

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

Communications Letter

December 31, 2019



**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, 2019, 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 deficiencies in internal control that we consider to be material weaknesses.

A significant deficiency is a deficiency, or a combination of deficiencies, in internal control that is less severe than a material weakness, yet important enough to merit attention by those charged with governance. The significant deficiency identified is stated within this letter.

The 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 29, 2020, 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 29, 2020

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 2019. 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, 2019. 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.

Our responsibility, as prescribed by professional standards, is to plan and perform our audit to obtain reasonable, rather than absolute, assurance about whether the financial statements are free of material misstatement. An audit of financial statements includes consideration of internal control over financial reporting as a basis for designing audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of the City's internal control over financial reporting. Accordingly, as part of our audit, we considered the internal control of the City solely for the purpose of determining our audit procedures and not to provide any assurance concerning such internal control.

We are also responsible for communicating significant matters related to the audit that are, in our professional judgement, relevant to your responsibilities in overseeing the financial reporting process. However, we are not required to design procedures for the purpose of identifying other matters to communicate to you.

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 supplements the basic audit financial statements, is to apply certain limited procedures in accordance with generally accepted auditing standards. However, the RSI was not audited and, because the limited procedures do not provide us with sufficient evidence to express an opinion or provide any assurance, we do not express an opinion or provide any assurance on the RSI.

Our responsibility for the supplementary information accompanying the financial statements, as described by professional standards, is to evaluate the presentation of the supplementary information in relation to the financial statements as a whole and to report on whether the supplementary information is fairly stated, in all material respects, in relation to the financial statements as a whole.

Planned Scope and Timing of the Audit

We conducted our audit consistent with the planned scope and timing we previously communicated to you.

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

Significant Accounting Policies

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 2019. No matters have come to our attention that would require us, under professional standards, to inform you about (1) the methods used to account for significant unusual transactions and (2) the effect of significant accounting policies in controversial or emerging areas for which there is a lack of authoritative guidance or consensus.

Significant Accounting Estimates

Accounting estimates are an integral part of the financial statements prepared by management and are based on management's current judgements. Those judgements are normally based on 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 markedly from management's current judgements. 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 and determined that they are reasonable in relation to the financial statements taken as a whole.

Financial Statement Disclosures

Certain financial statement disclosures involve significant judgment and are particularly sensitive because of their significance to financial statement users. 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

For the purposes of this communication, professional standards require us to accumulate all known and likely misstatements identified during the audit, other than those that we believe are trivial, and communicate them to the appropriate level of management. Further, professional standards require us to also communicate the effects of uncorrected misstatements related to prior periods on the relevant classes of transactions, account balances or disclosures, and the financial statements as a whole.

City of Falcon Heights Required Communication

Uncorrected and Corrected Misstatements (Continued)

Management did not identify and we did not notify them of any uncorrected financial statement misstatements.

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 our audit.

Representations Requested from Management

We have 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 auditor.

