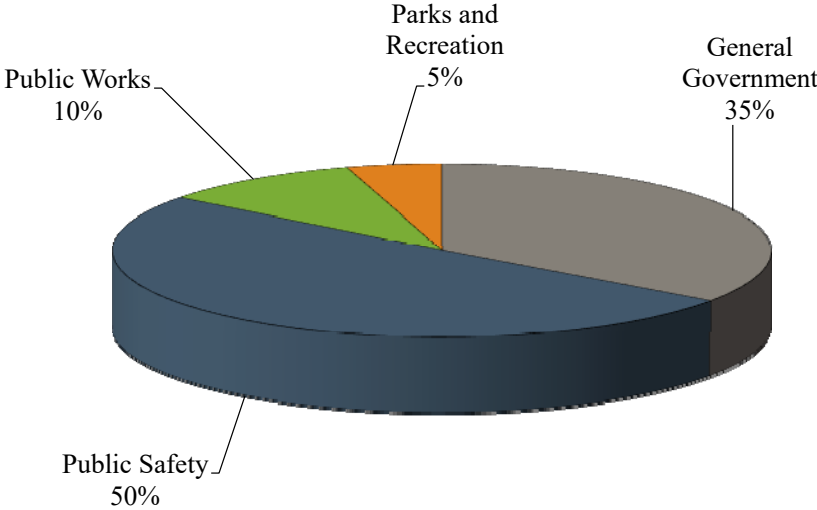
**City of Falcon Heights
Financial Analysis**

GENERAL FUND EXPENDITURES (CONTINUED)

General Fund Expenditures 2018



General Fund Expenditures 2017



**City of Falcon Heights
Financial Analysis**

GENERAL FUND BUDGET

	Original and Final Budget	Actual Amounts	Variance with Final Budget - Over (Under)
Revenues			
Taxes	\$ 1,487,059	\$ 1,504,556	\$ 17,497
Licenses and permits	67,450	72,340	4,890
Intergovernmental	727,291	706,270	(21,021)
Charges for services	58,810	65,213	6,403
Fines and forfeitures	50,000	35,719	(14,281)
Miscellaneous	15,200	110,083	94,883
Total revenues	2,405,810	2,494,181	88,371
Expenditures			
General government	712,141	659,423	(52,718)
Public safety	1,319,435	1,305,759	(13,676)
Public works	233,354	221,418	(11,936)
Parks and recreation	92,880	76,675	(16,205)
Total expenditures	2,357,810	2,263,275	(94,535)
Excess of receipts over disbursements	5,000	388,125	383,125
Other Financing Uses			
Transfers out	(48,000)	(48,000)	-
Net change in fund balance	\$ -	\$ 182,906	\$ 182,906

