

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

Communications Letter

December 31, 2017



**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, 2017, 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 were not 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 a certain deficiency in internal control that we consider to be a material weakness.

A deficiency in internal control exists when the design or operation of a control does not allow management or employees, in the normal course of performing their assigned functions, to prevent, or detect and correct, misstatements on a timely basis. A material weakness is a deficiency, or a combination of deficiencies in internal control, such that there is a reasonable possibility that a material misstatement of the City's financial statements will not be prevented, or detected and corrected, on a timely basis. The material weakness identified is stated within this letter.

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 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 30, 2018, 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.

BerganKDV Ltd.

Minneapolis, Minnesota
April 30, 2018

**City of Falcon Heights
Material Weakness**

LACK OF SEGREGATION OF ACCOUNTING DUTIES

The City continued to evaluate and improve the segregation of accounting duties among City staff during 2017. 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.

**City of Falcon Heights
Material Weakness**

LACK OF SEGREGATION OF ACCOUNTING DUTIES (CONTINUED)

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.

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 bank reconciliations were not approved or reviewed by another person.

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, 2017. Professional standards require that we provide you with the following information related to our audit.

OUR RESPONSIBILITY UNDER AUDITING STANDARDS GENERALLY ACCEPTED IN THE UNITED STATES OF AMERICA

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

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.

City of Falcon Heights Required Communication

QUALITATIVE ASPECTS OF ACCOUNTING PRACTICES

Management is responsible for the selection and use of appropriate accounting policies. The significant accounting policies used by the City are described in the notes to financial statements. No new accounting policies were adopted and the application of existing policies was not changed during the year ended December 31, 2017. 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 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.

DIFFICULTIES ENCOUNTERED IN PERFORMING THE AUDIT

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

CORRECTED AND UNCORRECTED MISSTATEMENTS

Professional standards require us to accumulate all known and likely misstatements identified during the audit, other than those that are clearly trivial, and communicate them to the appropriate level of management. Management has corrected all such misstatements.

One of the misstatements detected as a result of audit procedures and corrected by management was material, both individually and in the aggregate, to the financial statements taken as a whole.

**City of Falcon Heights
Required Communication**

DISAGREEMENTS WITH MANAGEMENT

For purposes of this letter, a disagreement with management is a financial accounting, reporting, or auditing matter, whether or not resolved to our satisfaction, that could be significant to the financial statements or the auditor's report. We are pleased to report that no such disagreements arose during the course of our audit.

MANAGEMENT REPRESENTATIONS

We requested certain representations from management that are included in the management representation letter.

MANAGEMENT CONSULTATIONS WITH OTHER ACCOUNTANTS

In some cases, management may decide to consult with other accountants about auditing and accounting matters, similar to obtaining a "second opinion" on certain situations. If a consultation involves application of an accounting principle to the City's financial statements or a determination of the type of auditor's opinion that may be expressed on those statements, our professional standards require the consulting accountant to check with us to determine that the consultant has all the relevant facts. To our knowledge, there were no such consultations with other accountants.

OTHER AUDIT FINDINGS OR ISSUES

We generally discuss a variety of matters, including the application of accounting principles and auditing standards, with management each year prior to retention as the City's auditors. However, these discussions occurred in the normal course of our professional relationship and our responses were not a condition to our retention.

