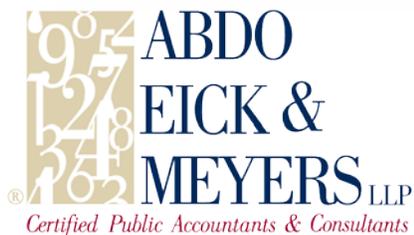


Management Communication

City of North Mankato
North Mankato, Minnesota

For the Year Ended
December 31, 2019



People
+ Process[®]
Going
Beyond the
Numbers

Management, Honorable Mayor and City Council
City of North Mankato, Minnesota

We have audited the financial statements of the governmental activities, the business-type activities, each major fund and the aggregate remaining fund information of the City of North Mankato (the City) for the year ended December 31, 2019 and have issued our report thereon dated June 29, 2020. Professional standards require that we provide you with information about our responsibilities under generally accepted auditing standards and *Government Auditing Standards*, as well as certain information related to the planned scope and timing of our audit. We have communicated such information in our letter to you dated October 23, 2019. Professional standards also require that we communicate to you the following information related to our audit.

Significant Audit Findings

In planning and performing our audit of the financial statements, we considered the City's internal control over financial reporting (internal control) to determine the audit procedures that are appropriate in the circumstances for the purpose of expressing our opinions on the 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. However, as described on the following pages, we identified a certain deficiency in internal control that we consider to be a material weakness and another deficiency that we consider to be a significant deficiency.

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 entity's financial statements will not be prevented, or detected and corrected on a timely basis. We consider the deficiency described on the following pages as item 2019-002 to be a material weakness.

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. We consider the deficiency described on the following pages as item 2019-001 to be a significant deficiency.

2019-001**Preparation of Financial Statements**

Condition: As in prior years, we were requested to draft the audited financial statements and related footnote disclosures as part of our regular audit services. Auditing standards require auditors to communicate this situation to the Council as an internal control deficiency. Ultimately, it is management's responsibility to provide for the preparation of your statements and footnotes, and the responsibility of the auditor to determine the fairness of presentation of those statements. However, based on auditing standards, it is our responsibility to inform you that this deficiency could result in a material misstatement to the financial statements that could have been prevented or detected by your management. Essentially, the auditors cannot be part of your internal control process.

Criteria: Internal controls should be in place to ensure adequate internal control over the reliability of financial records and reporting.

Cause: From a practical standpoint, we prepare the statements and determine the fairness of the presentation at the same time in connection with our audit. This is not unusual for us to do with organizations of your size.

Effect: The effectiveness of the internal control system relies on enforcement by management. The effect of deficiencies in internal controls can result in undetected errors. As in prior years, we have instructed management to review a draft of the auditor prepared financials in detail for accuracy; we have answered any questions that management might have, and have encouraged research of any accounting guidance in connection with the adequacy and appropriateness of classification of disclosures in your statements. We are satisfied that the appropriate steps have been taken to provide you with the completed financial statements.

Recommendation: Under these circumstances, the most effective controls lie in management's knowledge of the Organization's financial operations. It is the responsibility of management and those charged with governance to make the decision whether to accept the degree of risk associated with this condition because of cost and other considerations. Regarding the specific situations listed above, we would offer the following specific recommendation: 1) Utilize a disclosure checklist to ensure all required disclosures are present and agree to work papers, and 2) Agree your accounting information from your accounting software to the amounts reported in the financial statements.

Management Response:

For now, the City's management accepts the degree of risk associated with this condition and thoroughly reviews a draft of the financial statements.

2019-002**Material Audit Adjustments**

Condition: During our audit, adjustments were needed to record a number of accounting and audit adjustments, including the following material entries:

- To adjust various capital asset activity.

Criteria: The financial statements are the responsibility of the City's management.

Cause: City staff has not prepared a year-end trial balance reflecting all necessary accounting entries.

Effect: This indicates that it would be likely that a misstatement may occur and not be detected by the City's system of internal control. The audit firm cannot serve as a compensating control over this deficiency.

Recommendation: We recommend that management review each journal entry, obtain an understanding of why the entry was necessary and modify current procedures to ensure that future corrections are not needed.

Management Response:

Management will continue to review and gain an understanding of the audit adjustments in order to reduce the number of entries necessary for future audits.

Compliance and Other Matters

As part of obtaining reasonable assurance about whether the City's financial statements are free of material misstatement, we performed tests of its compliance with certain provisions of laws, regulations, contracts, grant agreements, and other matters noncompliance with which could have a direct and material effect on the determination of financial statement amounts. However, providing an opinion on compliance with those provisions was not an objective of our audit. While our audit provides a reasonable basis for our opinion, it does not provide a legal determination on the City's compliance with those requirements. The results of our tests disclosed no instances of noncompliance or other matters that are required to be reported in accordance with Government Auditing Standards, the Uniform Guidance or Minnesota statutes.