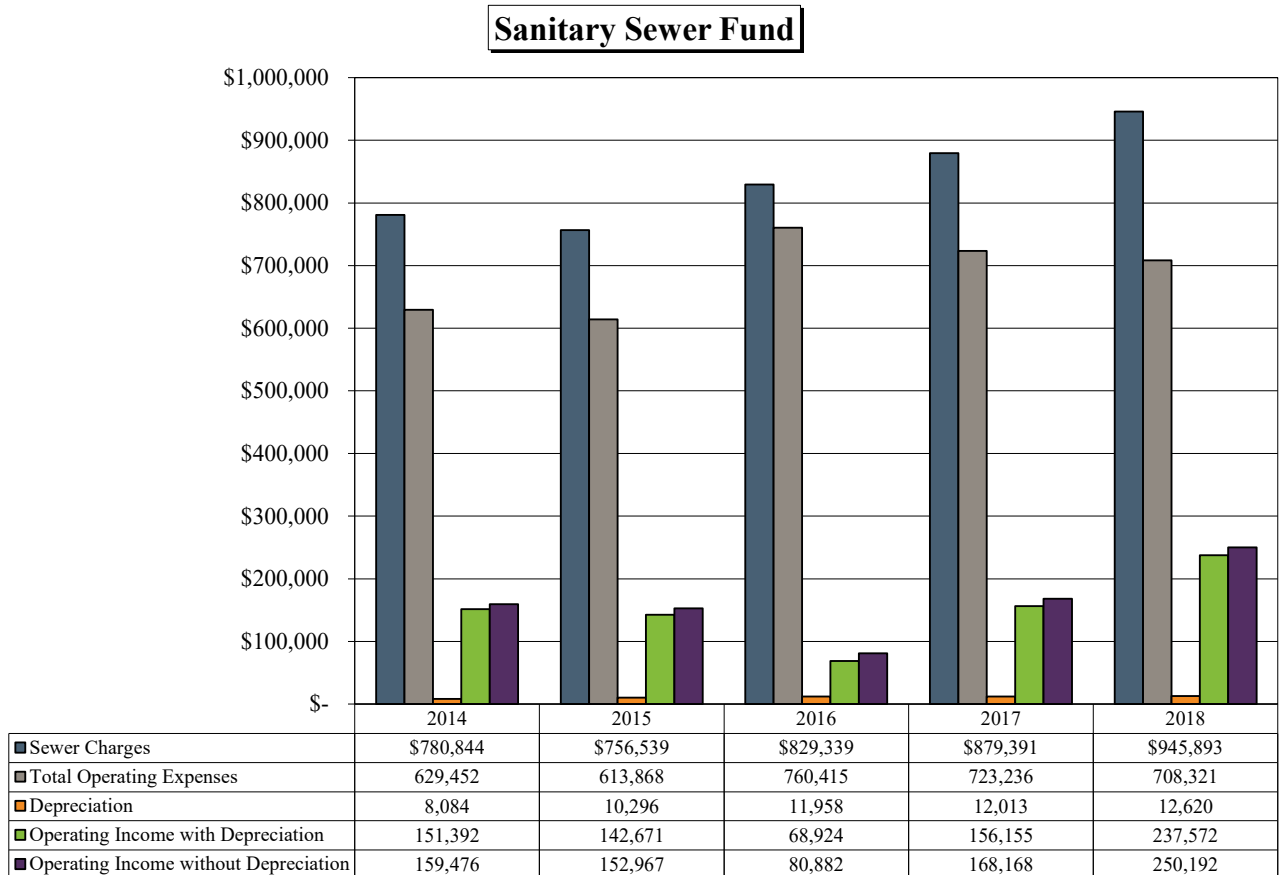
Overall, General Fund revenues were over budget by 3.7%, or \$88,371. The largest budget variance was in miscellaneous revenues, which exceeded budget amounts by \$94,883. This variance is a result of a conservative approach to the budget and receiving a reimbursement from the State Fair for its share of police activity. Other categories were relatively on budget.

Expenditures were under budget by \$94,535, or 4.0%. The largest variance was in general government, which was \$52,718 under budget. This variance was due to the administrator coordinator resigning in January 2018 and the position was vacant for a portion of the year. Other expenditures were closer to budgeted amounts.

**City of Falcon Heights
Financial Analysis**

SANITARY SEWER FUND

The graphs below and on the next page illustrate the current operations of the Sanitary Sewer and the Storm Drainage Funds.

