PRIOR LAKE-SPRING LAKE
WATERSHED DISTRICT
PRIOR LAKE, MINNESOTA

MANAGEMENT LETTER

FOR THE YEAR ENDED
DECEMBER 31, 2012
PRIOR LAKE-SPRING LAKE
WATERSHED DISTRICT
PRIOR LAKE, MINNESOTA

MANAGEMENT LETTER

FOR THE YEAR ENDED
DECEMBER 31, 2012
We have audited the financial statements of the governmental activities, each major fund, and the aggregate remaining fund information of the Prior Lake-Spring Lake Watershed District (the District), Prior Lake, Minnesota, for the year ended December 31, 2012. Professional standards require that we provide you with information about our responsibilities under generally accepted 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 November 14, 2012. Professional standards also require that we communicate to you 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.

Our responsibility is to plan and perform the audit to obtain reasonable, but not absolute, assurance that the financial statements are free of material misstatement. As part of our audit, we considered the internal control of the District. Such considerations were solely for the purpose of determining our audit procedures and not to provide any assurance concerning such internal control. We are responsible for communicating significant matters related to the audit that are, in our professional judgment, relevant to your responsibilities in overseeing the financial reporting process. However, we are not required to design procedures specifically to identify such matters.

A deficiency in internal control over financial reporting 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 combination of deficiencies in internal control, such that there is a reasonable possibility that a material misstatement of the District’s financial statements will not be prevented, or detected and corrected on a timely basis.

Our consideration of internal control over financial reporting was for the limited purposes described in the second paragraph of this section and was not designed to identify all deficiencies in internal control over financial reporting that might be significant deficiencies or material weaknesses and therefore, there can be no assurance that all such deficiencies have been identified. We did not identify any deficiencies in internal control that we consider to be material weaknesses.

Compliance

As part of obtaining reasonable assurance about whether the financial statements are free of material misstatement, we performed tests of compliance with certain provisions of Minnesota statutes. However, the objective of our tests was not to provide an opinion on compliance with such provisions. We noted no instances of noncompliance with Minnesota statutes.

Planned Scope and Timing of the Audit

We performed the audit according to the planned scope and timing.
Qualitative Aspects of Accounting Practices

Management is responsible for the selection and use of appropriate accounting policies. The significant accounting policies used by the District are described in Note 1 to the financial statements. The requirements of GASB statements No. 63 and 65 were adopted for the year ended December 31, 2012. The application of existing policies was not changed during the year. 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 estimates affecting the financial statements were capital asset basis, depreciation, and other postemployment benefits payable including the actuarial accrued liability.

Management’s estimate of these accounting estimates is based on estimated or actual historical cost and the estimated useful lives of capital assets. 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 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. In addition, none of the adjustments detected as a result of audit procedures and corrected by management were material, either individually or in the aggregate, to the financial statements taken as a whole.

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 April 22, 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 principle to the District’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 District’s auditors. However, these discussions occurred in the normal course of our professional relationship and our responses were not a condition to our retention.
Financial Position and Results of Operations

Our principal observations and recommendations are summarized on the following pages. These recommendations resulted from our observations made in connection with our audit of the District’s financial statements for the year ended December 31, 2012.

General Fund

The fund balance at December 31, 2012 was $148,910, an increase of $2,163 in comparison with the prior year. The total fund balance represents 139 percent of the 2013 General fund budget.

A table summarizing the General fund balance in relation to budget follows:

<table>
<thead>
<tr>
<th>Year</th>
<th>General Fund Balance December 31</th>
<th>Budget Year</th>
<th>General Fund Budget</th>
<th>Percent of Fund Balance to Budget</th>
</tr>
</thead>
<tbody>
<tr>
<td>2009</td>
<td>$148,265</td>
<td>2010</td>
<td>$192,292</td>
<td>77%</td>
</tr>
<tr>
<td>2010</td>
<td>196,973</td>
<td>2011</td>
<td>139,600</td>
<td>141%</td>
</tr>
<tr>
<td>2011</td>
<td>146,747</td>
<td>2012</td>
<td>98,165</td>
<td>149%</td>
</tr>
<tr>
<td>2012</td>
<td>148,910</td>
<td>2013</td>
<td>107,026</td>
<td>139%</td>
</tr>
</tbody>
</table>

Fund Balance as a Percent of Next Year’s Budget
The purposes and benefits of a General fund balance are as follows:

- Expenditures are incurred somewhat evenly throughout the year. However revenues are not received evenly. An adequate fund balance will provide the cash flow required to finance the General fund expenditures.

