PRIOR LAKE-SPRING LAKE
WATERSHED DISTRICT
PRIOR LAKE, MINNESOTA

MANAGEMENT LETTER

YEAR ENDED
DECEMBER 31, 2010

ABDO EICK & MEYERS LLP
Certified Public Accountants & Consultants

ABDO
EICK &
MEYERS LLP
Certified Public Accountants & Consultants

5201 Eden Avenue
Suite 250
Edina, MN 55436

April 22, 2011

Board of Managers
Prior Lake-Spring Lake Watershed District
Prior Lake, Minnesota

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, 2010. 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 October 26, 2010. 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 City. 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 City'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 purposed 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.

952.835.9090 • Fax 952.835.3261
www.aemcpas.com

Summary of Prior Year Findings

2009-1 Limited Segregation of Duties - Cash Disbursements, Cash Receipts, and Payroll

Condition: During our audit we reviewed procedures over cash disbursements and cash receipts and found the District to have limited segregation of duties related to these procedures.

Criteria: There are four general categories of duties: authorization, custody, record keeping and reconciliation. In an ideal system, different employees perform each of these four major functions. In other words, no one person has control of two or more of these responsibilities.

Current Year Status: The District has implemented procedures to improve their segregation of duties and we no longer consider it to be a significant deficiency.

2009-2 Material Audit Adjustments

Condition: During our audit adjustments were needed to record interest receivable, reclassify expenditures, reverse items improperly set up as accounts payable, record additional accounts payable, allocate tax revenue, and other miscellaneous entries. Also, a prior period adjustment was needed to eliminate accumulated depreciation on easements.

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

Current Year Status: No material audit adjustments were made during the audit.

2009-3 Declaration for Payment

Condition: Auditing for legal compliance requires a review of the District's deposits and investments. Our study indicated an instance of non-compliance that we believe is required to be remedied.

Criteria: Minnesota statute §471.38 requires that each declaration for payment be signed to the effect that such account, claim, or demand is just and correct and that no part of it has been paid. The statute is satisfied if on the back of Districts checks is a declaration as defined in Minnesota statute §471.391 reading "I declare under the penalties of law that this account, claim or demand is just and correct and that no part of it has been paid."

Current Year Status: The District now orders checks with the declaration pre-printed on the back.

2009-4 Broker Certification

Condition: Auditing for legal compliance requires a review of the District's deposits and investments. Our study indicated an instance of noncompliance that we believe is required to be remedied.

Criteria: Minnesota statute 118.A04, subdivision 9 requires the District to obtain broker certification forms from investment brokers annually.

Current Year Status: The District obtained broker certifications as required by State statute for the current year audit.

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. No new accounting policies were adopted and 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. Other postemployment benefits payable and the actuarial accrued liability were determined by the alternative measurement method allowed for plans with less than 100 members.

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, 2011.