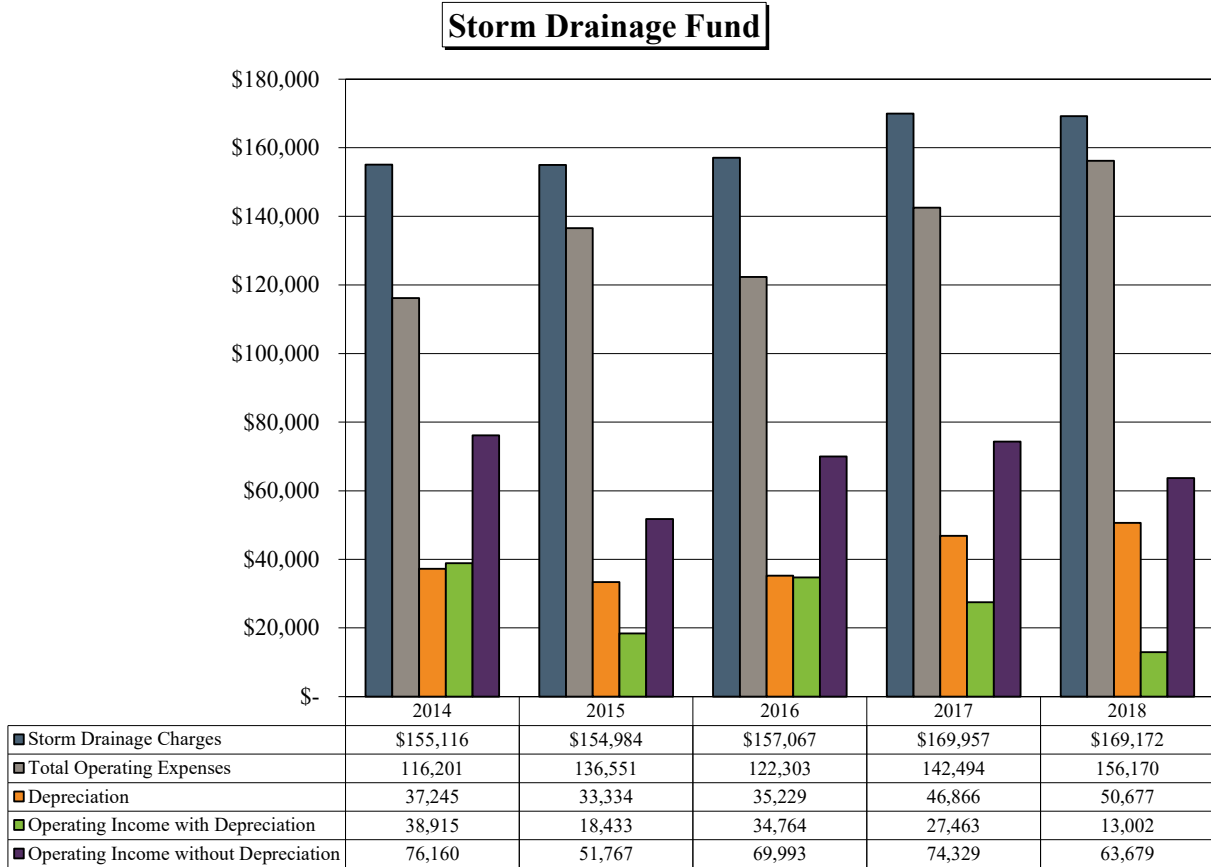


The Sanitary Sewer Fund realized operating income of \$237,572 during 2018. Sewer charges in 2018 increased by \$66,502 from 2017 due to receiving additional fees from the University of Minnesota. Expenses decreased \$14,915 due to a decrease in sewer charges from Met Council.

With an operating income of \$237,572, \$34,015 in nonoperating revenue, and \$230,000 in transfers out of the fund, the change in the Sanitary Sewer Fund net position was an increase of \$41,587. Total net position increased to \$2,330,639 in 2018.

**City of Falcon Heights
Financial Analysis**

STORM DRAINAGE FUND



Storm sewer charges for services stayed consistent with the prior year, decreasing \$785. Operating expenses increased in 2018, going from \$142,494 in 2017 to \$156,170 in 2018. This increase of \$13,676 was due to an increase in engineering costs in 2018. The Storm Drainage Fund had operating income of \$13,002 in 2018.

With \$3,322 in investment income, the Storm Drainage Fund had a total increase in net position of \$16,324. Ending net position at December 31, 2018 was \$1,542,294.

City of Falcon Heights 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 are extensive summaries 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.

**City of Falcon Heights
Emerging Issues**

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.

City of Falcon Heights
Emerging Issues

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.