Other Information in Documents Containing Audited Financial Statements

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

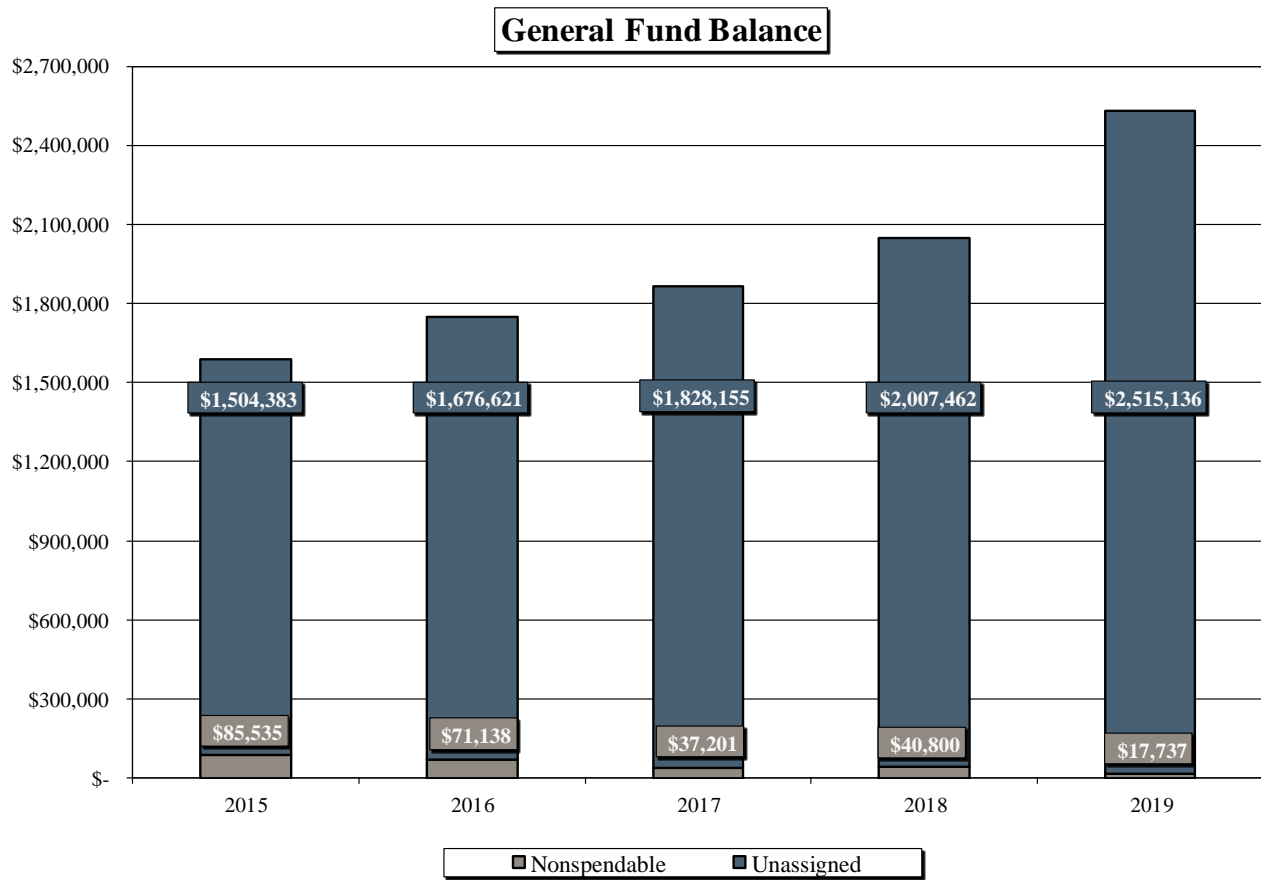
With respect to the supplementary information accompanying the financial statements, we made certain inquiries of management and evaluated the form, content and methods of preparing the information to determine that the information complies with accounting principles generally accepted in the United States of America, the method of preparing it has not changed from the prior period, and the information is appropriate and complete in relation to our audit of the financial statements. We compared and reconciled the supplementary information to the underlying accounting records used to prepare the financial statements or to the financial statements themselves.

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.