952.835.9090 • Fax 952.835.3261
www.aemcpas.com

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

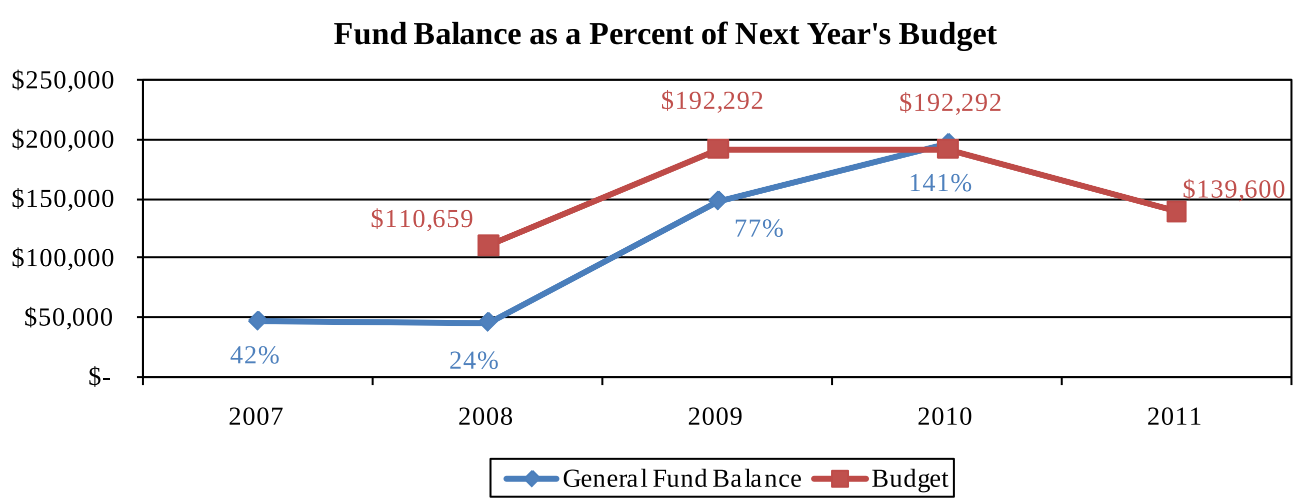
Our principal observations and recommendations are summarized on the following pages. These recommendations resulted from our observations made in connection with our audit of the District's financial statements for the year ended December 31, 2010.

General Fund

The fund balance at December 31, 2010 was $196,973, an increase of $48,708 in comparison with the prior year. The total fund balance represents 141 percent of the 2011 General fund budget.

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

Year	General Fund Balance December 31	Budget Year	General Fund Budget	Percent of Fund Balance to Budget
2007	$ 46,546	2008	$ 110,659	42 %
2008	45,574	2009	192,292	24
2009	148,265	2010	192,292	77
2010	196,973	2011	139,600	141



952.835.9090 • Fax 952.835.3261
www.aemcpas.com

The purposes and benefits of a General fund balance are as follows:

Purposes and Benefits

- 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 2010 General fund operations are summarized as follows:

	Final Budgeted Amounts	Actual Amounts	Variance with Final Budget
Revenues	$ 212,000	$ 215,767	$ 3,767
Expenditures	192,292	167,059	25,233
Net change in fund balances	19,708	48,708	29,000
Fund balances, January 1	148,265	148,265	-
Fund balances, December 31	$ 167,973	$ 196,973	$ 29,000

Overall, revenue and expenditure variances were positive. The positive variance in expenditures was due to several factors, most notably other office equipment expenditures which was under budget by $30,000. The largest negative variance for expenditures related to salaries and per diems which were $13,604 over budget.

Special Revenue Funds

Special revenue funds include funds used to account for revenue derived from specific revenue sources that are restricted to expenditures for specified purposes. The fund balances (deficits) of each fund in this group is as follows:

Fund	Fund Balances (Deficits) December 31, 2010	2009	Increase (Decrease)
Major			
Implementation	$ 2,200,439	$ 1,944,521	$ 255,918
Nonmajor			
Revolving Contingency	82,626	80,294	2,332
Milfoil Control	14,269	13,866	403
Outlet Maintenance Trust	2,291	(39)	2,330
Total	$ 2,299,625	$ 2,038,642	$ 260,983

The 2010 Implementation fund operations are summarized as follows:

	Final Budgeted Amounts	Actual Amounts	Variance with Final Budget
Revenues	$ 463,000	$ 469,796	$ 6,796
Expenditures	1,206,650	948,910	257,740
Excess (deficiency) of revenues over (under) expenditures	(743,650)	(479,114)	264,536
Other financing sources (uses)			
Transfers in	-	740,000	740,000
Transfers out	-	(4,968)	4,968
Total other financing sources (uses)	-	735,032	744,968
Net change in fund balances	(743,650)	255,918	1,009,504
Fund balances, January 1	1,944,521	1,944,521	-
Fund balances, December 31	$ 1,200,871	$ 2,200,439	$ 1,009,504

Revenues were over budget and expenditures were under budget; however, actual expenditures exceeded revenues by $479,114. The District budgeted $393,440 for easements that they did not purchase, but spent $387,959 more for contracted services than anticipated. The Implementation fund received a $740,000 transfer in which allowed fund balance to increase.