- Expenditures not anticipated at the time the annual budget was adopted may need immediate Board action. These would include capital outlay replacement, legal costs and other items. An adequate fund balance will provide the financing needed for such expenditures.

The 2012 General fund operations are summarized as follows:

<table>
<thead>
<tr>
<th></th>
<th>Final Budgeted Amounts</th>
<th>Actual Amounts</th>
<th>Variance with Final Budget</th>
</tr>
</thead>
<tbody>
<tr>
<td>Revenues</td>
<td>$100,000</td>
<td>$105,884</td>
<td>$5,884</td>
</tr>
<tr>
<td>Expenditures</td>
<td>$98,165</td>
<td>$103,721</td>
<td>$(5,556)</td>
</tr>
<tr>
<td>Net change in fund balances</td>
<td>1,835</td>
<td>2,163</td>
<td>328</td>
</tr>
<tr>
<td>Fund balances, January 1</td>
<td>146,747</td>
<td>146,747</td>
<td>-</td>
</tr>
<tr>
<td>Fund balances, December 31</td>
<td>$148,582</td>
<td>$148,910</td>
<td>$328</td>
</tr>
</tbody>
</table>

Revenue exceeded budget mainly due to property taxes and interest on investments. Expenditures were over budget. Following are some of the larger expenditure variances:

- Legal was over budget by $25,585
- Contracted services were over budget by $15,183
- Salaries and per diems were under budget by $25,710
Special Revenue Funds

Special revenue funds include funds used to account for revenue derived from specific revenue sources that are restricted or committed to expenditures for specified purposes.

The 2012 Implementation fund operations are summarized as follows:

<table>
<thead>
<tr>
<th></th>
<th>Final Budgeted Amounts</th>
<th>Actual Amounts</th>
<th>Variance with Final Budget</th>
</tr>
</thead>
<tbody>
<tr>
<td>Revenues</td>
<td>$467,990</td>
<td>$614,938</td>
<td>$146,948</td>
</tr>
<tr>
<td>Expenditures</td>
<td>$1,387,386</td>
<td>$1,156,999</td>
<td>$230,387</td>
</tr>
<tr>
<td>Net change in fund balances</td>
<td>(919,396)</td>
<td>(542,061)</td>
<td>377,335</td>
</tr>
<tr>
<td>Fund balances, January 1</td>
<td>2,254,776</td>
<td>2,254,776</td>
<td>0</td>
</tr>
<tr>
<td>Fund balances, December 31</td>
<td>$1,335,380</td>
<td>$1,712,715</td>
<td>$377,335</td>
</tr>
</tbody>
</table>

Revenues exceeded budget by $146,948 primarily due to grants and interest on investments.

Expenditures were under budget by $230,387. Following are the largest expenditure variances:

- Program costs were under budget by $363,554
- Salaries and per diems were over budget by $119,382
- Payroll taxes and benefits were over budget by $20,488
- Legal was under budget by $30,970

Debt Service Funds

Debt Service funds are a type of governmental fund to account for the accumulation of resources for the payment of interest and principal on debt.

Debt Service funds may have one or a combination of revenue sources pledged to retire debt. Currently the District debt services are being funded by property taxes.

In addition to the above pledged assets, other funding sources may be received by Debt Service funds as follows:

- Residual project proceeds from the related capital projects fund
- Investment earnings
- State or Federal grants
- Transfers from other funds

The following is a summary of the assets accumulated in each Debt Service fund and the related long-term debt at year end.