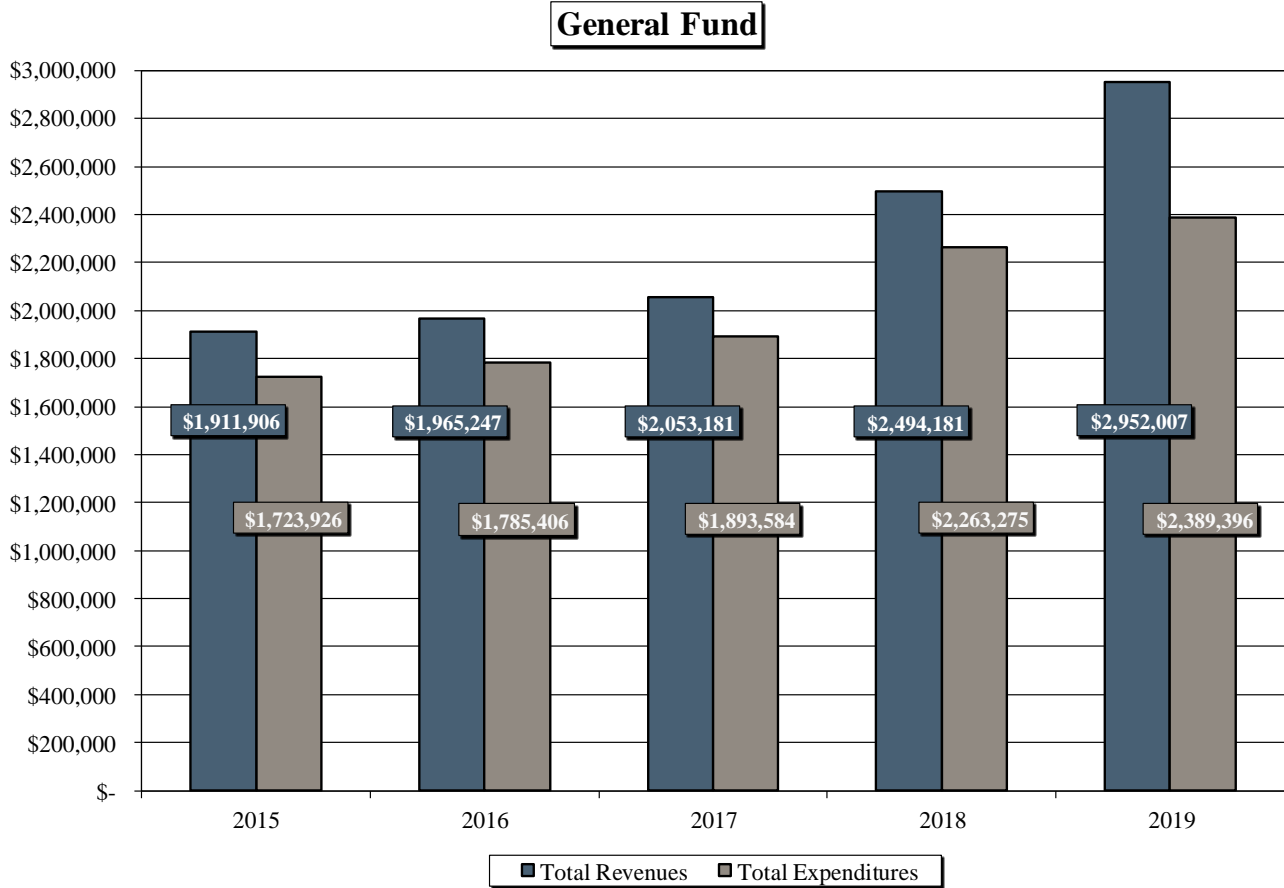
GENERAL FUND BALANCE

At December 31, 2019, the General Fund balance was \$2,532,873 which is an increase of \$484,611 from 2018. Based on current expenditure levels, the fund balance represents over 12 months of expenditures.



City of Falcon Heights Financial Analysis

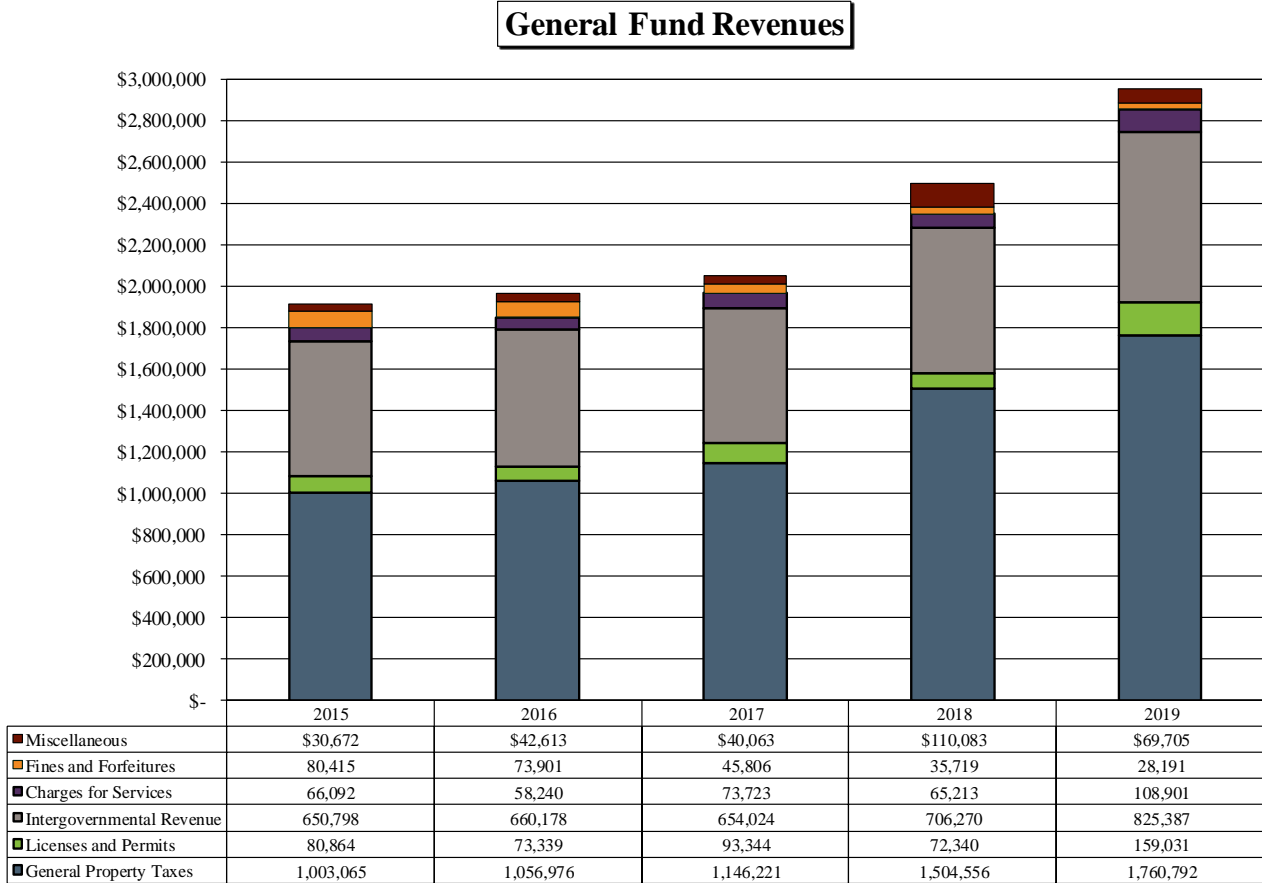
GENERAL FUND



General Fund revenues increased by \$457,826, or 18.4%, in 2019. Expenditures in the General Fund increased by \$126,121, or 5.6%, and resulted in total revenues exceeding expenditures by \$562,611. Further detailed explanations regarding variances will follow in subsequent charts.