OTHER MATTERS

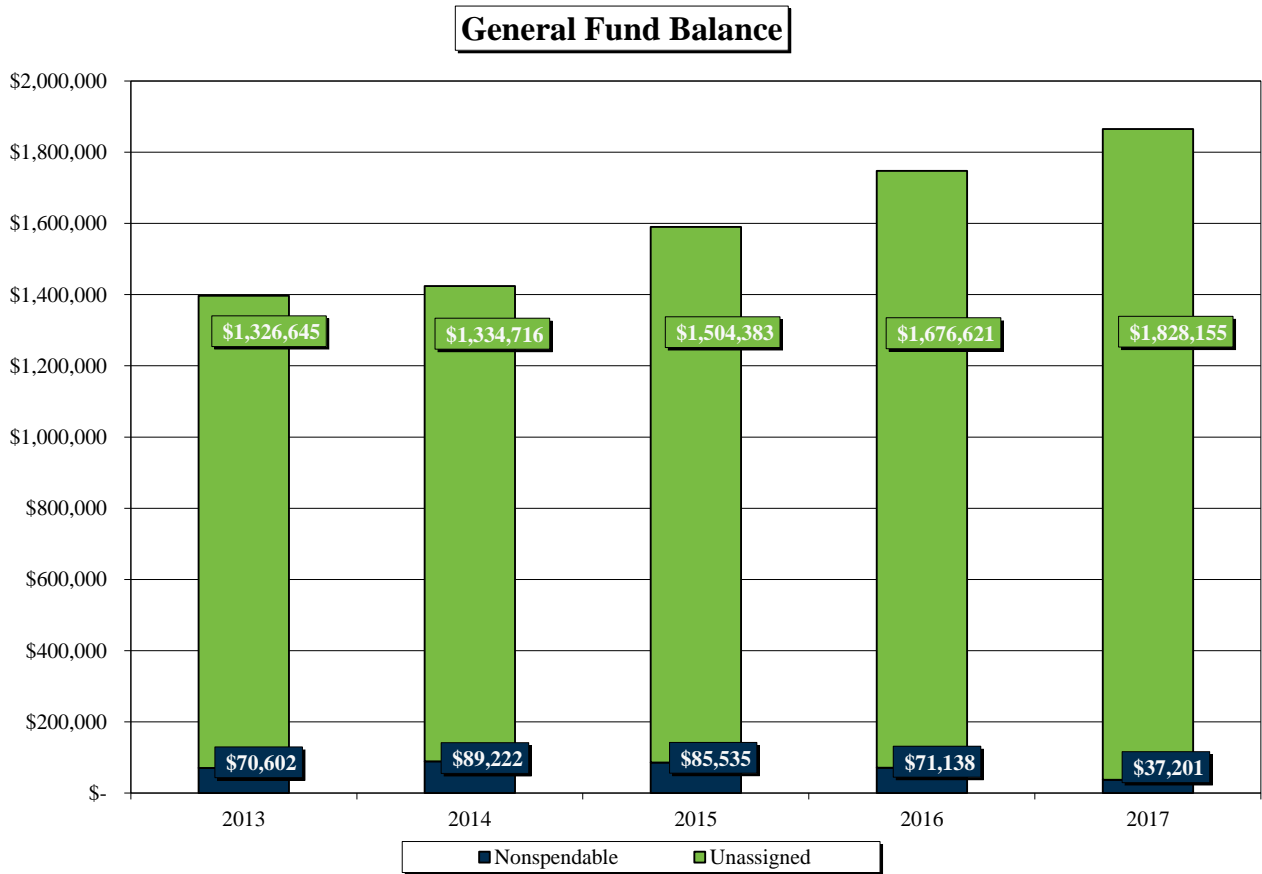
We applied certain limited procedures to the RSI that supplements the basic financial statements. Our procedures consisted of inquiries of management regarding the methods of preparing the information and comparing the information for consistency with management's responses to our inquiries, the basic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