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 Note 1 to the financial statements. The City changed accounting policies during 2019 related to accounting and financial reporting for fiduciary activities (GASB 84). 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 except those noted in Note 10. Our opinion is not modified with respect to this matter.

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. Significant estimates affecting the financial statements include the capital asset basis, the depreciation on capital assets, allowance for doubtful accounts and the liabilities for the City's Other Post-employment Benefits (OPEB) and City's pensions.

- Capital asset basis is based on estimated historical cost of the capital assets.
- Depreciation is based on the estimated useful lives of capital assets.
- Management's estimate of the allowance is based on past uncollectible accounts.
- OPEB liability is based on several factors including, but not limited to, anticipated retirement age for active employees, life expectancy, turnover, and healthcare cost trend rate.
- Management's estimate of its pension liability is based on several factors including, but not limited to, anticipated investment return rate, retirement age for active employees, life expectancy, salary increases and form of annuity payment upon retirement.

We evaluated the key factors and assumptions used to develop these accounting estimates in determining that it is reasonable in relation to the financial statements taken as a whole. The disclosures in the financial statements are neutral, consistent, and clear. Certain financial statement disclosures are particularly sensitive because of their significance to financial statement users.

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 trivial, and communicate them to the appropriate level of management. During our audit material adjustments were needed to adjust various capital asset activity. Management has corrected all such misstatements. We also assisted in preparing a number of year end accounting entries. These were necessary to adjust the City's records at year end to correct ending balances. The City should establish more detailed processes and procedures to reduce the total number of entries in each category. The City will receive better and timelier information if the preparation of year-end entries is completed internally.

Disagreements with Management

For purposes of this letter, professional standards define a disagreement with management as 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 have requested certain representations from management that are included in the management representation letter dated June 29, 2020.

Management Consultations with Other Independent 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 required supplementary information (RSI) (Management's Discussion and Analysis, the Schedules of Employer's Share of the Net Pension Liability, the Schedules of Employer's Contributions, and the Schedule of Changes in Net Pension Liability (Asset) and Related Ratios), Schedule of changes in the City's OPEB Liability and related ratios, which is information 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 (combining and individual fund financial statements and schedules and schedule of federal awards), which accompany the financial statements but are not RSI. With respect to this 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 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.

We were not engaged to report on the introductory section or statistical sections, which accompany the financial statements but is 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.

Future Accounting Standard Changes

The following Governmental Accounting Standards Board (GASB) Statements have been issued and may have an impact on future City financial statements: ⁽¹⁾

GASB Statement No. 87 - Leases

Summary

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.

Effective Date and Transition

The requirements of this Statement are effective for reporting periods beginning after December 15, 2019. Earlier application is encouraged.

Leases should be recognized and measured using the facts and circumstances that exist at the beginning of the period of implementation (or, if applied to earlier periods, the beginning of the earliest period restated). However, lessors should not restate the assets underlying their existing sales-type or direct financing leases. Any residual assets for those leases become the carrying values of the underlying assets.

How the Changes in This Statement Will Improve Accounting and Financial Reporting

This Statement will increase the usefulness of governments' financial statements by requiring reporting of certain lease liabilities that currently are not reported. It will enhance comparability of financial statements among governments by requiring lessees and lessors to report leases under a single model. This Statement also will enhance the decision-usefulness of the information provided to financial statement users by requiring notes to financial statements related to the timing, significance, and purpose of a government's leasing arrangements.

GASB Statement No. 89 - Accounting for Interest Cost Incurred before the End of a Construction Period

Summary

The objectives of this Statement are (1) to enhance the relevance and comparability of information about capital assets and the cost of borrowing for a reporting period and (2) to simplify accounting for interest cost incurred before the end of a construction period.

This Statement establishes accounting requirements for interest cost incurred before the end of a construction period. Such interest cost includes all interest that previously was accounted for in accordance with the requirements of paragraphs 5–22 of Statement No. 62, Codification of Accounting and Financial Reporting Guidance Contained in Pre-November 30, 1989 FASB and AICPA Pronouncements, which are superseded by this Statement. This Statement requires that interest cost incurred before the end of a construction period be recognized as an expense in the period in which the cost is incurred for financial statements prepared using the economic resources measurement focus. As a result, interest cost incurred before the end of a construction period will not be included in the historical cost of a capital asset reported in a business-type activity or enterprise fund.

This Statement also reiterates that in financial statements prepared using the current financial resources measurement focus, interest cost incurred before the end of a construction period should be recognized as an expenditure on a basis consistent with governmental fund accounting principles.