City of Falcon Heights Financial Analysis

GENERAL FUND REVENUES



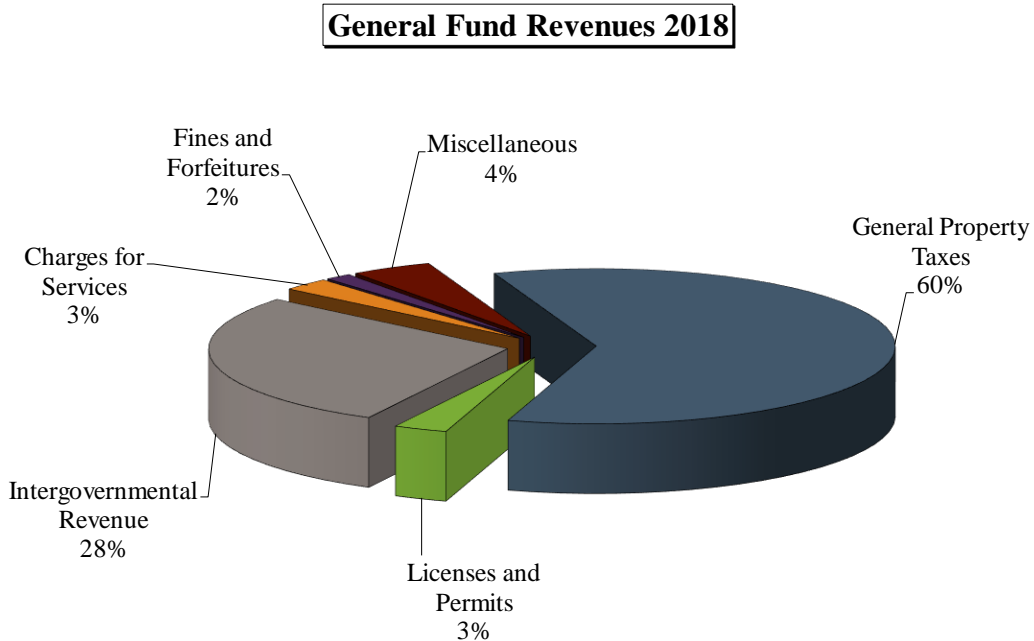
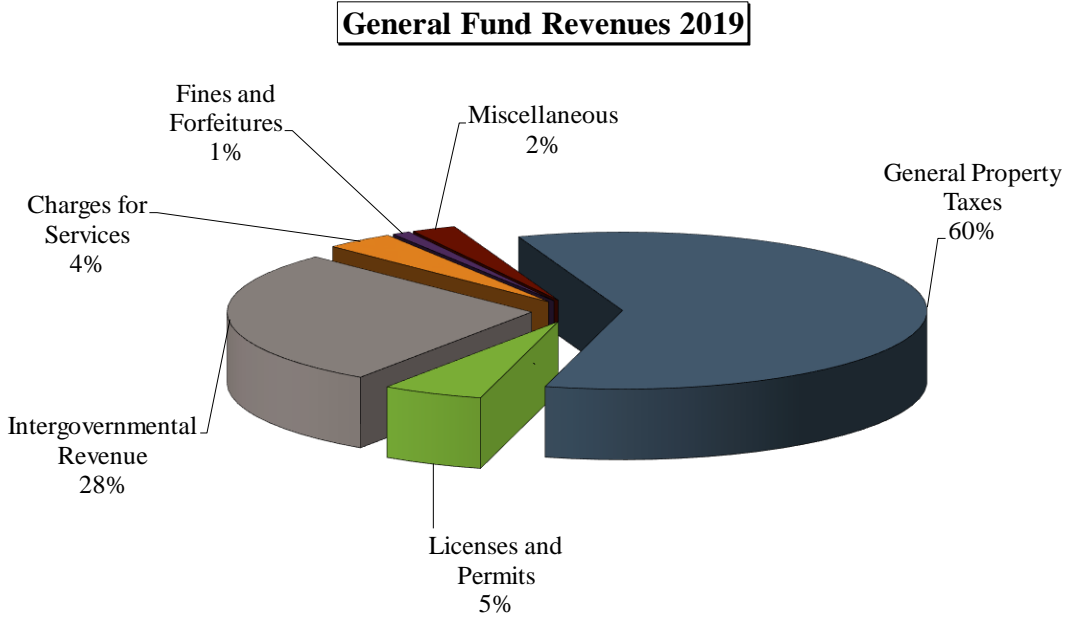
Property taxes increased \$256,236, or 17.0%, from 2018 due to an increase in the total amount levied in the fund in 2019. Intergovernmental revenues increased \$119,117 from the prior year, due to an increase in the amount of police aid recorded by the City. Licenses and permits increased by \$86,691 due primarily to an increase in the number of building permits issued. Charges for services increased by \$43,688 due in part to an increase in plan check fees. Miscellaneous revenues decreased \$40,378 in 2019 as a result of the City no longer receiving a reimbursement from the State Fair for its share in police activity.