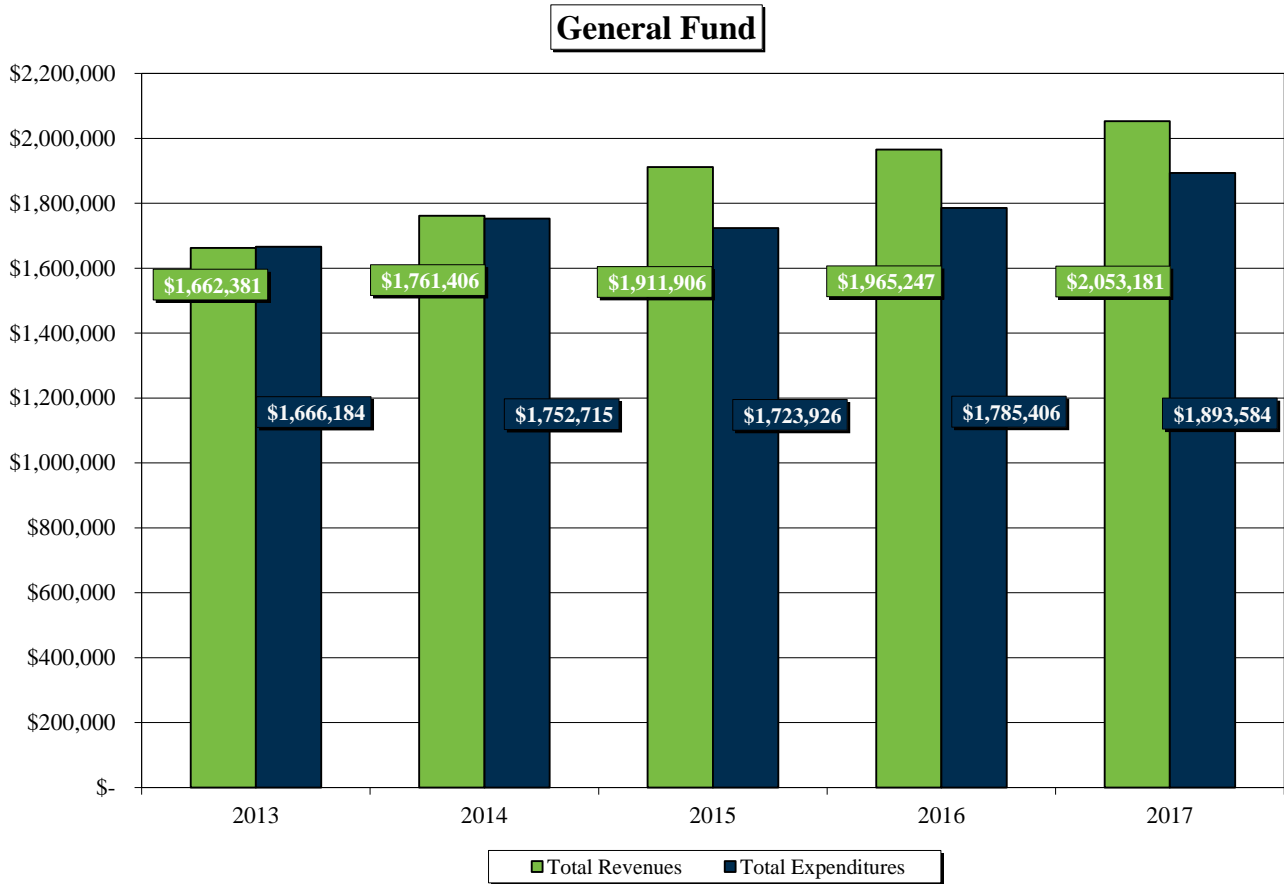
GENERAL FUND BALANCE

At December 31, 2017, the General Fund balance was \$1,865,356 which is an increase of \$117,597 from 2016. Based on current expenditure levels, the fund balance represents over 11 months of expenditures.



City of Falcon Heights Financial Analysis

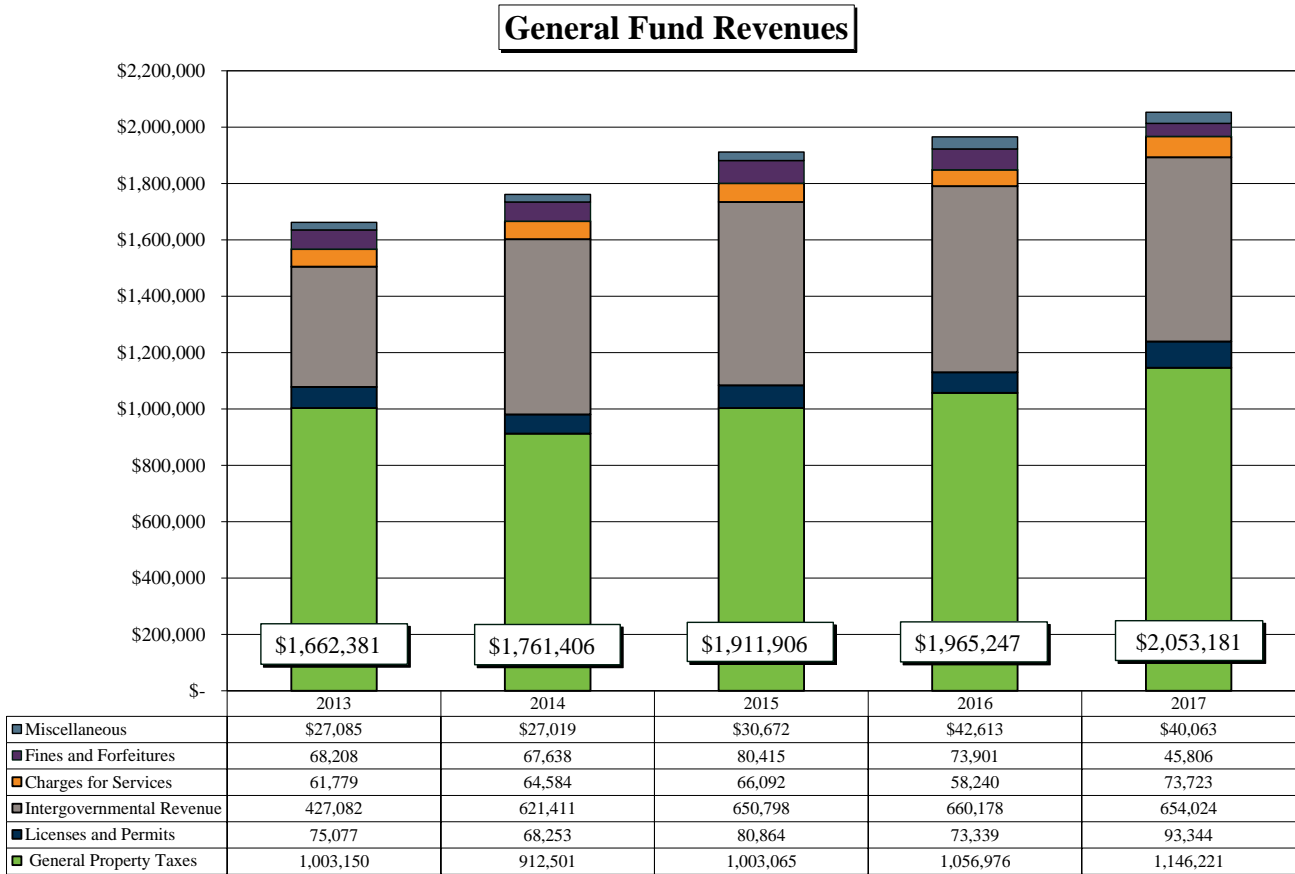
GENERAL FUND



General Fund revenues increased by \$87,934, or 4.5%, in 2017. Expenditures in the General Fund increased by \$108,178, or 6.1%, and resulted in total revenues exceeding expenditures by \$159,597. Further detailed explanations regarding variances will follow in subsequent charts.