<table>
<thead>
<tr>
<th>Fund</th>
<th>Cash and Temporary Investments</th>
<th>Total Assets</th>
<th>Bonds Outstanding</th>
<th>Maturity</th>
</tr>
</thead>
<tbody>
<tr>
<td>Bond Debt Service</td>
<td>$39,021</td>
<td>$1,238,552</td>
<td>$2,470,000</td>
<td>2021</td>
</tr>
</tbody>
</table>

During the year the District issued crossover refunding bonds, which will refund the 2006A bonds in 2013. The District should continue to monitor sources of payment for their debt obligations and ensure that there are sufficient resources to meet the debt obligations.
Capital Projects Funds

This group of funds includes most of the development activities in the District. A summary of the status of each fund follows:

<table>
<thead>
<tr>
<th>Fund</th>
<th>2012</th>
<th>2011</th>
<th>Increase (Decrease)</th>
</tr>
</thead>
<tbody>
<tr>
<td>Major</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>JPA/MOA Construction fund</td>
<td>$115,592</td>
<td>$113,314</td>
<td>$2,278</td>
</tr>
<tr>
<td>JPA/MOA Operations fund</td>
<td>153,524</td>
<td>141,823</td>
<td>11,701</td>
</tr>
<tr>
<td>Nonmajor</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>JPA/MOA Emergency fund</td>
<td>294,181</td>
<td>288,384</td>
<td>5,797</td>
</tr>
<tr>
<td>Bond Construction fund</td>
<td>20,525</td>
<td>99,053</td>
<td>(78,528)</td>
</tr>
<tr>
<td>Total</td>
<td>$583,822</td>
<td>$642,574</td>
<td>$(58,752)</td>
</tr>
</tbody>
</table>

Following are some specifics on the above funds:

**JPA/MOA Construction fund**
- There is $74,912 of unearned revenue at the end of the year

**JPA/MOA Operations fund**
- There was $171,830 of expenditures during the year
- There were transfers in of $80,520 during the year

**JPA/MOA Emergency fund**
- The only activity during the year was interest on investments

**Bond Construction fund** - This District fund was created in conjunction with the bond issuance.
- $1,992 of interest on investments
- $80,520 was transferred out during the year
Future Accounting Standard Changes

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

**GASB Statement No. 61 - The Financial Reporting Entity: Omnibus an Amendment of GASB Statements No. 14 and No. 34**

**Summary**

The objective of this Statement is to improve financial reporting for a governmental financial reporting entity. The requirements of Statement No. 14 and the related financial reporting requirements of Statement No. 34, were amended to better meet user needs and to address reporting entity issues that have arisen since the issuance of those Statements.

This Statement modifies certain requirements for inclusion of component units in the financial reporting entity. This Statement also amends the criteria for reporting component units as if they were part of the primary government (that is, blending) in certain circumstances.

This Statement clarifies the reporting of equity interests in legally separate organizations as well. It requires a primary government to report its equity interest in a component unit as an asset.

The provisions of this Statement are effective for financial statements for periods beginning after June 15, 2012. Earlier application is encouraged.

**How the Changes in This Statement Will Improve Financial Reporting**

The requirements of this Statement result in financial reporting entity financial statements being more relevant by improving guidance for including, presenting, and disclosing information about component units and equity interest transactions of a financial reporting entity.

**GASB Statement No. 66 - Technical Corrections- an Amendment of GASB Statements No. 10 and No. 62**

**Summary**

The objective of this Statement is to improve accounting and financial reporting for a governmental financial reporting entity by resolving conflicting guidance that resulted from the issuance of two pronouncements, Statements No. 54, *Fund Balance Reporting and Governmental Fund Type Definitions*, and No. 62, *Codification of Accounting and Financial Reporting Guidance Contained in Pre-November 30, 1989 FASB and AICPA Pronouncements*.

The provisions of this Statement are effective for financial statements for periods beginning after December 15, 2012. Earlier application is encouraged.