The other remaining General Fund revenues in 2019 stayed relatively consistent with the prior year.

City of Falcon Heights Financial Analysis

GENERAL FUND REVENUES (CONTINUED)

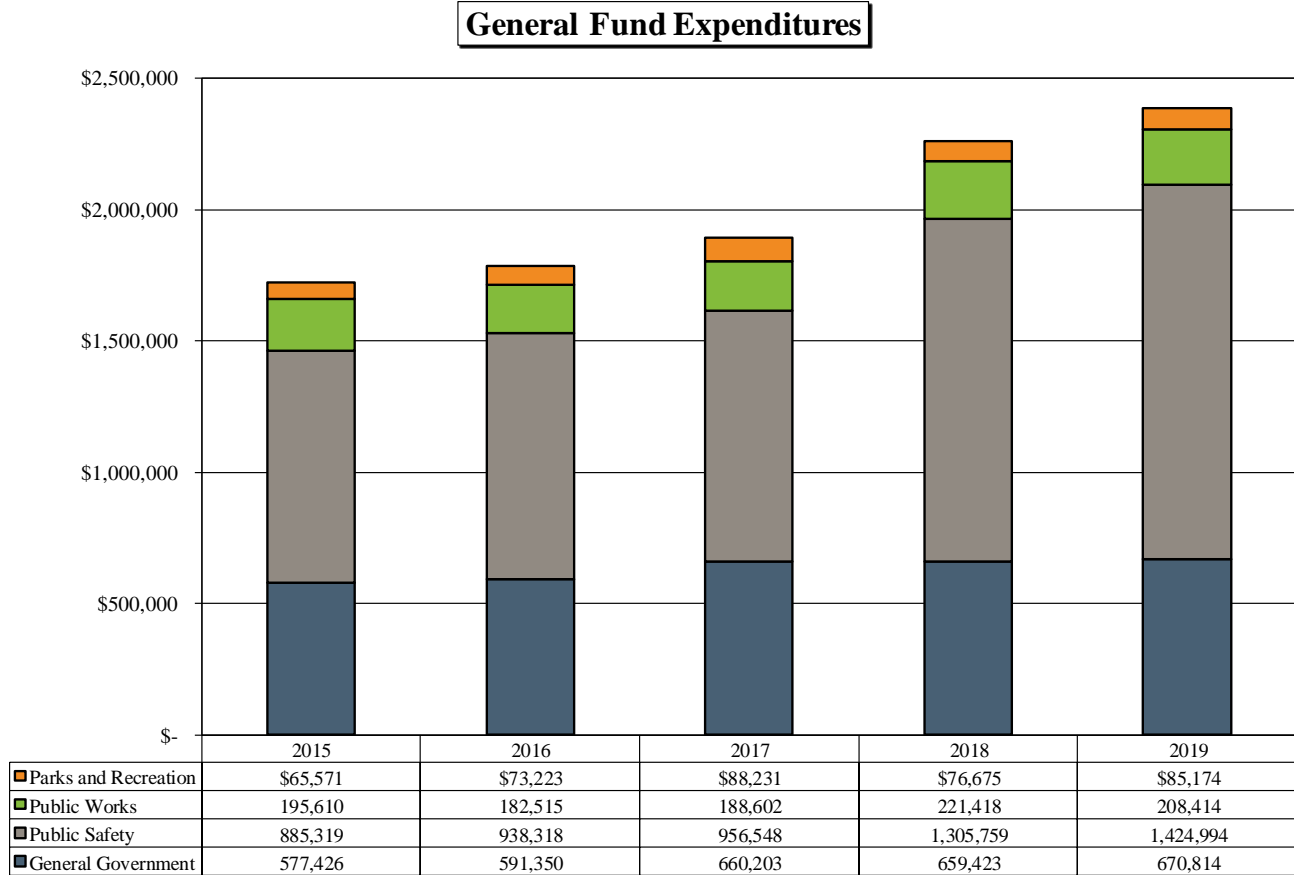
The following charts depict the components of the General Fund revenues by percentages.