City of Falcon Heights Financial Analysis

GENERAL FUND REVENUES



Property taxes increased \$89,245, or 8.4%, from 2016 due to an increase in the total amount levied in the fund in 2017. Licenses and permits increased \$20,005 from 2017 due to an increase in building permit revenues from the prior year. These increases were partially offset with a decrease in fines and forfeitures, which decreased \$28,095 from 2016. Fines and forfeitures can fluctuate from year to year and decreased in 2017 due to less court fines collected.

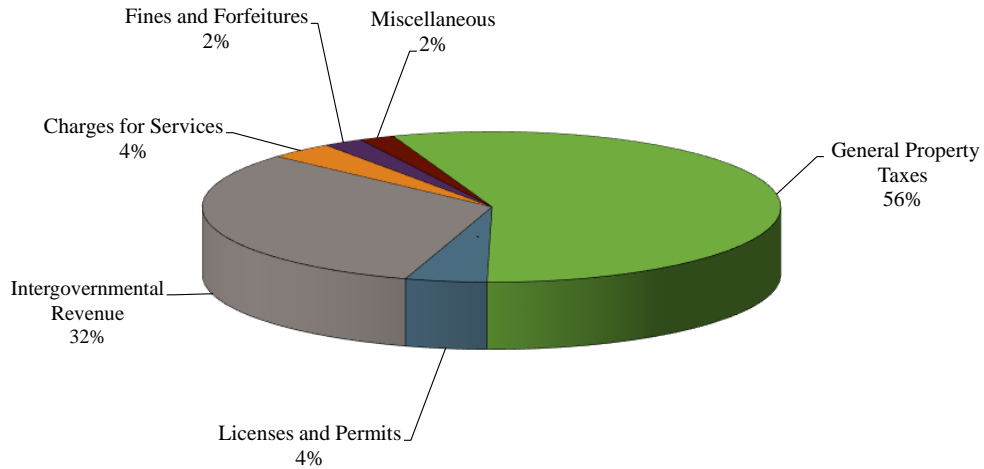
The other remaining General Fund revenues in 2017 stayed relatively consistent with the prior year.

City of Falcon Heights Financial Analysis

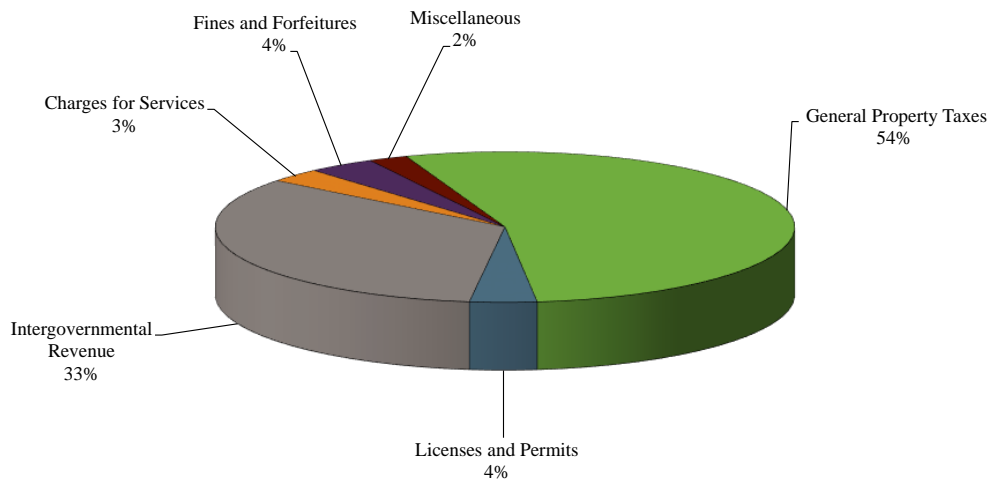
GENERAL FUND REVENUES (CONTINUED)