Future Accounting Standard Changes (Continued)

Effective Date and Transition

The requirements of this Statement are effective for reporting periods beginning after December 15, 2019. Earlier application is encouraged. The requirements of this Statement should be applied prospectively.

How the Changes in This Statement Will Improve Accounting and Financial Reporting

The requirements of this Statement will improve financial reporting by providing users of financial statements with more relevant information about capital assets and the cost of borrowing for a reporting period. The resulting information also will enhance the comparability of information about capital assets and the cost of borrowing for a reporting period for both governmental activities and business-type activities.

GASB Statement No. 91 - Conduit Debt Obligations

Summary

The primary objectives of this Statement are to provide a single method of reporting conduit debt obligations by issuers and eliminate diversity in practice associated with (1) commitments extended by issuers, (2) arrangements associated with conduit debt obligations, and (3) related note disclosures. This Statement achieves those objectives by clarifying the existing definition of a conduit debt obligation; establishing that a conduit debt obligation is not a liability of the issuer; establishing standards for accounting and financial reporting of additional commitments and voluntary commitments extended by issuers and arrangements associated with conduit debt obligations; and improving required note disclosures.

All conduit debt obligations involve the issuer making a limited commitment. Some issuers extend additional commitments or voluntary commitments to support debt service in the event the third party is, or will be, unable to do so.

An issuer should not recognize a conduit debt obligation as a liability. However, an issuer should recognize a liability associated with an additional commitment or a voluntary commitment to support debt service if certain recognition criteria are met. As long as a conduit debt obligation is outstanding, an issuer that has made an additional commitment should evaluate at least annually whether those criteria are met. An issuer that has made only a limited commitment should evaluate whether those criteria are met when an event occurs that causes the issuer to reevaluate its willingness or ability to support the obligor's debt service through a voluntary commitment.

This Statement also addresses arrangements—often characterized as leases—that are associated with conduit debt obligations. In those arrangements, capital assets are constructed or acquired with the proceeds of a conduit debt obligation and used by third-party obligors in the course of their activities. Payments from third-party obligors are intended to cover and coincide with debt service payments. During those arrangements, issuers retain the titles to the capital assets. Those titles may or may not pass to the obligors at the end of the arrangements.

This Statement requires issuers to disclose general information about their conduit debt obligations, organized by type of commitment, including the aggregate outstanding principal amount of the issuers' conduit debt obligations and a description of each type of commitment. Issuers that recognize liabilities related to supporting the debt service of conduit debt obligations also should disclose information about the amount recognized and how the liabilities changed during the reporting period.

Effective Date and Transition

The requirements of this Statement are effective for reporting periods beginning after December 15, 2020. Earlier application is encouraged.

Future Accounting Standard Changes (Continued)

How the Changes in This Statement Will Improve Accounting and Financial Reporting

The requirements of this Statement will improve financial reporting by eliminating the existing option for issuers to report conduit debt obligations as their own liabilities, thereby ending significant diversity in practice. The clarified definition will resolve stakeholders' uncertainty as to whether a given financing is, in fact, a conduit debt obligation. Requiring issuers to recognize liabilities associated with additional commitments extended by issuers and to recognize assets and deferred inflows of resources related to certain arrangements associated with conduit debt obligations also will eliminate diversity, thereby improving comparability in reporting by issuers. Revised disclosure requirements will provide financial statement users with better information regarding the commitments issuers extend and the likelihood that they will fulfill those commitments. That information will inform users of the potential impact of such commitments on the financial resources of issuers and help users assess issuers' roles in conduit debt obligations.

⁽¹⁾ *Note.* From GASB Pronouncements Summaries. Copyright 2019 by the Financial Accounting Foundation, 401 Merritt 7, Norwalk, CT 06856, USA, and is reproduced with permission.

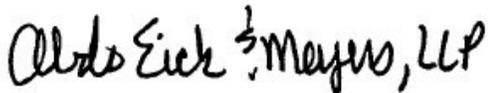
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Restriction on Use

This communication is intended solely for the information and use of the City Council, management and the Minnesota Office of the State Auditor and is not intended and should not be used by anyone other than those specified parties.

Our audit would not necessarily disclose all weaknesses in the system because it was based on selected tests of the accounting records and related data. The comments and recommendations in the report are purely constructive in nature, and should be read in this context.

If you have any questions or wish to discuss any of the items contained in this letter, please feel free to contact us at your convenience. We wish to thank you for the continued opportunity to be of service and for the courtesy and cooperation extended to us by your staff.



ABDO, EICK & MEYERS, LLP
Mankato, Minnesota
June 29, 2020