General Fund sources of revenue remained consistent in 2019 compared to 2018.

City of Falcon Heights Financial Analysis

GENERAL FUND EXPENDITURES



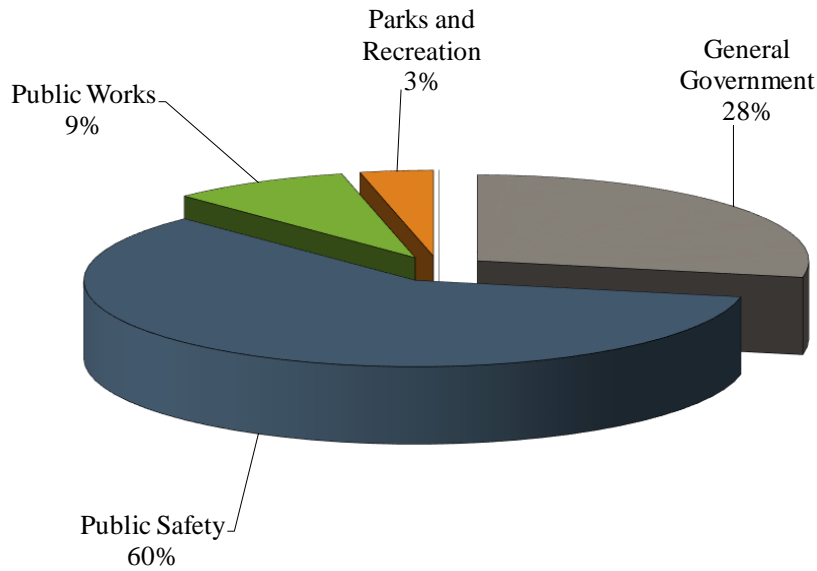
In 2019, expenditures increased \$126,121, or 5.6%, from 2018. Public safety expenditures increased \$119,235, or 9.1% in 2019. This increase was due to increasing police service charges from Ramsey County.

Other expenditures stayed relatively consistent with the prior year.

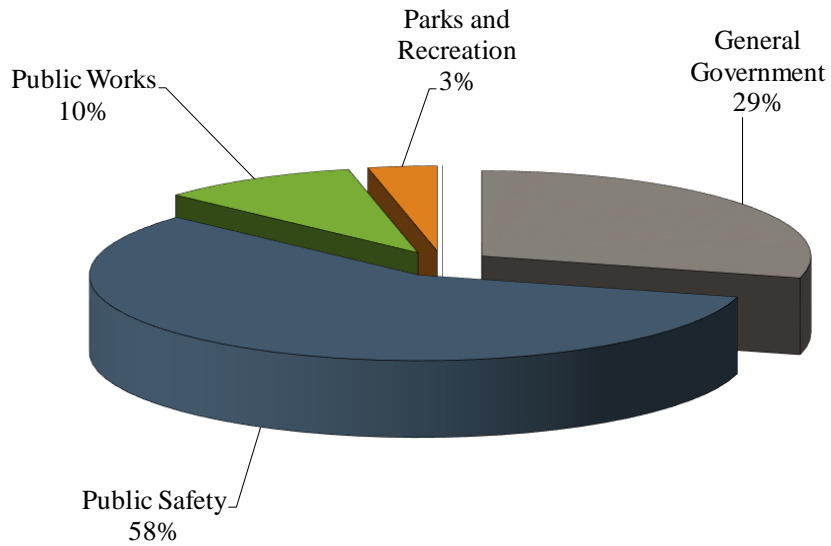
**City of Falcon Heights
Financial Analysis**

GENERAL FUND EXPENDITURES (CONTINUED)

General Fund Expenditures 2019



General Fund Expenditures 2018



**City of Falcon Heights
Financial Analysis**

GENERAL FUND BUDGET

	Original and Final Budget	Actual Amounts	Variance with Final Budget - Over (Under)
Revenues			
Taxes	\$ 1,747,260	\$ 1,760,792	\$ 13,532
Licenses and permits	69,250	159,031	89,781
Intergovernmental	713,232	825,387	112,155
Charges for services	59,730	108,901	49,171
Fines and forfeitures	35,000	28,191	(6,809)
Miscellaneous	44,226	69,705	25,479
Total revenues	2,668,698	2,952,007	283,309
Expenditures			
General government	727,770	670,814	(56,956)
Public safety	1,512,927	1,424,994	(87,933)
Public works	253,449	208,414	(45,035)
Parks and recreation	96,552	85,174	(11,378)
Total expenditures	2,590,698	2,389,396	(201,302)
Excess of receipts over disbursements	78,000	562,611	484,611
Other Financing Uses			
Transfers out	(78,000)	(78,000)	-
Net change in fund balance	\$ -	\$ 484,611	\$ 484,611