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

General Fund Revenues 2017



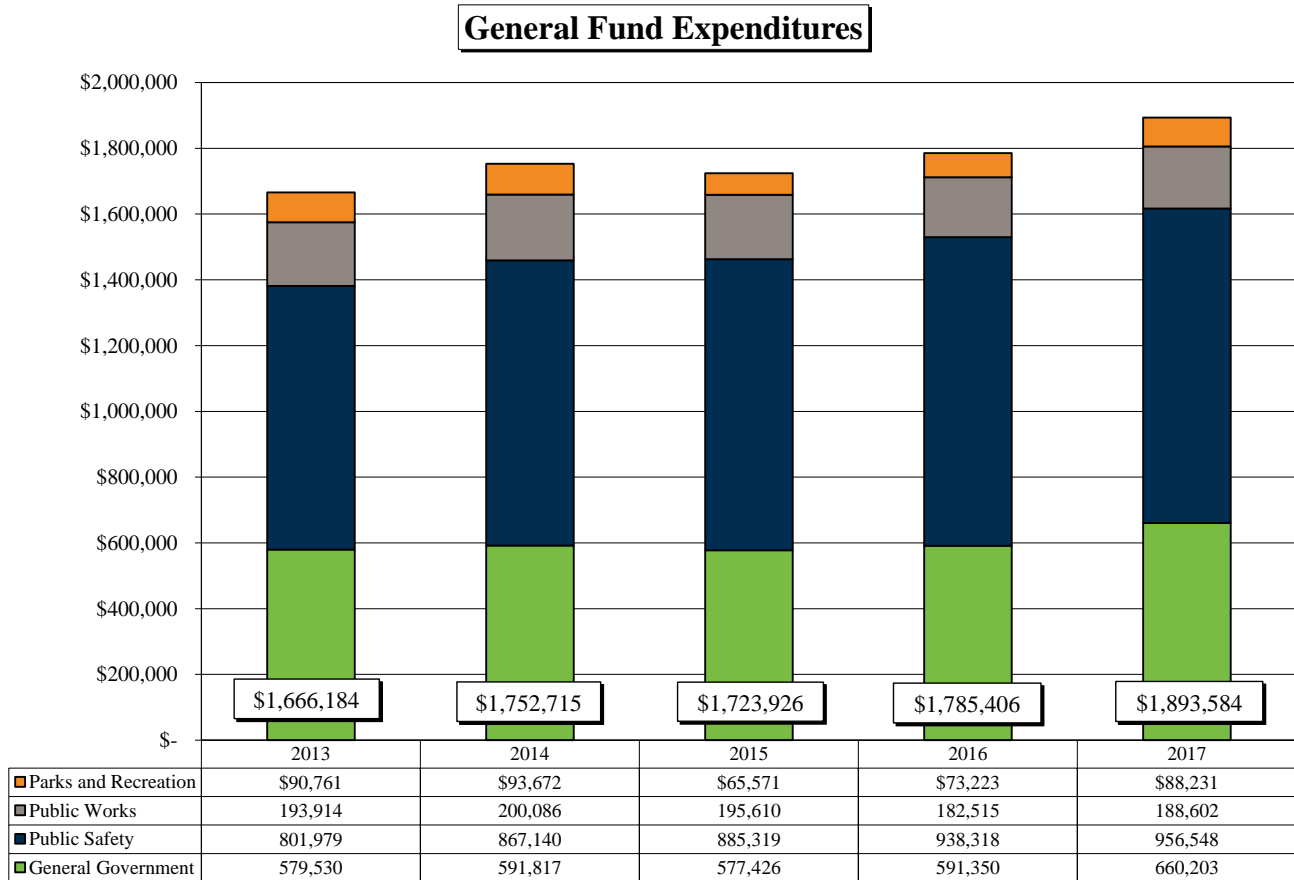
General Fund Revenues 2016



General Fund sources of revenue remained consistent in 2017 compared to 2016.

City of Falcon Heights Financial Analysis

GENERAL FUND EXPENDITURES

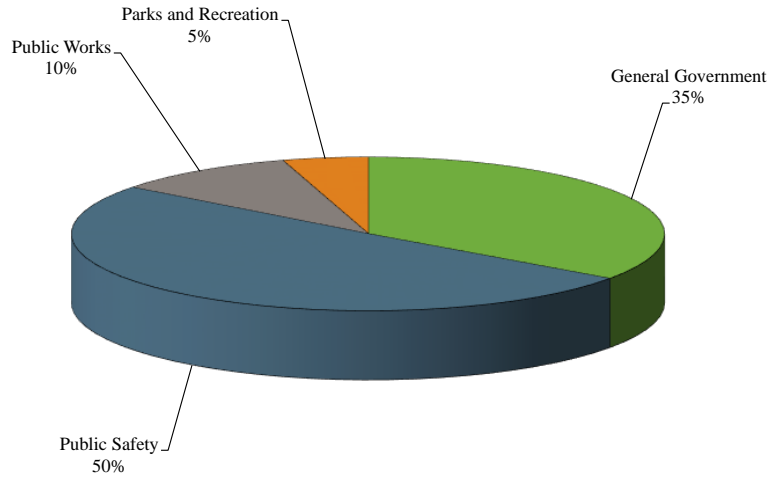


In 2017, expenditures increased \$108,178, or 6.1%, from 2016. General government accounted for \$68,853 of the total increase. This increase was due to increase in building inspection costs, an increase in the cost of healthcare premiums and an increase in wages. Public safety increased \$18,230, or 1.9% from the prior year due to an increase in police service costs and dispatch fees. Other expenditures stayed relatively consistent with the prior year.