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 the following revenue sources pledged to retire debt as follows:

- Property taxes - Primarily for general City benefit projects such as parks and municipal buildings. Property taxes may also be used to fund special assessment bonds which are not fully assessed.

- Capitalized interest portion of bond proceeds - After the sale of bonds, the project may not produce revenue (tax increments or special assessments) for a period of one to two years. Bonds are issued with this timing difference considered in the form of capitalized interest.

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.

Fund	Cash and Temporary Investments	Total Assets	Bonds Outstanding	Maturity
Bond Debt Service	$ 54,518	$ 57,890	$ 1,440,000	2021

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:

Fund	Fund Balances December 31, 2010	Fund Balances December 31, 2009	Increase (Decrease)
Major			
JPA/MOA Construction	$ 105,833	$ 95,784	$ 10,049
JPA/MOA Operations	132,462	128,724	3,738
Nonmajor			
JPA/MOA Emergency	269,348	213,158	56,190
Bond Construction	173,374	1,033,736	(860,362)
Total	$ 681,017	$ 1,471,402	$ (790,385)

The increases and decreases in fund balances is mostly related to transfers between capital project funds related to the cost-share allocation for the funds established pursuant to the Memorandum of Agreement.

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. 54 - *Fund Balance*

This statement was issued in March of 2009 and is effective for periods beginning after June 15, 2010.

This new standard is intended to improve the usefulness of information provided to financial report users about fund balance by providing clearer, more structured fund balance classifications, and clarifying the definitions of existing governmental fund types.

GASB No. 54 distinguishes fund balance between amounts that are considered non-spendable, such as fund balance associated with inventories, and other amounts that are classified based on the relative strength of the constraints that control the purposes for which specific amounts can be spent. The following classifications and definitions will be used:

- *Restricted* - amounts constrained by external parties, constitutional provision, or enabling legislation
- *Committed* - amounts constrained by a government using its highest level of decision-making authority
- *Assigned* - amounts a government intends to use for a particular purpose
- *Unassigned* - amounts that are not constrained at all will be reported in the general fund.

In addition to the classifications of fund balance, the standard clarified the definitions of individual governmental fund types, for example, special revenue funds, debt service funds, and capital project funds.

GASB Statement No. 59 – *Financial Instruments Omnibus*

Summary

The objective of this Statement is to update and improve existing standards regarding financial reporting and disclosure requirements of certain financial instruments and external investment pools for which significant issues have been identified in practice. This Statement provides for the following amendments:

- Statement 31 is clarified to indicate that a 2a7-like pool, as described in Statement 31, is an external investment pool that operates in conformity with the Securities and Exchange Commission's (SEC) Rule 2a7 as promulgated under the Investment Company Act of 1940, as amended.

- Statement No. 40, Deposit and Investment Risk Disclosures, is amended to indicate that interest rate risk information should be disclosed only for debt investment pools—such as bond mutual funds and external bond investment pools—that do not meet the requirements to be reported as a 2a7-like pool.

The provisions of this Statement are effective for financial statements for periods beginning after June 15, 2010. Earlier application is encouraged.

How the Changes in This Statement Will Improve Financial Reporting

The requirements of this Statement will improve financial reporting by providing more complete information, by improving consistency of measurements, and by providing clarifications of existing standards. Emphasizing the applicability of SEC requirements to 2a7-like external investment pools provides practitioners with improved guidance. Finally, limiting interest rate risk disclosures for investments in mutual funds, external investment pools, and other pooled investments to debt investment pools provides better guidance regarding the applicability of interest rate risk disclosures.

* * * * * *

This report 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.

Abdo Eick & Meyers, LLP

April 22, 2011
Minneapolis, Minnesota

ABDO, EICK & MEYERS, LLP
Certified Public Accountants