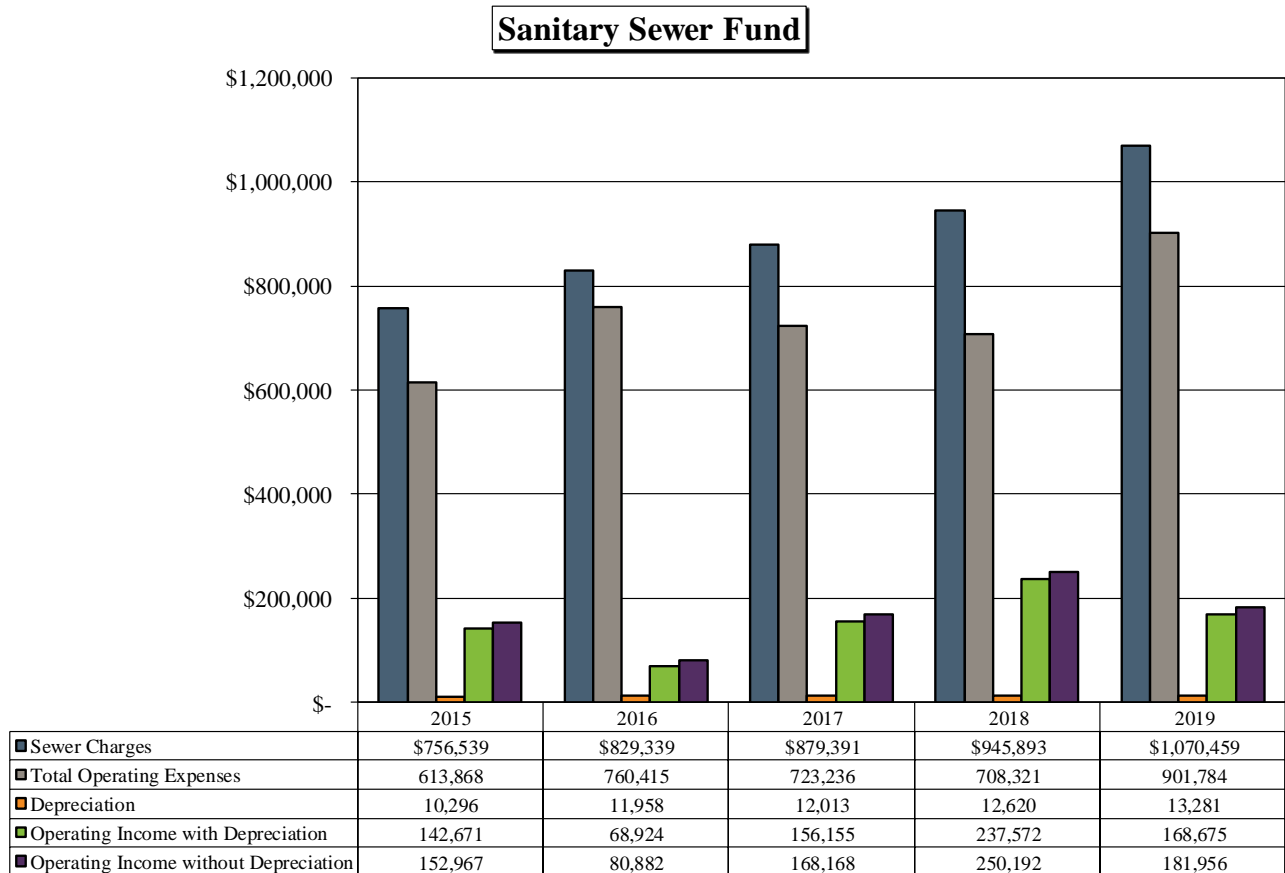
Overall, General Fund revenues were over budget by 10.6%, or \$283,309. The largest budget variance was in intergovernmental revenue, which exceeded budget amounts by \$112,155. This variance is a result of the recording of additional police aid, which was not budgeted. Revenue for licenses and permits was over budget by \$89,781 due higher than budgeted building activity. Charges for services were over budget by \$49,171 with the plan check fees bringing in more revenue than anticipated. Other categories were relatively on budget.

Expenditures were under budget by \$201,302, or 7.8%. The largest variance was in public safety, which was \$52,718 under budget. This variance was due to funding for police expenditures coming in under estimated amounts along with changes in fire personnel. General government expenditures were under budget by \$56,956 due in part to staffing turnover. Public works was also under budget, coming in \$45,035 under budget as a result of an additional snow plow being used with more snow removal being performed internally by the City.