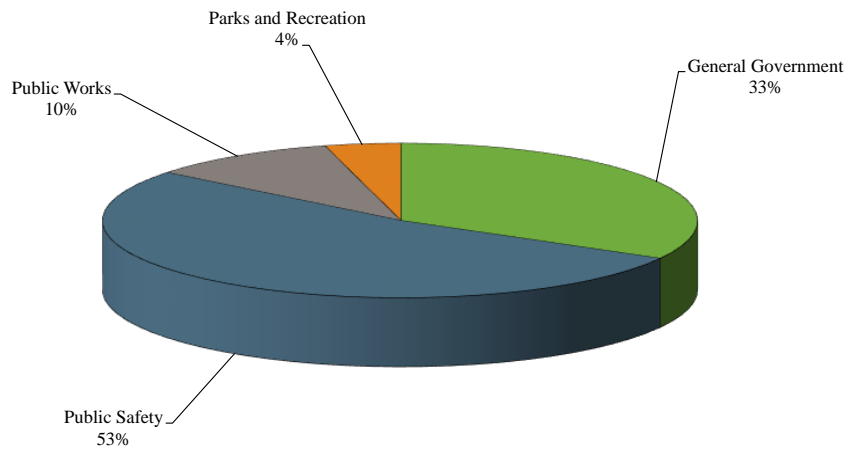
City of Falcon Heights Financial Analysis

GENERAL FUND EXPENDITURES (CONTINUED)

General Fund Expenditures 2017



General Fund Expenditures 2016



**City of Falcon Heights
Financial Analysis**

GENERAL FUND BUDGET

	Original and Final Budget	Actual Amounts	Variance With Final Budget - Over (under)
Revenues			
Taxes	\$ 1,152,646	\$ 1,146,221	\$ (6,425)
Licenses and permits	59,950	93,344	33,394
Intergovernmental	668,524	654,024	(14,500)
Charges for services	52,935	73,723	20,788
Fines and forfeitures	73,000	45,806	(27,194)
Miscellaneous	15,500	40,063	24,563
Total revenues	2,022,555	2,053,181	30,626
Expenditures			
General government	678,150	660,203	(17,947)
Public safety	972,966	956,548	(16,418)
Public works	236,649	188,602	(48,047)
Parks and recreation	92,790	88,231	(4,559)
Total expenditures	1,980,555	1,893,584	(86,971)
Excess of receipts over disbursements	5,000	388,125	383,125
Other Financing Uses			
Transfers out	(42,000)	(42,000)	-
Net change in fund balance	\$ -	\$ 117,597	\$ 117,597

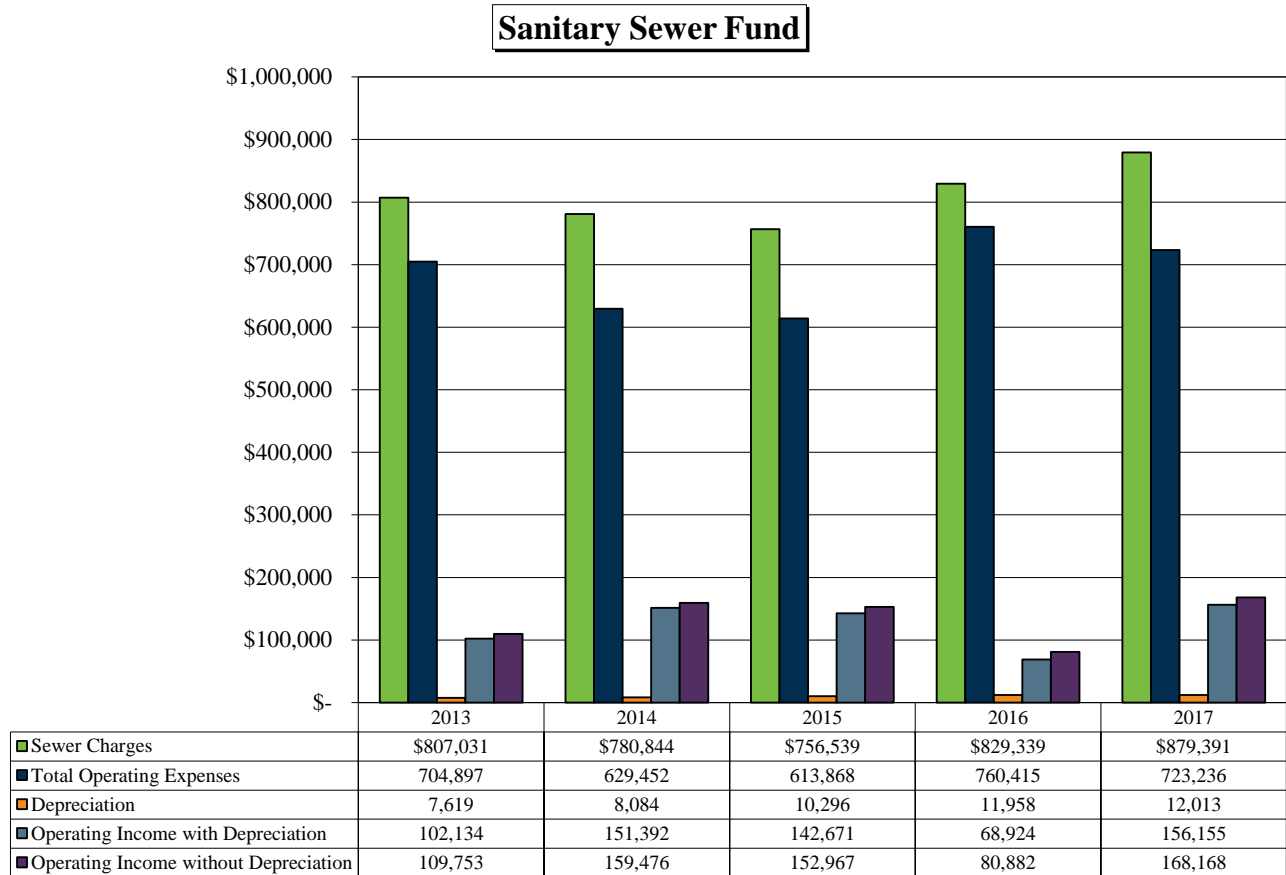
Overall, General Fund revenues were over budget by 1.5%, or \$30,626. This is primarily due to conservative budget estimates in licenses and permits, charges for services and miscellaneous revenues. These categories were a combined \$78,745 over budget in 2017. This was offset by fines and forfeitures, which were under budget by \$27,194, which was budgeted based on revenues received in the 2016.

