

CITY OF LITCHFIELD, MINNESOTA

MANAGEMENT LETTER

DECEMBER 31, 2010

Conway, Deuth & Schmiesing, PLLP
Certified Public Accountants
Litchfield, Minnesota

CITY OF LITCHFIELD, MINNESOTA
YEAR ENDED DECEMBER 31, 2010
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INDEPENDENT AUDITOR'S REPORT

Honorable Mayor and City Council
City of Litchfield
Litchfield, Minnesota

We have completed an audit of the financial position of the City of Litchfield, Minnesota for the year ended December 31, 2010. As a result of this audit, we have issued the following reports: Required Communications and Schedule of Findings on Accounting Issues and Internal Controls.

Our comments and recommendations related to observations made during our visit are communicated in the following pages for the administration's consideration. Although these comments are not based on an in-depth study of a particular subject area or potential problem, the administration is often able to utilize this information in future decisions or actions.

We would like to acknowledge the assistance and courtesies extended to us by the personnel of the City of Litchfield during our audit. We look forward to discussing with you matters presented herein.

The information presented on the following pages is intended for the information of the Council and management. However, this report is matter of public record and its distribution is not limited.

Conway, Deuth & Schmiessing, PLLP

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Certified Public Accountants
Litchfield, Minnesota

June 20, 2011

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June 20, 2011

Honorable Mayor and City Council
City of Litchfield
Litchfield, 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 Litchfield, Minnesota for the year ended December 31, 2010. Professional standards require that we provide you with the following information about our responsibilities under generally accepted auditing standards, *Government Auditing Standards* and OMB Circular A-133, as well as certain information related to the planned scope and timing of our audit. We have communicated such information to you in our engagement letter dated January 11, 2011. Professional standards also require that we communicate to you the following information related to our audit.

Significant Audit Findings

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 of Litchfield, Minnesota are described in Note 1 to the financial statements. As described in Note 1. J. to the financial statements, the City adopted Statement of Governmental Accounting Standards (GASB Statement) No. 51, *Accounting and Financial Reporting for Intangible Assets*, in 2010. Restatement was unnecessary since all intangible assets were considered to have indefinite useful lives. We noted no transactions entered into by the governmental unit 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 estimate affecting the financial statements was:

Management's estimate of depreciation is based on the number of years an asset is in service. We evaluated the key factors and assumptions used to develop the depreciation estimate in determining that it is reasonable in relation to the financial statements taken as a whole.

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. Management has corrected all such misstatements. Material misstatements detected as a result of audit procedures were corrected by management.

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 20, 2011.

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 principal 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.

This information is intended solely for the use of the City Council and management of the City of Litchfield, Minnesota and is not intended to be and should not be used by anyone other than these specified parties.

Conway, Deuth & Schmiesing, PLLP

CONWAY, DEUTH & SCHMIESING, PLLP
Certified Public Accountants
Litchfield, Minnesota

June 20, 2011

CITY OF LITCHFIELD, MINNESOTA

SCHEDULE OF FINDINGS ON ACCOUNTING ISSUES AND INTERNAL CONTROLS

We noted certain matters involving the internal control structure and its operation that we consider being control deficiencies under standards established by the American Institute of Certified Public Accountants. A control deficiency 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 misstatements on a timely basis.

INTERNAL CONTROL

The objective of internal accounting control is to provide reasonable, but not absolute, assurance as to the safeguarding of assets against loss from unauthorized use or disposition, and the reliability of financial records for preparing financial statements and maintaining accountability for assets. The concept of reasonable assurance recognizes that the cost of a system of internal accounting control should not exceed the benefits derived and also recognizes that the valuation of these factors necessarily requires estimates and judgments by management.

It should be recognized that within the City, an inherent risk is present with certain positions. It is very common for City's such as the City of Litchfield, to assign many major responsibilities to a few key individuals in an attempt to operate within limited budgets. The audit did not raise any specific concerns with any position. The inherent risk is again addressed only to maintain the awareness of the internal control structure and to encourage the Council's continual review of financial information at monthly meetings.

DEFICIT CASH BALANCES

We noted several capital projects funds with deficit cash balances as December 31, 2010. Governmental units frequently pool the cash accounts of several funds for greater efficiency and physical control. If one fund overdraws its share of the pooled cash account, that fund should report an interfund liability in the fund financial statements (rather than "negative cash") to whatever fund the City's management has deemed to have "loaned" the cash to the overdrawn fund. The fund deemed to have loaned the cash should report an interfund receivable from the overdrawn fund. We recommend the City implement a policy for addressing deficit cash positions and interfund loans.

SMMPA REIMBURSEMENTS

During preliminary review of the Electric Fund, we noted a bill in the amount of \$17,942 for diesel fuel that was eligible for reimbursement from SMMPA but was not submitted. We recommend the City develop safeguards to ensure all eligible expenses are submitted to SMMPA for reimbursement.

GASB 54 FUND BALANCE REPORTING AND GOVERNMENTAL FUND TYPE DEFINITIONS

In March 2009 the Governmental Accounting Standards Board (GASB) issued Statement No. 54, Fund Balance Reporting and Governmental Fund Type Definitions. This Statement is designed to improve financial reporting by establishing fund balance classification that are easier to understand and apply. In essence, it establishes a hierarchy based largely on the extent to which a government is bound to observe spending constraints that govern how it can use amounts reported in the governmental funds balance sheet.

Fund Balance Reporting

The initial distinction made in reporting fund balance is identifying amounts considered nonspendable such as fund balance associated with inventories and prepaid expenses. Statement 54 also establishes fund balance classifications for spendable fund balance based on constraints imposed on how resources can be spent. The existing components of fund balance (reserved; unreserved, designated; and undesignated) are being replaced by restricted, committed, assigned, and unassigned as defined below:

- *Restricted* - amounts that can be spent only for the specific purposes stipulated by constitution, external resource providers, or through enabling legislation.
- *Committed* - amounts that can be used only for the specific purposes determined by a formal action of the government's highest level of decision-making authority.
- *Assigned* - amounts intended to be spent by the government for specific purposes. In governmental funds other than the General Fund, assigned fund balance represents the amount that is not restricted or committed.
- *Unassigned* - the residual classification for the General Fund for all amounts not contained in the other classifications.

Governments are required to disclose information about the processes through which constraints are imposed on amounts in the committed and assigned classifications.

Governments also are required to classify and report amounts in the appropriate fund balance classifications by applying their accounting policies that determine whether restricted, committed, assigned, and unassigned amounts are considered to have been spent. Disclosure of the policies in the notes to the financial statements is required.

Governmental Fund Type Definitions

The definitions of the general fund, special revenue fund types, capital projects fund types, and permanent fund types are clarified in GASB Statement 54. Interpretations of certain terms within the definition of the special revenue fund type have been provided and, for some governments, those interpretations may affect the activities they choose to report in those funds. The capital projects fund type definition also was clarified for better alignment with the needs of preparers and users. Definitions of other governmental fund types also have been modified for clarity and consistency.

The requirements of GASB Statement 54 are effective for periods beginning after June 15, 2010. Fund balance reclassifications made to conform to the provisions of this Statement should be applied retroactively by restating fund balance for all prior periods presented. We recommend that management begin to study and evaluate these changes for financial statement reporting and disclosure purposes. We further recommend the Council enact policies as deemed necessary to comply with GASB Statement 54.