**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.

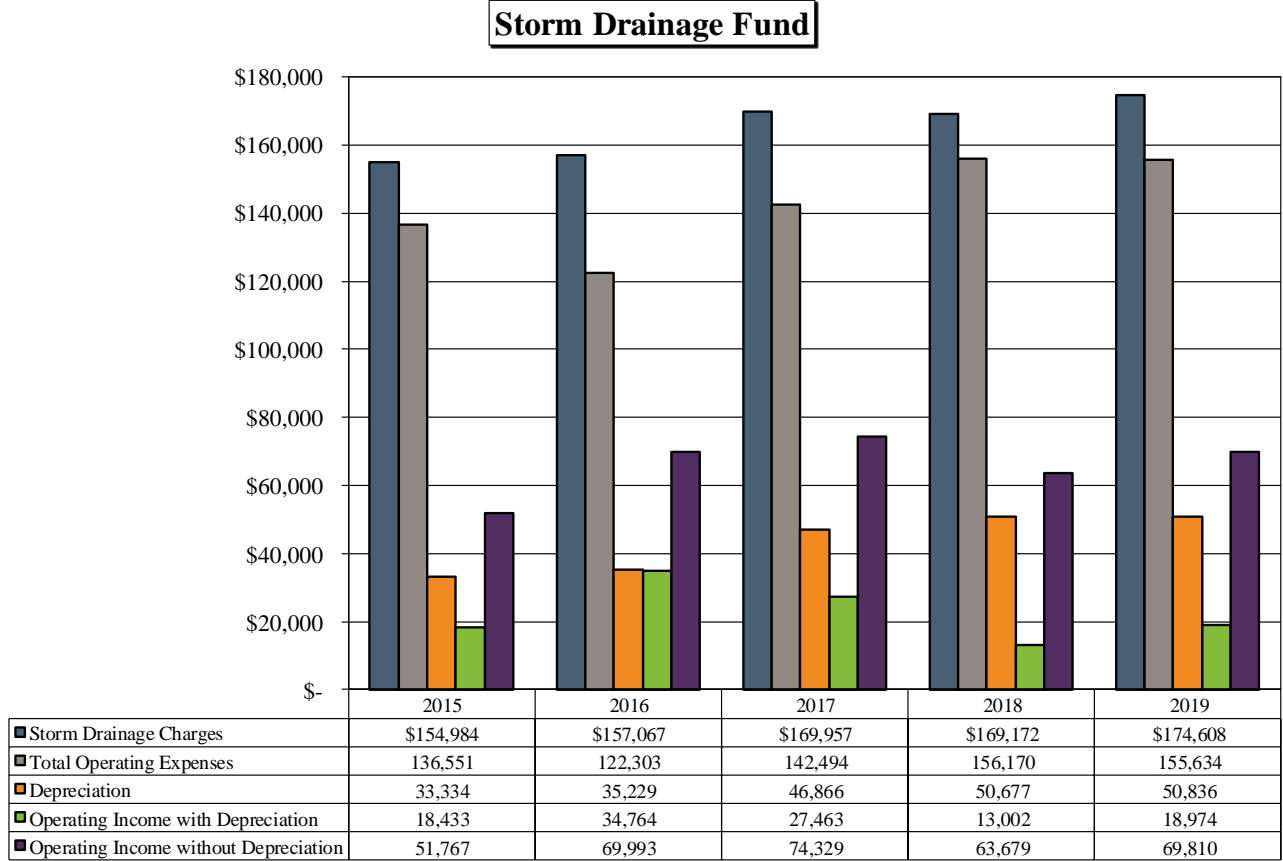


The Sanitary Sewer Fund realized operating income of \$168,675 during 2019. Sewer charges in 2019 increased by \$124,566 from 2018 due to receiving sewer access charges for the connection of an apartment building. Expenses increased \$193,463 due to the costs related to the sewer access connections along with an increase in system maintenance expenses.

With an operating income of \$168,675 and \$48,177 in nonoperating revenue, the change in the Sanitary Sewer Fund net position was an increase of \$216,852. Total net position increased to \$2,547,491 in 2019.

**City of Falcon Heights
Financial Analysis**

STORM DRAINAGE FUND



Storm sewer charges for services stayed relatively consistent with the prior year, increasing \$5,436. Operating expenses decreased slightly in 2018 by \$536. The Storm Drainage Fund had operating income of \$18,974 in 2019.

With \$7,741 in investment income, the Storm Drainage Fund had a total increase in net position of \$26,715. Ending net position at December 31, 2019, was \$1,569,009.

City of Falcon Heights Emerging Issue

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. 87 – Leases** – GASB has issued GASB Statement No. 87 relating to accounting and financial reporting for leases. This new statement establishes a single model for lease accounting based on the principle that leases are financing of the right to use an underlying asset.

The following is an extensive summary of the current update. 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. 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.

**City of Falcon Heights
Emerging Issue**

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

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.