Expenditures were under budget by \$86,971, or 4.4%. The largest variance was in public works which was \$48,047 under budget, mostly due to budgeting for more snow removal costs in 2017. 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.

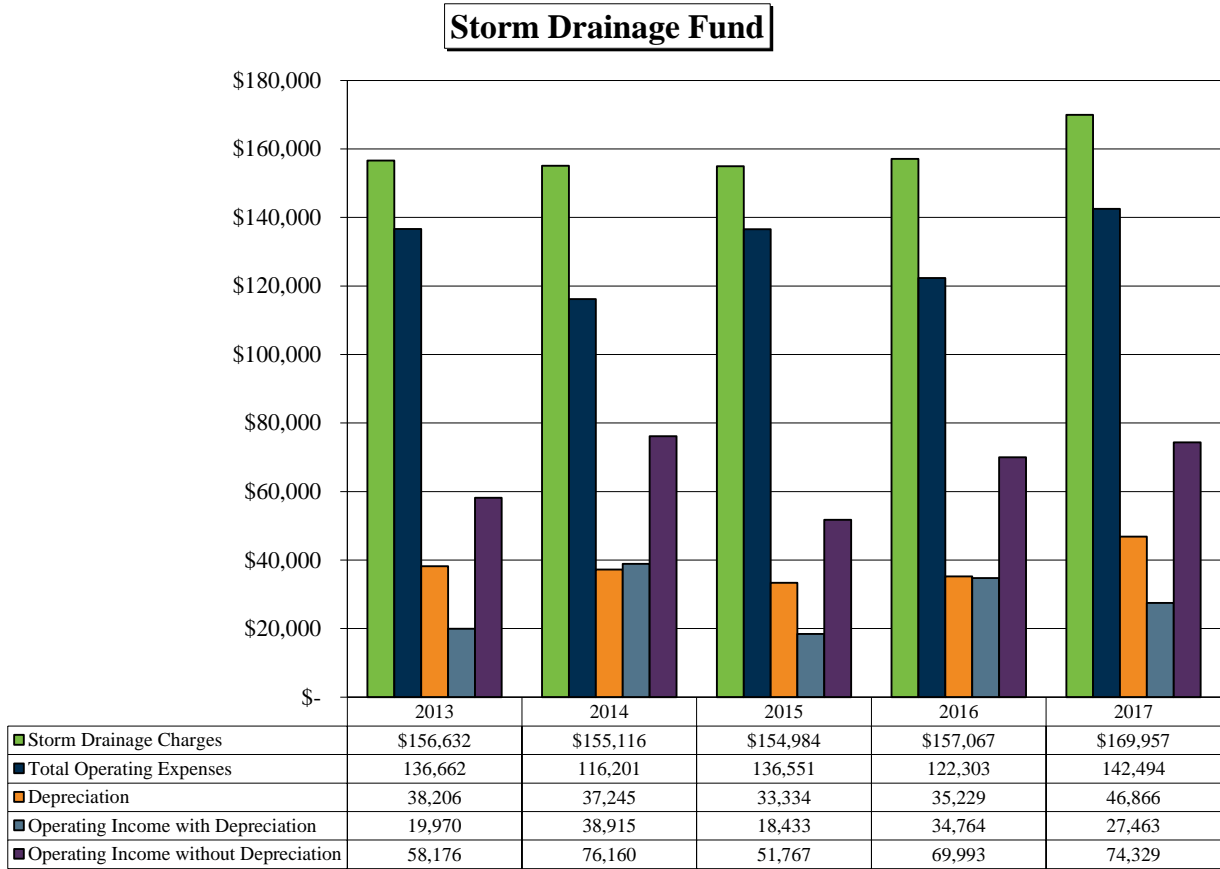


The Sanitary Sewer Fund realized operating income of \$156,155 during 2017. Sewer charges in 2017 increased by \$50,052 from 2016 due to an increase in sewer rates and additional charges received from the University of Minnesota. Expenses in the fund decreased, going from \$760,415 in 2016, to \$723,236 in 2017. This decrease was due to a large televising project in 2016 as well as more repairs needed in 2016.

With an operating income of \$156,155, \$17,988 in nonoperating revenue, and \$400,000 in net transfers out of the fund, the change in the Sanitary Sewer Fund net position was a decrease of \$225,857. Total net position fell to \$2,289,052 in 2017.

**City of Falcon Heights
Financial Analysis**

STORM DRAINAGE FUND



Storm sewer charges for services increased \$12,890 from the prior year. Operating expenses also increased in 2017, going from \$122,303 in 2016 to \$142,494 in 2017. This increase of \$20,191 was due to an increase in depreciation expense, additional repairs during the year, and an increase in wages. The Storm Drainage Fund had operating income of \$27,463 in 2017.

With \$1,330 in investment income, the Storm Drainage Fund had a total increase in net position of \$28,793. Ending net position at December 31, 2017 was \$1,525,970.

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. 75 – Accounting and Financial Reporting for Postemployment Benefits Other Than Pensions** – GASB has issued GASB Statement No. 75 relating to accounting and financial reporting for postemployment benefits other than pensions. This new statement requires governments in all types of OPEB plans to present more extensive note disclosures and required supplementary information (RSI) about their OPEB liabilities.
- **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. 75 – ACCOUNTING AND FINANCIAL REPORTING FOR POSTEMPLOYMENT BENEFITS OTHER THAN PENSIONS

The primary objective of this Statement is to improve accounting and financial reporting by state and local governments for postemployment benefits other than pensions (other postemployment benefits or OPEB). It also improves information provided by state and local governmental employers about financial support for OPEB that is provided by other entities. This Statement results from a comprehensive review of the effectiveness of existing standards of accounting and financial reporting for all postemployment benefits (pensions and OPEB) with regard to providing decision-useful information, supporting assessments of accountability and interperiod equity, and creating additional transparency.