**How the Changes in This Statement Will Improve Financial Reporting**

The requirements of this Statement resolve conflicting accounting and financial reporting guidance that could diminish the consistency of financial reporting and thereby enhance the usefulness of the financial reports.
Future Accounting Standard Changes - Continued

GASB Statement No. 67 - The Financial Reporting for Pension Plans - an Amendment to GASB Statement No. 25

Summary

The objective of this Statement is to improve financial reporting by state and local governmental pension plans. This Statement results from a comprehensive review of the effectiveness of existing standards of accounting and financial reporting for pensions 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. 25, Financial Reporting for Defined Benefit Pension Plans and Note Disclosures for Defined Contribution Plans, and No. 50, Pension Disclosures, as they relate to pension plans that are administered through trusts or equivalent arrangements (hereafter jointly referred to as trusts) that meet certain criteria.

The requirements of Statements No. 25 and No. 50 remain applicable to pension plans that are not administered through trusts covered by the scope of this Statement and to defined contribution plans that provide postemployment benefits other than pensions.

This Statement is effective for financial statements for fiscal years beginning after June 15, 2013. Earlier application is encouraged.

How the Changes in This Statement Will Improve Financial Reporting

The requirements of this Statement will improve financial reporting primarily through enhanced note disclosures and schedules of required supplementary information that will be presented by the pension plans that are within its scope. The new information will enhance the decision-usefulness of the financial reports of these pension plans, their value for assessing accountability, and their transparency by providing information about measures of net pension liabilities and explanations of how and why those liabilities changed from year to year. The net pension liability information, including ratios, will offer an up-to-date indication of the extent to which the total pension liability is covered by the fiduciary net position of the pension plan. The comparability of the reported information for similar types of pension plans will be improved by the changes related to the attribution method used to determine the total pension liability. The contribution schedule will provide measures to evaluate decisions related to the assessment of contribution rates in comparison to actuarially determined rates, when such rates are determined. In that circumstance, it also will provide information about whether employers and nonemployer contributing entities, if applicable, are keeping pace with actuarially determined contribution measures. In addition, new information about rates of return on pension plan investments will inform financial report users about the effects of market conditions on the pension plan's assets over time and provide information for users to assess the relative success of the pension plan's investment strategy and the relative contribution that investment earnings provide to the pension plan's ability to pay benefits to plan members when they come due.
Future Accounting Standard Changes - Continued

GASB Statement No. 68 - The Accounting and Financial Reporting of Pensions- an Amendment of GASB Statement No. 27

The primary objective of this Statement is to improve accounting and financial reporting by state and local governments for pensions. It also improves information provided by state and local governmental employers about financial support for pensions 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 pensions with regard to providing decision-useful information, supporting assessments of accountability and interperiod equity, and creating additional transparency.

This Statement replaces the requirements of Statement No. 27, Accounting for Pensions by State and Local Governmental Employers, as well as the requirements of Statement No. 50, Pension Disclosures, as they relate to pensions that are provided through pension plans administered as trusts or equivalent arrangements (hereafter jointly referred to as trusts) that meet certain criteria. The requirements of Statements 27 and 50 remain applicable for pensions that are not covered by the scope of this Statement.

This Statement is effective for fiscal years beginning after June 15, 2014. Earlier application is encouraged.

How the Changes in This Statement Will Improve Financial Reporting

The requirements of this Statement will improve the decision-usefulness of information in employer and governmental nonemployer contributing entity financial reports and will enhance its value for assessing accountability and interperiod equity by requiring recognition of the entire net pension liability and a more comprehensive measure of pension expense. Decision-usefulness and accountability also will be enhanced through new note disclosures and required supplementary information.

* * * * *

This communication is intended solely for the information and use of Board of Managers, management and the Minnesota Office of the State Auditor, and is not intended to be and should not be used by anyone other than these 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 opportunity to be of service and for the courtesy and cooperation extended to us by your staff.

April 22, 2013
Minneapolis, Minnesota

ABDO, EICK & MEYERS, LLP
Certified Public Accountants