

CITY OF LITCHFIELD, MINNESOTA

MANAGEMENT LETTER

DECEMBER 31, 2012

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

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CITY OF LITCHFIELD, MINNESOTA

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Quality | Dedication | Integrity

Honorable Mayor and Members of the 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, 2012. 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 letter dated January 8, 2013. 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 to the financial statements, the City implemented Governmental Accounting Standards Board Statement No. 63. Adoption of the provisions of this statement results in significant changes to net asset classification within the government-wide and proprietary fund financial statements. We noted no transactions entered into by the City during the year for which there is a lack of authoritative guidance or consensus. All significant transactions have been recognized in the financial statements in the proper period.

Accounting estimates are an integral part of the financial statements prepared by management and are based on management's knowledge and experience about past and current events and assumptions about future events. Certain accounting estimates are particularly sensitive because of their significance to the financial statements and because of the possibility that future events affecting them may differ significantly from those expected. The most sensitive 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.

The financial statement disclosures are neutral, consistent, and clear.

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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. Material misstatements detected as a result of audit procedures were corrected by management.

Disagreements with Management

For purposes of this letter, 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 May 20, 2013.

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.

Other Matters

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 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.

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

May 20, 2013

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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 deficiencies in internal control under standards established by the American Institute of Certified Public Accountants. 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.

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.

GASB 65 ITEMS PREVIOUSLY REPORTED AS ASSETS AND LIABILITIES

GASB No. 63 was implemented this year. GASB No. 63 provided guidance on financial reporting related to deferred outflows of resources and deferred inflows of resources. The pronouncement impacted the government-wide, governmental fund, proprietary fund, and fiduciary fund financial statements.

The objective of this statement was to improve financial reporting by standardizing the presentation of deferred outflows of resources and deferred inflows of resources and their effects on government's net position. It alleviated uncertainty about reporting those financial statement elements by providing guidance where none previously existed.

"Deferred inflows" and "deferred outflows" are defined as follows:

- **Deferred Inflows** - An acquisition of net assets by the government that is applicable to a future reporting period. The most common example for a city would be special assessments receivable at December 31 which are not received within 60 days following year end.
- **Deferred Outflows** - A consumption of net assets by the government that is applicable to a future reporting period. The most common example for a city would be deferred funding charges paid on bonds. These would be shown only on the government-wide Statement of Net Position.

Upon implementation, the City's Statement of Net Assets (the government-wide statement) became the Statement of Net Position. Components of the Statement of Net Position includes assets, deferred outflows of resources, liabilities, deferred inflows of resources, and net position. Net position will continue to be reported in three categories, which will include net investment in capital assets, restricted, and unrestricted.

The governmental fund balances must continue to use the balance sheet presentation it has always used and will retain the terminology "fund balance" versus "net position".

GASB 65 ITEMS PREVIOUSLY REPORTED AS ASSETS AND LIABILITIES (Cont'd)

The GASB was careful at the time GASB No. 63 was issued to state that nothing on the balance sheet could be classified as a deferred inflow or deferred outflow until specifically proscribed by the GASB. It made none of those decisions in the GASB No. 63, opting instead to delve into the issue more specifically under a different standard.

GASB No. 65 is the final standard that was issued to close the loop on the concepts of deferred inflows and deferred outflows as a result of the issuance of GASB Statement No. 63. GASB No. 65 reclassifies, as deferred outflows or deferred inflows of resources, certain items that were previously recorded as assets and liabilities. In addition, the GASB also found certain items that it felt should not hit the balance sheet at all; as a result, this statement requires recognition of those items as either an outflow (expenditure/expense) or inflow (revenue) of resources.

One other important provision in GASB Statement No. 65 relates to the use of the term "deferred". Under this pronouncement, the GASB has restricted the use of this terminology only to items reported as deferred inflows or deferred outflows. Items which had previously been termed "deferred revenue" will now be called "unavailable revenue" or "unearned revenue".

We recommend that management of the City begin the process of evaluating the impact of implementation of this standard. Changes will be necessary to your financial records and will benefit the City to begin this process now. If requested, Conway, Deuth and Schmiesing, PLLP will assist in the implementation. These services will be billed separate from, and in addition to, your annual audit engagement fees. Please contact us with any questions.