This Statement replaces the requirements of Statements No. 45, *Accounting and Financial Reporting by Employers for Postemployment Benefits Other Than Pensions*, as amended, and No. 57, *OPEB Measurements by Agent Employers and Agent Multiple-Employer Plans*, for OPEB. Statement No. 74, *Financial Reporting for Postemployment Benefit Plans Other Than Pension Plans*, establishes new accounting and financial reporting requirements for OPEB plans.

**City of Falcon Heights
Emerging Issues**

ACCOUNTING STANDARD UPDATE – GASB STATEMENT NO. 75 – ACCOUNTING AND FINANCIAL REPORTING FOR POSTEMPLOYMENT BENEFITS OTHER THAN PENSIONS (CONTINUED)

GASB Statement No. 75 requires governments to report a liability on the face of the financial statements for the OPEB that they provide:

- Governments that are responsible only for OPEB liabilities related to their own employees and that provide OPEB through a defined benefit OPEB plan administered through a trust that meets specified criteria will report a *net OPEB liability*—the difference between the total OPEB liability and assets accumulated in the trust and restricted to making benefit payments.
- Governments that participate in a cost-sharing OPEB plan that is administered through a trust that meets the specified criteria will report a liability equal to their *proportionate share of the collective OPEB liability* for all entities participating in the cost-sharing plan.
- Governments that do not provide OPEB through a trust that meets specified criteria will report the *total OPEB liability* related to their employees.

GASB Statement No. 75 carries forward from Statement No. 45 the option to use a specified alternative measurement method in place of an actuarial valuation for purposes of determining the total OPEB liability for benefits provided through OPEB plans in which there are fewer than 100 plan members (active and inactive). This option was retained in order to reduce costs for smaller governments.

GASB Statement No. 75 requires governments in all types of OPEB plans to present more extensive note disclosures and required supplementary information (RSI) about their OPEB liabilities. Among the new note disclosures is a description of the effect on the reported OPEB liability of using a discount rate and a healthcare cost trend rate that are one percentage point higher and one percentage point lower than assumed by the government. The new RSI includes a schedule showing the causes of increases and decreases in the OPEB liability and a schedule comparing a government's actual OPEB contributions to its contribution requirements.

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

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.

**City of Falcon Heights
Emerging Issues**

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

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.

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.

**City of Falcon Heights
Emerging Issues**

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

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.

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.